Thomson Financial News

German watchdog BaFin's Sanio calls for tighter rules for banks, rating agencies

04.09.08, 7:02 AM ET

FRANKFURT (Thomson Financial) - BaFin President Jochen Sanio told Die Zeit he wants tighter regulation of banks and credit rating agencies in the wake of the subprime loan crisis.

'We have just passed almost two decades of deregulation, and now we can see the results,' the chief of the German financial watchdog said in an interview to be published tomorrow.

Sanio said he is 'pretty stunned by the failure of U.S. rating agencies.'

'I think it is only right to make (rating) agencies subject to international standards that are passed by global consensus among all regulators. Current rules need to be tightened.'

The source of financial market turbulence was that U.S. mortgage banks 'handed out loans of increasing volumes to people unworthy of credit,' Sanio said, adding that 'something like this must never happen again.'

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EU's McCreevy says rating agencies must resolve conflict of interest
April 18, 2008: 03:33 AM EST

FRANKFURT, Apr. 18, 2008 (Thomson Financial delivered by Newstex) -- EU internal markets commissioner Charlie McCreevy said turmoil in the global credit markets proves that rating agencies must solve a conflict of interest between rating and advising on structured products. (NYSE:HZK)

'The rating agencies cannot continue as hitherto and therefore I do not rule out regulatory measures,' McCreevy said in an interview with German daily Boersen-Zeitung.

The option of establishing an independent external supervisor needs to be looked into, he said, and added that an international rather than a European solution is to be preferred in this regard.

Asked about demands that credit institutes increase their capital reserves, McCreevy said these are unlikely to be incorporated in the proposed changes to Basel II, which will be submitted in October.

'But I have no doubt that credit institutes will have to have higher capital reserves in two to three years at the latest. That is one of the core lessons of the crisis,' he said.

McCreevy stressed that, despite recent criticism that the mark-to-market system for valuing assets may have intensified the crisis, he does not see a better alternative.

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CAs, rating agencies headed for a fight

18 Apr 2008, 0229 hrs IST, Pankaj Doval, TNN

NEW DELHI: Chartered accountants and credit rating agencies are headed for a confrontation. Raising doubts over the processes adopted by credit rating agencies, ICAI, the top CA body, is planning to lodge a formal complaint with market regulator SEBI over lack of transparency and standardisation in the work of rating agencies.

However, leading agencies like Crisil and Fitch have rubbished this claim.

Ved Jain, president of ICAI, said there should be a regulatory body to monitor services of rating agencies and added that ICAI was "ready to take charge". "There are no standards or fixed parameters that rating agencies follow while giving reports and the whole process lacks transparency." Jain said there is an urgent need to devise certain standards.

"We had already raised the matter with former SEBI chief M Damodaran and now plan to take it up again with present chief CB Bhave. ICAI can play an active part in managing the agencies and working out parameters for their functioning," Jain said. The ICAI could help in ensuring compliance to prescribed standards, he said, adding that its committee on corporate governance was studying the issue.

Rating agencies assign credit ratings for debt obligations and debt instruments of companies. For this, they consider the issuer's credit worthiness, among other parameters. Importantly, they also rate public offers, which has a direct bearing on investors.

However, ICAI's charges have been refuted by rating agencies. Roopa Kudva, MD and CEO of Crisil, said rating agencies are regulated by SEBI and they follow a transparent process. "India is among the first countries in the world where credit agencies are regulated and we follow stringent criteria for doing business. We need to renew our licences every three years and SEBI has a right to inspect us. We are regulated like any other market intermediary," Kudva said.

She said rating agencies maintained "high level of transparency" and it would not be right to standardise processes. "If you do this, then you reduce the exercise to a mechanical check-box approach against our method of business, financial and management analysis."

Amit Tandon, MD at Fitch Ratings India, said, rating agencies are regulated by SEBI. "Not only that, we also discuss with RBI on what we do." Tandon said systems and processes followed by rating agencies are transparent.

REUTERS

US lawmaker wants SEC to beef up credit rater rules

Fri Apr 18, 2008 5:33pm EDT

By Rachelle Younglai

WASHINGTON, April 18 (Reuters) - The U.S. Securities and Exchange Commission may need more power to oversee the credit rating agencies and ensure that the ratings are accurate, a senior Democratic senator said on Friday.

Credit rating agencies like Moody's Corp (MCO.N: Quote, Profile, Research) and Standard & Poor's (MHP.N: Quote, Profile, Research) have come under fire for their role in the subprime mortgage crisis that has roiled the U.S. credit market. Critics say they issued inaccurate ratings on securitized products backed by subprime mortgages, and were too slow to cut ratings after the products performed poorly.

The SEC is considering additional rules for credit raters such as requiring better disclosure of past ratings, limiting conflicts of interest, and requiring rating agencies to differentiate between corporate bonds and more complex structured finance products.

But Sen. Jack Reed, a Democrat from Rhode Island, said the SEC needed to "go beyond this and do much more."

"Do they need more authority? That is an issue that should be on the table," Reed said in an interview with Reuters. "We have seen over the last several months some significant inaccuracies in ratings."

Alternatively, the rating industry may need some kind of market mechanism or self enforcement mechanism that validates ratings, he said.

"This is an issue that is staring the commission right in the face -- who will do it best?," he said.

Reed, the chairman of a Senate banking subcommittee on securities and investment, also wants to give the SEC some $40 million more than it requested for its fiscal 2009 budget.

The SEC is responsible for ensuring credit rating agencies follow their stated procedures for managing conflicts of interest as well as ensuring they make the adequate disclosures. The SEC, however, does not have jurisdiction over how the firms come up with their ratings.

The SEC has not asked Congress to give it more authority over credit rating companies.

The SEC, which is now functioning with three Republican commissioners and awaiting confirmation of two Democratic ones, indicated it saw no reason to expand its role.

"At this point in time, I think that the commission is operating under the sense that we do have the authority that we need," SEC Commissioner Kathleen Casey told reporters on the sidelines of the Mutual Fund Directors Forum conference.

Separately, SEC Chairman Christopher Cox said current law did not give the agency power "to actually critique the rating models or to substitute the government's judgment for the firms." He spoke to reporters on the sidelines of a U.S. Chamber of Commerce event.

Congress acted two years ago to give the SEC more oversight of credit rating companies when lawmakers sought to encourage more competition in the rating industry.

Reed is initiating an effort to give the SEC an additional $40 million to police the markets and protect investors.

"I think it's appropriate, given the market turmoil, (and) given that the risk assessment by some of these companies was not adequate," Reed said. "In order for the SEC to engage risk assessment, they need additional resources."

Reed said he was reaching out to lawmakers on the appropriations committee, which approves federal agency budgets.

For fiscal 2009, the SEC is asking for about $914 million, an increase of less than 1 percent over the budget of the current year ending Sept. 30.

(Reporting by Rachelle Younglai, editing by Richard Chang)

THE WALL STREET JOURNAL

Senate Democrats Wary Of Foreign-Regulator Plan

By JUDITH BURNS

April 2, 2008; Page A10

WASHINGTON (Wall Street Journal) -- Some Senate Democrats have this to say about a Securities and Exchange Commission plan for mutual recognition of high-quality foreign regulators: Not so fast.

Jack Reed

Sen. Jack Reed (D., R.I.) questioned the wisdom of the SEC's idea Tuesday and said he would be reluctant to accept it at a time when lawmakers doubt how well U.S. regulators enforce existing investor-protection regulations.

Sen. Reed, chairman of the Senate Banking Committee's securities subcommittee, said he will express his concerns in a letter this week to SEC Chairman Christopher Cox and call for a Senate hearing on the mutual-recognition concept.

Separately, Sen. Reed said he and Senate Banking Committee Chairman Christopher Dodd (D., Conn.) are seeking a Government Accountability Office report on the SEC enforcement division. Sen. Reed said he wants to know if the SEC has sufficient staff and funding to investigate wrongdoing and whether it has made fundamental changes in how it handles cases.

Mr. Cox said a mutual-recognition system wouldn't be built quickly. "We're taking a very deliberate and measured approach," Mr. Cox said Tuesday. He also said he expects the agency would benefit from the GAO study sought by Sen. Reed.

Mr. Cox has pressed for the SEC to create a system that would allow non-U.S. exchanges and brokers to have access to U.S. investors without being subject to U.S. regulation.

Sen. Reed called for a slower pace, saying lawmakers first want an analysis of U.S. regulatory breakdowns in the issuance of mortgages to subprime borrowers and the marketing of securities based on mortgage payments.

"I think you need to look back before you can go forward," Sen. Reed told reporters.

Sen. Reed also criticized a Treasury Department blueprint for financial-regulatory change unveiled Monday by Treasury Secretary Henry Paulson. He said the recommendations miss the mark in key areas by ignoring accounting for securities backed by subprime loans and the role of credit-rating agencies that gave high ratings to such securities.

"Any reform of the system has to reform credit-rating agencies," he said, adding that the SEC needs more authority over such firms "or a new agency needs to be established" to do it.

REUTERS

SEC commissioner hopes for credit rater plan

Fri Apr 11, 2008 4:42pm EDT
By Rachelle Younglai
WASHINGTON (Reuters) - A U.S. Securities and Exchange Commission member said on Friday she hopes the agency will soon propose changes to the rules governing credit rating agencies, which have been criticized for assigning high ratings to products such as mortgage-backed securities.
"It is my hope... that we would be able to propose amendments to our rules in the near term," SEC Commissioner Kathleen Casey told reporters on the sidelines of a Council of Institutional Investors conference.
"We are trying to be sensitive to the fact that if we are going to be able to get rules in place in a timely way, that we would need to propose them soon," she said.
Under consideration at the SEC is whether to require credit rating agencies, like Moody's Corp (MCO.N: Quote, Profile, Research), Fimalac SA (LBCP.PA: Quote, Profile, Research) majority owned Fitch Ratings and McGraw-Hill Cos Inc's (MHP.N: Quote, Profile, Research) Standard & Poor's, to differentiate between corporate bonds and structured finance products as well as make disclosures about past ratings.
The rating agencies have been accused of failing to highlight the risks associated with assets secured by pools of mortgages, conducting weak analyses and granting higher ratings than warranted because they are paid by the companies or issuers whose securities they rate.
As the SEC mulls the changes, Casey said the SEC should reduce any undue reliance on credit rating agencies and "at a minimum" carefully reevaluate all the references to the ratings in its rules.
"I think there is a belief that the regulatory reliance ... has reinforced an overreliance on credit ratings," she said.
Some of the SEC rules, such as those governing money market funds, rely on the credit rating agencies by requiring the funds to hold securities that are rated highly.
Casey said the SEC should not favor one business model, such as one in which the rating agencies are paid by securities issuers, over another model, such as subscribers paying the rating agencies.
The SEC's oversight of rating agencies was formalized
and strengthened by 2006 legislation. Since then the agency has been examining their role in the subprime mortgage meltdown and whether they were influenced by companies and underwriters.
The SEC is also looking at whether the raters followed their stated procedures for managing conflicts of interest in their businesses.
Casey said the SEC must avoid micromanaging the credit rating agencies because that could drive up costs and produce unintended consequences.
"Doing so would only add costs, offer at best negligible benefits, and likely have the unintended consequence of further enhancing the franchise of the entrenched incumbents," she told the conference.
(Reporting by Rachelle Younglai, editing by Tim Dobbyn)

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CAPITOL REPORT

Credit-rating agencies return to crosshairs

By Robert Schroeder, MarketWatch
Last update: 4:06 p.m. EST Nov. 26, 2007

WASHINGTON (MarketWatch) -- It's tough to be a credit-rating agency these days. And it may just get tougher.

Under fire for underestimating the danger of bonds backed by subprime mortgages, big companies like Moody's, Fitch and Standard & Poor's have weathered congressional scrutiny of their industry, seen a law passed in 2006 that clarifies how they're officially recognized by regulators and are now the subject of a Securities and Exchange Commission probe into whether they followed proper procedures for rating mortgage-backed securities. See earlier story.

And if that wasn't enough, observers are debating how much further the ratings-industry needs to be changed.

Add it up and it's looking increasingly like the folks who pass judgment on debt and securities are awaiting some kind of judgment themselves.

The verdict for now, though? Uncertain. What is certain is that few appear to be satisfied with the way things are going.

The ratings agency model is "now broken," says Kyle Bass, a managing partner at Hayman Capital Partners.

He was answering a question posed at a recent event at the American Enterprise Institute titled "Is the rating agency system broken or fine?"

Having to ask the question in the first place probably means it's at least shaky if not broken. What to do about it is more difficult, but there is no shortage of ideas.

Bass and others say the companies should get rid of the "issuer-pays" system, for one thing. It strikes many as a big conflict of interest that Moody's and others are paid by the companies they rate. But the companies argue the current system saves investors money.

"What we feel is important is the steps you take to mitigate any potential conflicts of interest," says Anthony Mirenda, director of corporate communications at Moody's. He says the company uses a number of safeguards including assigning ratings by committee. Analysts also aren't involved in fee discussions with issuers, he says.

Vickie Tillman, executive vice president of Standard & Poor's Credit Market Services, told a Senate panel in September that without payment for ratings by companies, the public ratings issued would be subscription-based instead of free of charge to investors. Standard & Poor's is a unit of the McGraw-Hill Cos.

Moreover, S&P says it's tightening its criteria and boosting the frequency of its reviews as well as modifying analytical models. It's also doing a survey of originators and their practices concerning data integrity, says a company spokesperson.

Alex Pollock of AEI has another idea: let those who buy decide.

"Why couldn't a group of major institutional investors set up their own rating agency?" Pollock asked the other day. Under Pollock's proposal, the agency would be capitalized by and paid for by the investors and work from their point of view.

Ask Frank Raiter of Luminent Mortgage Capital and Clayton Holdings and he'll say the answer is having ratings agencies update their models at least once a year, use the same loan level data and publish their surveillance criteria. Raiter agreed that S&P, Moody's and the like are "severely disconnected," if not broken, but stressed that the blame for the subprime fallout has to be shared with issuers and investors. Read more subprime coverage.

Those same issuers and investors, of course, are going to keep relying on the agencies for what Pollock characterizes as opinions about the future.

And, as The Wall Street Journal reported earlier this month, some banks and hedge funds rely on credit ratings even when they know the ratings could be flawed, because many mortgage instruments are so difficult to value. On Nov. 9, The Journal reported that the ratings agencies looked poised over the next few weeks to downgrade hundreds of mortgage-related investments worth tens of billions of dollars, creating the potential for more market unrest.

Investors and credit-raters still need each other. But with casualties mounting in Wall Street CEO suites over unexpected losses and the SEC still investigating the industry, expect lawmakers and regulators to keep trying to get the credit-raters into the repair shop. ■

Robert Schroeder is a reporter for MarketWatch in Washington.

MarketWatch

SEC seeks funds to oversee rating firms, Wall Street

By Judith Burns
Last update: 9:06 a.m. EDT April 17, 2008

(Updates with further comment from SEC and lawmakers and background information, starting in seventh paragraph.)

WASHINGTON (MarketWatch) -- Wall Street's top cop wants Congress to provide additional funding for federal oversight of investment banks and credit rating agencies, saying it is "vitally important" to do so.

Securities and Exchange Commission Chairman Christopher Cox raised the issue Wednesday at a House Appropriations subcommittee hearing on the SEC's proposed $913 million budget for fiscal 2009.

The collapse last month of Bear Stearns Cos. (BSC) revealed a regulatory gap in oversight of investment banks on a consolidated basis, Cox told the House panel. While commercial banks are subject to such supervision by federal bank regulators, there is no counterpart for investment banks, only a voluntary program created by the SEC covering five of Wall Street's largest banks, including Bear Stearns.

Cox said he thinks it is "vitally important" to have consolidated oversight of investment bank companies and urged Congress to consider mandating and funding such a program.

"It doesn't exist now in law, I believe it should," Cox told lawmakers.

In contrast, Congress gave the SEC new authority in 2006 to inspect and regulate credit rating agencies. Cox said the SEC is being very aggressive in using its new authority over rating firms and suggested that if it had gotten it a year earlier, "that would have made a difference."

Rating firms, under fire for giving high ratings initially to securities backed by home mortgage loans to risky "subprime" borrowers, are getting more scrutiny from the SEC. Cox said he expects the agency will issue a proposal by late June to tighten rules for rating firms and provide more data on their track record, which he said should help enhance competition in an industry dominated by Standard & Poor's, a division of McGraw-Hill Cos. and Moody's Investors Service, a subsidiary of Moody's Corp.

While the SEC didn't seek additional funding for credit-rating oversight in the past, Cox endorsed the idea of a dedicated funding stream for that effort and for the consolidated supervisory program.

Cox told reporters after the hearing that although the SEC is shifting more funds and resources to both areas using its current budget, he hopes to reach agreement with Congress on a funding stream that would provide "the right amount" of new funds for such efforts.

"How Congress chooses to do this is up to Congress," Cox added.

For its part, Cox said the SEC's consolidated supervisory program for Wall Street investment banks was "created out of thin air" using exemptions from SEC net-capital rules. Banks in the program - Bear Stearns, Goldman Sachs Group Inc., Lehman Brothers Holdings Inc., Morgan Stanley and Merrill Lynch & Co. - are able to reduce capital reserves in exchange for giving the SEC access to their entire operations, not just their registered brokerage and advisory units. Cox said the SEC offered the plan because "Europe was going to," and U.S. regulators wanted to prevent Wall Street's biggest banks from relocating to Europe.

Without the voluntary program in place, regulators, including the Federal Reserve, would not have had any consolidated information available when Bear began its downward spiral in mid-March, Cox testified. He told reporters that he now wants to "formalize" the program and secure funding to run it. House lawmakers seemed open to the idea.

"I want to be sure that you have the resources," said Rep. Mark Kirk, R-Ill. Rep. Jose Serrano, D-N.Y., who chairs the appropriations subcommittee responsible for the SEC's budget, worried that the SEC's proposed budget for fiscal 2009, which begins Oct. 1, won't be sufficient to the keep the best employees at the agency.

Cox defended the plan to provide SEC employees with a 4.5% pay raise, including merit pay and cost-of-living increases, and said the agency itself is doing its job "better than ever before."

Asked about a recent U.S. Treasury Department blueprint for financial regulatory reform, Cox said although the SEC did not take part in producing it, he agrees with the goal of modernizing oversight of U.S. financial markets and market participants.

Nearly all of the blueprint's recommendations, including a call to merge the SEC with the Commodity Futures Trading Commission, would require congressional approval, Cox noted.

Pressed on whether he would favor such a merger, Cox said that would depend on how it is done. He said he could foresee "serious jurisdictional challenges" to an SEC-CFTC merger given that each agency is overseen by different congressional committees that may not want to give up their oversight role.

-Contact: 201-938-5400

guardian.co.uk

Investors urged to look beyond credit ratings

Reuters
Wednesday April 16 2008
By Natalie Harrison

LONDON, April 16 (Reuters) - Investors need to carry out more credit work of their own before buying debt rather than relying on credit ratings, debt market participants said on Wednesday.

The three major rating agencies -- Moody's Investors Service, Standard & Poor's and Fitch Ratings -- have come under fire in the wake of sharp downgrades on structured products with exposures to the U.S. subprime market to "junk" from triple-A.

The recent Financial Stability Forum report, commissioned by the Group of Seven nations, recently called for tougher standards for ratings companies. U.S. Securities and Exchange Commission Chairman Christopher Cox said on Wednesday the SEC would soon propose more rules to police credit rating agencies.

But speakers at a conference in London, organised by the Centre for the Study of Financial Innovation, said the role of rating agencies was limited.

"Investors have to do more homework. Ratings are an interesting benchmark but they are just an opinion," said Joe Biernat, head of credit research at European Credit Management.

Away from the troubled field of structured finance there was praise for the role of ratings agencies.

"Ratings agencies have done a really good job on corporate ratings for a long time. There is a great deal of consistency," Biernat said. He described triple-A corporate rankings as "sacred".

But there remains concern over a conflict of interest at ratings agencies who charge issuers, rather than investors, for assigning a rating.

"No-one would deny there is a conflict of interest. The question is how to deal with it and whether there is an alternative business model," said Richard Hunter, managing director and regional credit officer for Fitch Ratings.

"The market is looking for an opinion. If we can give a credible opinion, we will do it, but if we can't we won't."

Fitch was praised for its recent decision to continue to rate U.S. bond insurer MBIA, which it recently downgraded to AA, the third highest investment grade, from AAA even after the company asked it to stop rating its debt.

Hunter said there was pressure on agencies from other areas too.

"We have had calls from Western European regulators asking us not to take actions on banks," he said.

COMPETITION VS REGULATION

A lack of historical information on structured credit performance was one reason touted as to why downgrades on securitised products have been so severe. It also called into question about whether some complex structures should be rated at all.

"The real issue is not who pays for the ratings, but whether the ratings are accurate. People should be able to rely on the ratings. A triple-A should be a triple-A," said Sean Egan, managing director of Egan-Jones Ratings, where investors pay for ratings.

"The current situation is not sustainable. It is broken. In structured credit, we have dramatic rating inflation and we're seeing the fallout from that now."

There is also a place in the market for more buy-side research similar to that offered by independent research firm CreditSights which would help increase competition within the industry.

Regulation could hinder that though, Hunter warned. "We can sustain regulation far more easily than a new entrant possibly could," he said.

The FSF recommendations include a separate rating scale for structured debt versus corporate bonds and proposals to raise capital requirements for complex debt.

"Investors do not want separate scales. They want us to get the existing scale right," said Hunter.

He also said that adding liquidity risk to ratings would be very difficult to do.

(Reporting by Natalie Harrison; editing by Elaine Hardcastle)

Forbes.com

The Croesus Chronicles

The Blame Game

Robert Lenzner 04.18.08, 6:00 AM ET

The blame game for the disastrous financial crisis is in full, unedifying bloom, especially as it is being played by former chairmen of the Federal Reserve Board, an eminent institution where ordinarily, discretion is better part of valor.

First, there was former chairman Alan Greenspan blaming the bubble-bursting on "the investment community," and vainly trying to deflect the legitimate and well-deserved carping against his free market Ayn Rand ideology.

Croesus thinks it is credible that regulators could have slowed the runaway train and limited the money-center banks from their reckless greed. Greenspan's need to defend himself smacks of worry about his place in history--fiddling while Wall Street burned. Indeed, the not-too-shy Barry Ritholtz of Fusioninvest.com sounded off some days ago, ladling 85% of the blame for the crisis onto Greenspan and an inexplicable 15% onto his successor, Ben Bernanke.

Chiming in was another former Fed chairman, the austere Paul Volcker, in the most unusual and probably improper role of fingering current Fed Chairman Ben Bernanke for the radical policy moves that "extended to the very edge of its [the Fed's] lawful and implied power, transcending certain long-embedded central-banking principles and practices."

Whew! No way you can read that sentence and not get the impression the purist former monetary boss was displeased with the $29 billion non-recourse loan made Bernanke's Fed made to JPMorgan Chase in order to stave off a devastating meltdown in the markets.

The next day, Volcker admonished the press for misrepresenting his intentions, and broadened the blame game to the laissez-faire climate of benign supervision. There was no pressure to change--not on Washington, on Wall Street or Main Street, Volcker said, blaming the mess on "everyone."

"The sheer complexity, opaqueness and systemic risks embedded in the new markets have enormously complicated both official and private responses," Volcker pointed out. All true, and he suggested the regulators can't handle complexity, opaqueness and systemic risk--a terrible admission that ranks as the domestic version of our intelligence operation before Sept. 11.

In quite another class is the disgustingly egomaniacal ranting of former General Electric chairman Jack Welch against current GE chairman Jeffrey Immelt for foolishly--yes, let's admit it--predicting a steady 10% growth in earnings.

"Here's the screw-up: You made a promise that you'd deliver this, and you missed three weeks later," Welch spouted, jumping on the bandwagon of attacks on Immelt. Let's be blunt. Immelt was foolish to predict gains when half the company is in the finance business and the finance business is suffering.

Croesus blames the somnambulant experts on Wall Street, who are supposed to know that GE is half a lending company and thus must be compromised by ruinous credit markets.

Remember? It was called GE Credit, once upon a time. The analysts should have scoffed at Immelt if they were on top of their games.

Welch gets Croesus' "worst game blamer" award for the week by unnecessarily sticking it to his successor in a very public, quite undignified and highly egocentric manner. Welch has become a leading member of club of those ready to pounce on any opinion-making opportunity if there's a television camera there to capture it. Wise heroes of business with halos 'round their domes don't need to push their wares like this. It's unseemly and should tarnish Welch, Croesus hopes.

Soon enough, there's going to be plenty of blame placed on the non-regulated, unsupervised operators in the credit markets who are responsible for the meltdowns that have required what Volcker called "taking the Fed to the brink of policy that might be considered illegal, and not in the province of the central bank."

Clearly, a dangerous precedent has been established as many investors seem to believe mistakenly that the bottom for financial stocks has been reached. There wasn't much advanced expectation of **Merrill Lynch**'s $10 billion writedown Wednesday.

Get ready for a shock: Croesus has been told that every Wall Street firm knew it was selling risky securities to unsuspecting investors. Packagers like TCW and Pimco were putting these questionable securities in packages to be sold on to others and receiving substantial fees for being the middleman. And the rating agencies, which are meant to be supervised by the SEC, were free to get paid for putting their highest imprimatur on deals that were simply not solid.

This blame game is going to be fought out in the courts. Investors will sue the investment banks and the packagers. Reinsurance companies may sue the investment banks and hedge funds whose holdings they guaranteed. Some $3 billion of Merrill Lynch's writeoffs, by the way, were deals with monoline insurers.

The blame game has a long way to go.

REUTERS

Lawmakers ask SEC and credit raters about conflicts

Wed Sep 26, 2007 1:48pm EDT
By John Poirier and Rachelle Younglai
WASHINGTON (Reuters) - The Securities and Exchange Commission is investigating whether issuers and underwriters of subprime mortgages unduly influenced credit-rating services, the agency's head told a Senate panel on Wednesday.
Credit rating agencies like Moody's Corp, Standard & Poor's and Fitch have been criticized for not responding quickly enough to deteriorating conditions in the subprime mortgage market. They have also been accused of conducting weak analyses and granting higher ratings because they are paid by the companies whose securities they rate.
SEC Chairman Christopher Cox told a Senate Banking Committee hearing that his agency was also examining whether the credit raters followed their stated procedures for managing conflicts of interest in the business.
"The examination will seek to determine whether the (credit raters') role in the process of bringing residential mortgage-backed securities to market impaired their ability to be impartial," Cox said.
The credit rating industry is dominated by Moody's; Standard & Poor's, a unit of McGraw Hill Cos Inc; and Fitch, a unit of France's Fimalac SA.
'IMMACULATE DECEPTION'
Lawmakers questioned the raters' relationships with companies that issue financial instruments and scolded them for not taking responsibility for their role in the housing market meltdown.
Sherrod Brown, a Democrat from Ohio, likened it to "witnessing the immaculate deception" as no one involved in the subprime mess has taken responsibility for their actions.
Democrat Charles Schumer of New York, a member of the committee, said it might be time for the credit rating industry to change its structure to address concerns about conflicts of interest.
"The question looms: Should the structure be changed or should there be two types of agencies out there -- one that is paid for by investors and one that is paid for by the issuer?" Schumer said.
There was no indication that Schumer or other committee members would introduce legislation addressing the structure of the industry.
Richard Shelby, the Senate Banking Committee's top Republican, and Rhode Island Democrat Jack Reed, who chaired the hearing, asked Cox whether the SEC had enough authority to oversee the credit raters.
Cox said that Congress had "struck a sound balance" with its 2006 law giving the SEC more oversight of credit raters. "We have ample authority," Cox said.
However, he added that the SEC needed more information before contemplating any changes in the new law.
Cox would not specify what was needed but later told reporters: "I don't think we need to wait for any more problems" and said there was plenty to examine.

Under the 2006 law, the SEC requires registered credit raters to disclose the procedures and methodologies behind their ratings, as well as conflicts of interest. The agency is studying whether to require the rating firms to disclose more performance statistics and historical default and downgrade rates, Cox said.

INDUSTRY'S DEFENSE

Representatives of the credit rating firms defended the industry.

Vickie Tillman, S&P executive vice president of credit market services, said the company was taking steps to ensure ratings are sound and was reviewing rated transactions more frequently.

If issuers did not pay the rating agencies, the firms would have to charge a subscription, which would severely limit the transparency and broad dissemination of ratings, Tillman said. "This would result in less, not more, information in the market," she told lawmakers.

Tillman said that any conflicts of interest can be managed. For example, S&P analysts are not compensated on the revenue they generate or involved in negotiating fees, she said.

Michael Kanef, group managing director at Moody's, said its ratings had done a "good job" predicting the relative credit risk of debt securities and debt issuers. "They are not statements of fact about past occurrences," he said.

Columbia University law professor John Coffee said the financial markets currently do not punish inaccuracy by the credit raters. He proposed that a rating firm's status with the SEC should depend on maintaining an acceptable level of accuracy.

(Reporting by Rachelle Younglai)

http://www.marketoracle.co.uk/Article3625.html

The Market Oracle

The Coming Collapse of International Credit Ratings Agencies - Moody's, Standard & Poor, and Fitch

Stock-Markets / Global Financial System Feb 06, 2008 - 02:23 PM
By: Alex Wallenwein

So you thought the Ambac/MBIA bond insurers crisis was bad?

You ain't seen nothin' yet

The problem, the challenge, the scandal, is not that the bond insurers are about to be downgraded. The real scandal lies in the fact that they haven't been downgraded a long time ago - and much deeper than from "AAA" to "AA". In fact, what needs to be downgraded are the major international credit ratings agencies, Moody's, Standard & Poor, and Fitch.

Ironically, they are already in the process of downgrading themselves. Moody's, for example, recently issued a statement cautioning investors not to rely on its ratings so exclusively. Ha! That's like a corporate CFO saying investors shouldn't rely on the company's financial statements so much when making their decisions.

Why Downgrade the Ratings Agencies?

Why do they need to be downgraded? Because the top three or four ratings agencies are ridiculously behind the curve when it comes to letting investors know about problems with the entities whose credit standing and investment outlook they (pretend to) rate. The reason for that appears to be an unresolvable conflict of interest which emanates from how these agencies get paid. They get paid for their services by the companies (and governments) whose performance they rate.
Somewhere in the distant past, in the early 1970s, they were paid by the investors who needed to tap them for their information so investors could make educated judgments on investment risks. That is no longer so. Now, they serve two masters at the same time - but only one master really gets the benefit: the one who pays them. Unfortunately, the ones left in the dust in this scenario are the world's institutional and professional investors, and they are largely the ones who most influence the prices of investment products.

What's the Big Deal?

The ratings agencies are the paper investing world's equivalent of an air traffic control system. Particularly institutional investors rely on them almost exclusively when deciding whose debt paper to buy and whose to ditch.
Picture yourself as the pilot of a big airliner. It is nighttime, it's foggy, and you need to land. The question is: are the runway and the landing approach clear? You communicate with the tower of the airport of your destination, and you hear: "Oh sure,go ahead" through your earphones, so you commence your landing approach.
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The world's institutional investors are as dependent on the accuracy of the agencies' ratings as airline pilots are on air traffic controllers, but just like in our analogy, the change in payment structure has compromised the interests of the recipient of the information.
One result of this conflict of interest is that, according to an interview with Sean Egan of Egan-Jones Ratings aired on CNBC Friday, February 1, 2008, the ratings agencies' bank and Wall Street investment house customers have actually exerted pressure on the agencies to issue ratings on CDOs - the very subprime mortgage-backed instruments that caused the current credit crunch!
As if that wasn't bad enough, the ratings agencies then reportedly began to demand that bond insurers develop "mutiple streams of income" in order to get their coveted "AAA" ratings - and that entailed insuring CDOs as well, which ultimately benefited their customers, the bankers, who wanted to push that toxic stuff into the markets.
Naturally, the agencies bowed to their masters requests, which in part caused them to sustain the very subprime-related losses they are now being downgraded for. Funny how that works, isn't it?

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The upshot of all this is that the entire global professional investing world has traditionally heavily relied on these ratings outfits in making investment decisions. "AAA" ratings that used to be regarded as immovable, solid landmarks in the investment landscape now turn out to be nothing more than shape-shifting phantoms.
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There is no telling how many other companies and bond-issuing governmental entities might be affected in a similar way. Quite tellingly, and in anticipation of potential future criticism, Moody's has recently warned that it may have to downgrade the United States of America's credit rating.
There are international efforts underway to "fix" the coming ratings disaster by making the companies adhere to "higher ethical standards. Yeah, right. That has always helped, hasn't it? Just think "Sarbanes-Oxley". The only thing that will fix the problem is to prohibit the ratings companies from accepting money from the institutions they rate. Period.
But, regardless of how, whether, and when the ratings companies themselves will get fixed, the neglect they have shown in the past has caused systemic problems. That malfeasance is opening up a veritable maelstrom, a *black hole* for international credit ratings. The collective reputation of these agencies has pumped up the value of many bank and government-issued debt instruments for the past three decades - and now that "value" is threatening to collapse.
The question now is: on how many - and on which ones - of these credit ratings did they goof up? Six years ago they failed to timely warn of Enron, Worldcom, and others. Now, it's Ambac and MBIA. Who's next?

The very fact that these agencies have been whitewashing their clients' credit ratings over the past several decades throws every single rating they have issued into doubt.

That means there are likely to be huge numbers of bone-deep ratings cuts coming down the pike - and nobody knows which ones, or how deep those cuts will be.
One thing, however, is almost for certain: The very fact that Moody's has warned of a credit downgrade for the

United States indicates that such a downgrade is probably long *overdue* - and that will spook a whole lot of international US treasury investors - like China, India, Japan, and Saudi Arabia.
Let that sink in for a moment.
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Considering how far these outfits may well appear to be behind the curve, that means the world is anticipating a humongous jump in long term and short term interest rates - and that in spite of the US Fed's desperate and frantic attempts to lower domestic borrowing costs.

Interest Rates Will Have to Rise

Unfortunately, as far as most government bonds are concerned, higher returns mean that a lot of bonds have to be sold because, with bonds, yields are an inverse function of price. For the yield to go up, the price must go down, and that means selling, selling, selling.
The astute investor will anticipate that - and get the hell out of bonds of any kind. And, oh yeah, as interest rates rise across the board, companies will find it more expensive to borrow money, so it gets harder to make profits (which is already pretty damn hard as it is these days) and that means stocks will suffer as well.
Where do you think all of that newly homeless investment capital will go? It will seek a safe haven - but bonds, especially those of the US government kind, will long since have lost that status by then, even in paper investors' minds.
That just about leaves only gold, its precious metallic cousins, and the related investment vehicles such as precious metals ETFs, stocks, and mutual funds with any hope of decent returns.
It will be very interesting to watch this happen: Millions of investors, institutional and private, all rushing to invest in only a handful of companies, while bidding *down* the price of fiat money.

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Editor, Publisher
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The Coming Collapse of International Credit Ratings Agencies - Moody's, Standard & Poor, and Fitch

Stock-Markets / Global Financial System Feb 06, 2008 - 02:23 PM
By: Alex Wallenwein

Stock Markets

So you thought the Ambac/MBIA bond insurers crisis was bad?

You ain't seen nothin' yet

The problem, the challenge, the scandal, is not that the bond insurers are about to be downgraded.
The real scandal lies in the fact that they haven't been downgraded a long time ago - and much deeper than from "AAA" to "AA". In fact, what needs to be downgraded are the major international credit ratings agencies, Moody's, Standard & Poor, and Fitch.

Ironically, they are already in the process of downgrading themselves. Moody's, for example, recently issued a statement cautioning investors not to rely on its ratings so exclusively. Ha! That's like a corporate CFO saying investors shouldn't rely on the company's financial statements so much when making their decisions.

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Just like driving your car, investing only makes sense if you can see where you are going. The Euro vs Dollar Monitor is the golden windshield wiper that removes the media's greasy film of financial misinformation from your investment outlook. Don't drive your investment vehicle without it!

REUTERS

Lawmakers ask SEC and credit raters about conflicts

Wed Sep 26, 2007 1:48pm EDT
By John Poirier and Rachelle Younglai
WASHINGTON (Reuters) - The Securities and Exchange Commission is investigating whether issuers and underwriters of subprime mortgages unduly influenced credit-rating services, the agency's head told a Senate panel on Wednesday.
Credit rating agencies like Moody's Corp, Standard & Poor's and Fitch have been criticized for not responding quickly enough to deteriorating conditions in the subprime mortgage market. They have also been accused of conducting weak analyses and granting higher ratings because they are paid by the companies whose securities they rate.
SEC Chairman Christopher Cox told a Senate Banking Committee hearing that his agency was also examining whether the credit raters followed their stated procedures for managing conflicts of interest in the business.
"The examination will seek to determine whether the (credit raters') role in the process of bringing residential mortgage-backed securities to market impaired their ability to be impartial," Cox said.
The credit rating industry is dominated by Moody's; Standard & Poor's, a unit of McGraw Hill Cos Inc; and Fitch, a unit of France's Fimalac SA.
'IMMACULATE DECEPTION'
Lawmakers questioned the raters' relationships with companies that issue financial instruments and scolded them for not taking responsibility for their role in the housing market meltdown.
Sherrod Brown, a Democrat from Ohio, likened it to "witnessing the immaculate deception" as no one involved in the subprime mess has taken responsibility for their actions.
Democrat Charles Schumer of New York, a member of the committee, said it might be time for the credit rating industry to change its structure to address concerns about conflicts of interest.
"The question looms: Should the structure be changed or should there be two types of agencies out there -- one that is paid for by investors and one that is paid for by the issuer?" Schumer said.
There was no indication that Schumer or other committee members would introduce legislation addressing the structure of the industry.
Richard Shelby, the Senate Banking Committee's top Republican, and Rhode Island Democrat Jack Reed, who chaired the hearing, asked Cox whether the SEC had enough authority to oversee the credit raters.
Cox said that Congress had "struck a sound balance" with its 2006 law giving the SEC more oversight of credit raters. "We have ample authority," Cox said.

However, he added that the SEC needed more information before contemplating any changes in the new law. Cox would not specify what was needed but later told reporters: "I don't think we need to wait for any more problems" and said there was plenty to examine.

Under the 2006 law, the SEC requires registered credit raters to disclose the procedures and methodologies behind their ratings, as well as conflicts of interest. The agency is studying whether to require the rating firms to disclose more performance statistics and historical default and downgrade rates, Cox said.

INDUSTRY'S DEFENSE

Representatives of the credit rating firms defended the industry.

Vickie Tillman, S&P executive vice president of credit market services, said the company was taking steps to ensure ratings are sound and was reviewing rated transactions more frequently.

If issuers did not pay the rating agencies, the firms would have to charge a subscription, which would severely limit the transparency and broad dissemination of ratings, Tillman said. "This would result in less, not more, information in the market," she told lawmakers.

Tillman said that any conflicts of interest can be managed. For example, S&P analysts are not compensated on the revenue they generate or involved in negotiating fees, she said.

Michael Kanef, group managing director at Moody's, said its ratings had done a "good job" predicting the relative credit risk of debt securities and debt issuers. "They are not statements of fact about past occurrences," he said.

Columbia University law professor John Coffee said the financial markets currently do not punish inaccuracy by the credit raters. He proposed that a rating firm's status with the SEC should depend on maintaining an acceptable level of accuracy.

(Reporting by Rachelle Younglai)

CNNMoney.com

Subprime contagion?

Ohio's attorney general is investigating the role that credit-rating agencies like Moody's played in rubberstamping dicey bonds, report Fortune's Katie Benner and Adam Lashinsky.

By Katie Benner and Adam Lashinsky, Fortune

FORTUNE

July 5 2007: 11:16 AM EDT

(Fortune Magazine) -- While Bear Stearns is the most recent financial institution to find itself caught up in the subprime-mortgage quagmire, the three credit-rating agencies - Standard & Poor's, Moody's (Charts), and Fitch - may be the next ones to see their good names dragged through the mud.

The reason? Ohio attorney general Marc Dann is building a case against them based on the role he believes their ratings played in the marketing of risky mortgage-related securities.

"The ratings agencies cashed a check every time one of these subprime pools was created and an offering was made," Dann told *Fortune*, referring to the way the bond issuers paid to get their asset-backed securities (ABSs) and collateralized debt obligations (CDOs) rated by the agencies. These ratings run from AAA for debt with the lowest risk of default all the way down to noninvestment- grade bonds, which many pension funds are prohibited from purchasing in their charters. "[The agencies] continued to rate these things AAA . [So they are] among the people who aided and abetted this continuing fraud," adds Dann.

Ohio has the third-largest group of public pensions in the United States, and they've got exposure: The Ohio Police & Fire Pension Fund has nearly 7 percent of its portfolio in mortgage- and asset-backed obligations.

Moody's says that Dann's accusations are nonsense. "We perform a very significant but extremely limited role in the credit markets. We issue reasoned, forward-looking opinions about credit risk," says Fran Laserson, vice president of corporate communications at Moody's. "Our opinions are objective and not tied to any recommendations to buy and sell." She further points out that while some securities have lost significant value, none have actually defaulted. (S&P and Fitch declined to comment.)

Dann and a growing legion of critics contend that the agencies dropped the ball by issuing investment-grade ratings on securities backed by subprime mortgages they should have known were shaky. To his mind, the seemingly cozy relationship between ratings agencies and investment banks like Bear Stearns only heightens the appearance of impropriety. In addition to receiving fees from bond issuers that want ratings, S&P, Moody's, and Fitch do not vet data provided by these customers - information the agencies use to make their credit assessments. It's a bit like a take-home final. Or as Moody's puts it in its own code of conduct, "Moody's has no obligation to perform, and does not perform, due diligence." The other two agencies have similar provisions.

Moody's and its cohorts might have some wiggle room. "The agencies are on fairly strong ground that their ratings are just opinions, but that doesn't absolve them from liability risk," says Steve Thel, a securities law professor at Fordham University.

Dann contends also that the ratings are used as benchmarks by institutional investors. He is not alone in this assessment. According to experts in structured finance valuations, the ratings agencies are the central drivers, particularly in the riskier areas of asset-backed securities markets. The pool of buyers would be much smaller without a rating because pension and mutual funds hold only investment-grade bonds, says Christopher Whalen, who sold asset-backed securities at Bear Stearns and is now a principal at Institutional Risk Analytics, which provides tools to credit officers to assess bonds.

"The rating drives everything," adds Sylvain Raynes, a former Moody's analyst and currently a principal at R&R Consulting, a firm that examines these securities.

Others point out that CDOs are too complex for even sophisticated investors to parse, so the ratings take on great importance. "It is unreasonable to think that people could do the quantum math to figure out the ultimate aggregate default rate on a CDO. So, yes, there is a greater expectation that the gatekeepers will scrutinize the underlying credit," says Doug Cifu, a partner who specializes in private equity and finance at Paul Weiss Rifkind Wharton & Garrison.

Regardless of whether a lawsuit materializes, the ratings agencies already seem to be policing themselves. Of the pool of securities created from 2006 subprime mortgages, Moody's has downgraded 19 percent of the issues they've rated and put 30 percent on a watch list. Sadly for Wall Street, if the ratings agencies feel the need to downgrade even more, it will certainly constrict the cheap debt that has fueled the bull market.

Or as Whalen puts it, "The Street dragged everyone into increasingly bizarre and illiquid instruments, and there was huge profitability there, but what it did was buy itself a lot of trouble."

Find this article at:
http://money.cnn.com/2007/07/05/news/economy/subprime.fortune/index.htm

INTERNATIONAL
Herald Tribune

CDOs mask huge subprime losses, abetted by credit rating agencies

By Richard Tomlinson and David Evans

Bloomberg News

Friday, June 1, 2007

LONDON: The numbers looked compelling. Buy this investment-grade collateralized debt obligation and you will get a return of up to 10 percent, Credit Suisse Group said. That was almost 25 percent more than the average yield on a similarly rated corporate bond.

Investors snapped up the $340.7 million collateralized debt obligation, or CDO, a collection of securities backed by bonds, mortgages and other loans, within days of the Dec. 12, 2000, offering.

The CDO buyers had assurances of its quality from the three leading credit rating companies - Standard & Poor's, Moody's Investors Service and Fitch Group. Each had blessed most of the CDO with the highest rating, AAA or Aaa.

Investment-grade ratings on 95 percent of the securities in the CDO gave no hint of what was in the debt package - or that it might collapse. It was loaded with risky debt, from junk bonds to subprime home loans. Over the next six years, the CDO's value plummeted as defaults mounted in its underlying securities.

By the end of 2006, losses totaled about $125 million.

The failed Credit Suisse CDO may be an omen of far worse to come in the booming market for these investments. Sales of collateralized debt instruments worldwide have soared since 2004, reaching $503 billion last year, a fivefold increase in three years, according to data compiled by Morgan Stanley.

CDO holdings have already declined in value by between $18 billion and $25 billion because of falling repayment rates by subprime U.S. mortgage holders, Lehman Brothers Holdings estimated.

In many cases, investors do not even know that values have dropped. In this secretive market, there is no easy way for them to find out what their CDOs are worth.

The uncharted slide of the Credit Suisse CDO points to the critical and poorly understood role played by rating companies in assessing risk and acting as de facto regulators in a market that has no official watchdogs.

Many of the world's CDOs are owned by banks and insurance companies, and the people who regulate those firms rely on the raters to police the CDOs.

"As regulators, we just have to trust that rating agencies are going to monitor CDOs and find the subprime," said Kevin Fry, chairman of the Invested Asset Working Group of the U.S. National Association of Insurance Commissioners. "We can't get there. We don't have the resources to get our arms around it."

The three leading rating companies, all based in New York, say that policing CDOs is not their job. They just offer their educated opinions, said Noel Kirnon, senior managing director at Moody's.

"What we're saying is that many people have the tendency to rely on it, and we want to make sure that they don't," said Kirnon, whose firm commands 39 percent of the global credit rating market by revenue.

S&P, which controls 40 percent, asks investors in its published CDO ratings not to base any investment decision on its analyses. Fitch, which has 16 percent of the worldwide credit rating field, says its analyses are just opinions and investors should not rely on them.

The rating companies apply their usual disclaimer about the reliability of their analyses to CDOs. S&P says in small print: "Any user of the information contained herein should not rely on any credit rating or other opinion contained herein in making any investment decision."

Joseph Mason, a finance professor at Drexel University in Philadelphia and a former economist at the U.S. Treasury Department, said the ratings were undermined by the disclaimers.
"I laugh about Moody's and S&P disclaimers," he said. "The ratings giveth and the disclaimer takes it away. Once you're through with the disclaimers, you're left with very little new information."
When it comes to CDOs, rating companies actually do much more than evaluate them and give them letter grades. The raters play an integral role in putting the CDOs together in the first place.
Banks and other financial firms typically create CDOs by wrapping together 100 or more bonds and other securities, including debt investments backed by home loans.
Credit rating companies help the financial firms divide the CDOs into sections known as tranches, each of which gets a separate grade, said Charles Calomiris, a professor of financial institutions at Columbia University in New York.
Credit raters participate in every level of packaging a CDO, said Calomiris, who has worked as a consultant for Bank of America, Citigroup, UBS and other major banks. The rating companies tell CDO assemblers how to squeeze the most profit out of the CDO by maximizing the size of the tranches with the highest ratings, he said.
"It's important to understand that unlike in the corporate bond market, in the securitization market, the rating agencies run the show," he said. "This is not a passive process of rating corporate debt. This is a financial engineering business."
As home buyers and investors grapple with the subprime mortgage crisis, many have not yet realized the extent to which that turbulence is spilling into CDOs. Foreclosure filings in the United States surged to 147,708 in April, up 62 percent from April 2006, as subprime borrowers stopped making mortgage payments.
As foreclosures increase, the subprime-backed securities in CDOs begin to crumble. Subprime mortgage securities make up about $100 billion of the $375 billion of CDOs sold in the United States in 2006. Investors have little idea how toxic some of these CDOs are, Mason of Drexel said.
"We compose CDOs with a bunch of this stuff," he said. "Now we just jack up the risk, jack up the misunderstanding.
"We're throwing our money to the wind. We now know the defaults are in the mortgage pools and it's only a matter of time before they accumulate to levels that will threaten the CDO market."
David Evans reported from Los Angeles.

Notes:

REUTERS

Ohio atty gen probes rating agencies' subprime role

Fri Jul 6, 2007 3:40pm EDT

CHICAGO, July 6 (Reuters) - Ohio's attorney general is investigating the role of Wall Street rating agencies to determine whether they have any culpability in the subprime mortgage meltdown, his spokeswoman said on Friday.

Attorney General Marc Dann's spokeswoman, Jennifer Brindisi, said the probe was part of an overall mortgage fraud investigation into various parties involved in subprime loans, including lenders and investment banks.

She pointed to a recent presentation by Joshua Rosner, a managing director at investment research firm Graham Fisher & Co., that tied a misapplication of agency ratings to many of the problems in mortgage-backed securities and collateralized debt obligations.

Brindisi said of particular interest was the assertion the rating agencies may have a role in creating these securities.

She added that the attorney general's office has been talking with Moody's Investors Service and would use consultants to help guide its investigation.

Moody's spokesman Tony Mirenda on Friday declined to comment on the investigation. Spokesmen for the other major agencies -- Standard & Poor's Ratings Services and Fitch Ratings -- did not immediately respond to phone calls seeking comment.

Dann told Fortune magazine that rating agencies made money every time a subprime pool was created and offered and continued to rate these securities triple-A. **He said the rating agencies were among those that "aided and abetted this continuing fraud," according to a story on Fortune's Web site.**

Others also have been critical of rating agencies for maintaining top-grade ratings on troubled securities, including Bill Gross, manager of the world's largest bond fund at Pacific Investment Management Co., or PIMCO, who claimed the agencies failed to warn investors about the risk.

Dann has said that predatory lending was driving Ohio's high foreclosure rate and last month he filed suit against 10 companies over alleged inflated property appraisals.

Ohio ranked among the top 10 states in terms of high mortgage foreclosure rates in May, according to RealtyTrac data. For all of 2006, the state ranked eighth among states.

AFP Urges SEC to Take Action on Conflicts of Interest in Credit Rating Agencies

Washington, DC - September 27, 2007 – The Association for Financial Professionals (AFP) urges the Securities and Exchange Commission (SEC) to review its recently finalized rules regarding credit rating agencies.

"We are encouraged that the SEC is conducting an examination of the role that credit rating agencies played in the current subprime mortgage market turmoil and look forward to seeing their conclusions. Unfortunately, the current mortgage market problem highlights the conflict of interest issues that AFP's members first identified in 2001," said Jim Kaitz, AFP President and CEO.

"The final rules approved by the SEC in May made significant progress in addressing many of concerns regarding the credit rating agencies. However, additional steps can be taken. As such, I urge the SEC to finish the job by reviewing its rules and adopting the recommendations that AFP made in its March 2007 comment letter," Kaitz continued.

In its March 12, 2007, comment letter to the SEC, AFP recommended that the Commission add the following to its prohibited conflicts list:

1. NRSROs should be required to establish distinct and absolute separation between rating analysts and credit rating agency staff responsible for generating revenue from credit ratings, rating assessment services, corporate governance reviews, or other ancillary services offered by the credit rating agency.
2. The Commission should bar analyst compensation from being linked in any way to revenue generated from credit ratings or any ancillary services. The potential for a credit rating agency or individual analyst to abuse the market power associated with NRSRO recognition to boost revenue or personal earnings is obvious.

"I applaud Chairman Kanjorski for his leadership on this issue and for holding today's hearing. While the focus today is understandably on the subprime mortgage market, credit rating agencies play a critical role in many other segments of the global capital markets, which is why we worked so closely with Representative Kanjorski (D-PA) and Senator Shelby (R-AL) to enact the Credit Rating Agency Reform Act of 2006," Kaitz said.

Last year, Congress approved the Credit Rating Agency Reform Act of 2006. The reform act gave the SEC additional authority to oversee recognized rating agencies. That authority allows the SEC to impose an element of accountability on rating agencies to produce credible and reliable ratings. The reform act also gave the SEC the authority to address the conflicts of interest issues that were highlighted in today's hearing.

The Association for Financial Professionals (AFP) serves more than 16,000 individual members throughout all stages of their careers in treasury and financial management. Headquartered in Bethesda, MD, AFP provides professional certification, continuing education, research, development of industry standards, financial tools and publications, training and career development and representation to legislators and regulators. AFP's global reach includes AFP of Canada, a Toronto-based membership organization and gtnews, a London-based, on-line resource for the treasury and finance community.

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E.C. may probe rating agencies over subprime

By Aude Lagorce, MarketWatch
Last update: 6:05 a.m. EDT Aug. 16, 2007

LONDON (MarketWatch) -- The European Commission will investigate the role played by credit-rating agencies in the recent crisis over subprime U.S. mortgages amid growing concern that they should have warned investors sooner of the dangers of investing in mortgage-backed securities, according to a published report.

The Commission will review the current voluntary code used by agencies such as Moody's and Standard & Poor's as it worries they were too slow in warning about problems in the $1.1 trillion U.S. subprime market, according to the report in the Financial Times.

The voluntary code was designed to tackle conflicts of interest as rating agencies are paid by the firms they rate. It was set up after the collapse of energy trader Enron.

"If the rating agencies believe this is going to be business as usual, they are very wrong," an unnamed Commission official was quoted as saying.

According to the FT, Internal Market Commissioner Charlie McCreevy had said he wanted to give the code time to prove itself but the U.S. subprime meltdown has highlighted some weaknesses. He's expected to decide on whether to propose new legislation sometime in 2008.

In the U.S., the Securities and Exchange Commission introduced rules for agencies in June.

Credit rating agencies have so far been relatively immune to the blame game as investors look for the culprits of the current meltdown.

While lenders have been criticized for making lenient loans, homebuyers for seeking easy mortgages and Wall Street underwriters for making a bundle turning them into securities, the credit ratings agencies have so far emerged relatively unscathed.

But their responsibility for the current crisis is now being questioned.

The various agencies indeed gave top ratings to many securities built on the questionable loans, making them appear as safe as a U.S. Treasury bond.

In an extensive article published Wednesday, the Wall Street Journal sheds some light on the role played by the rating companies. It stressed that far from working in isolation, the agencies instead often cooperated with the underwriters designing these mortgage bonds. The collaboration insured that any new security or bond designed by the underwriters would get high-enough ratings to be marketable. See story on WSJ.com

As a result of the rating agencies' collaboration and generally benign ratings, more of these securities based on subprime mortgages got marketed, which in turn meant more leeway for lenient lenders making these loans to offer more of them.

According to the FT, while banks first warned about a potential crisis in subprime mortgages last year, credit agencies waited until April to significantly downgrade ratings on relevant securities.

Moody's declined to comment. S&P didn't return calls for comment.

The FT report said McCreevy met with senior executives from ratings agency Standard & Poor's last month and expressed his concern over the mortgage market.

McCreevy has reportedly invited securities regulators from across Europe to a meeting next month to discuss rating agencies and the recent problems.

McCreevy's spokesman at the Commission couldn't be reached for comment.

S&P is a unit of McGraw Hill.

Aude Lagorce is a senior correspondent for MarketWatch in London

FT.com
FINANCIAL TIMES

Bigger sheriffs needed

ByGary Silverman
Published: March 21 2008 21:17 | Last updated: March 21 2008 21:17

It has been less than a fortnight since he left the New York state government, but I am already beginning to feel a certain nostalgia for Eliot Spitzer.

I can't say I particularly miss Spitzer the man. Spitzer's professional self-immolation – as the alleged "client nine" of a call-girl ring – underscores the questions about his character that surfaced during his years as attorney-general and governor.

But I am developing a hankering for Spitzer the spectre – the presence who became known as the Sheriff of Wall Street. As it turned out, he hadn't been gone for more than a couple of days before we learnt again that without proper sheriffs, the local cowboys have a tendency towards self-inflicted wounds.

The latest evidence comes in the form of Bear Stearns, an investment bank that collapsed a few days after Spitzer rode off into the sunset. Worth roughly $20bn about a year ago, Bear agreed to be sold to JPMorgan Chase last weekend for roughly $230m – or less than it cost the Texas Rangers baseball team to sign Alex Rodriguez a few years back.

The exact reasons Bear bit the dust could be the subject of debate for years to come. But there can be little argument that it is the latest casualty of a credit crisis that began in the badlands of the financial world known as the subprime mortgage market.

Subprime lending has long loomed as one of the financial world's less savoury activities, involving as it does the provision of higher interest loans to lower income people, generally speaking. However, it grew rapidly in recent years as bankers pooled payments from these loans to back securities that were sold to investors. Now, owners of these securities have lost billions of dollars and I would argue that's because free markets, like frontiers, don't work well without sheriffs to keep order.

The problem in the subprime world was the lack of checks and balances. Everyone involved had the same incentive – to produce more mortgages. Brokers earned fees by arranging the loans and selling them to banks. Bankers earned fees by creating securities from the mortgages and selling them to ravenous investors around the world. Rating agencies earned fees for attesting to the reliability of this mortgage paper.

Eventually, the brokers ran out of legitimate borrowers and began signing up unreliable ones, even people who could not produce a proper pay stub. Bankers quietly moved the mortgages down the bond assembly line. The rating agencies trusted in the procedures of the banks. Investors banked on the rating agencies. Only disaster stopped the subprime machine.

What was missing was a proper supervisor – an entity that could observe the entire process and keep it running smoothly. You would think we would have such authorities in the US but we don't.

One of the big errors in this regard dates back to the last years of the Clinton administration, when the US enacted financial reform legislation that allowed financial companies greater freedom but kept the existing system of financial regulation.

It was a solution that pleased the bankers and the bureaucrats. Financial firms got to do just about whatever they wanted. But the regulators maintained control of their traditional fiefdoms, meaning different entities regulated different financial services.

This created a problem in businesses such as subprime mortgages, which involved many different activities. No one supervised the whole thing.The regulators were blind men examining elephants. They knew what they touched but little else.

One of the sad things about Spitzer was that he, too, was a creature of this fragmented regulatory system. His role, while dramatic, was limited. As New York attorney-general, he could pursue people who might have broken state laws. But he couldn't directly address the structural problems that led to Wall Street malfeasance, and, in a sense, his brand of prosecutorial theatre served as a distraction from them.

When Spitzer resigned as governor, there was no small measure of chortling in New York, but, as the subprime debacle and the Bear collapse show, the last laugh could be on Wall Street. We not only need Spitzers here, we need better Spitzers – broader Spitzers – to keep things from getting out of hand.

I learnt as much during my years covering Wall Street for this newspaper. Indeed, as the Bear collapse occurred, my thoughts kept returning to something one of the grand old men of Wall Street had said to me and a colleague during a meeting a few years back.

It was a background conversation, a chance for us to get to know one another, and our Wall Street friend was in fine form, holding forth on politics and joking around. When the time came for us to leave, he looked at us, flexed his bicep and pointed to it with his index finger. "The only thing that matters is this," he said.

I didn't argue with him then and I won't argue with him now. To get things done on Wall Street you have to show some muscle. Our elected government would be well advised to remember that.

Gary Silverman is the FT's US news editor

Chrystia Freeland is away.

Daily news headlines: 27 March 2008,
Iosco proposes changes to rating agencies' code of conduct
Credit rating agencies under fire from Iosco
MADRID – The International Organisation of Securities Commissions (Iosco) has proposed changes to the code of conduct for credit rating agencies (CRAs) in its new consultation paper, The Role of Credit Rating Agencies in Structured Finance Markets.
The consultation paper says processes and procedures need to be strengthened to improve the quality and integrity of the ratings process – criticised for lacking transparency and independence.
The Iosco recommendations specify that decision-making over ratings downgrades be objective and that CRAs establish an independent function responsible for periodic reviews of an agency's rating methodologies and models. Iosco also warned agencies to refrain from rating structured products if the complexity of the product raises doubts about the validity of their ratings models and methodologies.
Conflicts of interest are another concern. The paper says CRAs should conduct periodic reviews over their employee remuneration practices, and disclose whether any one client and its affiliates constitute over 10% of the CRA's annual revenue.
Iosco requests comments on the consultation paper by April 25, 2008.
Source: **OpRisk & Compliance**

naked capitalism

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Saturday, February 9, 2008

SEC Proposes Cosmetic Regulations for Rating Agencies

The Wall Street Journal and Bloomberg report that the SEC is mulling regulations for rating agencies. Note that rating agencies have benefited from being a protected class, since the SEC determines who can be a Nationally Recognized Statistical Ratings Organization, yet heretofore has imposed no obligations on them.

In the 1970s, the SEC set regulatory capital requirements on various types of financial institutions; these in turn rested on credit ratings set by NRSROs. The three large incumbents, Moody's Standard & Poor's and Fitch were given the designation.

Only a very few firms have been able to join the club since then; the SEC has not only failed to set standards for new applicants, but is also has never acknowledged receipt of applications. Thus NRSROs have the unique advantage of enjoying a high regulatory barrier to entry with no accompanying responsibilities.

And the new SEC proposals are a continuation of this proud, hands-off, no obligations tradition. Its great reform proposal? To require the rating agencies to publish how well their past ratings have done and disclose performance differences among ratings for different product categories.

The latter requirement flies in the face of the myth that the rating agencies have promulgated, namely, that their ratings mean the same thing, in terms of default risk, across products. That practice started slipping in the early 1990s, yet the agencies continued to maintain that their ratings standards were the consistent across products.

Note also that this proposal fails to acknowledge the fundamental conflict of interest that created this mess, that the ratings agencies are paid by issuers, when their ratings are for the use of investors. Taking that one on is too hard for an SEC ideologically opposed to meaningful intervention, no matter how patent the need for it is.

Contrast this attitude with the tough words from an EU regulator, as quoted in Reuters:

> European Union Internal Market Commissioner, Charlie McCreevy, warned on Wednesday that if credit ratings agencies did not correct the lack of distinctive ratings for structured finance products, he would take action.
>
> "If the proposals are not forthcoming in coming months, I would not hesitate to move forward to have it addressed with regulatory action," McCreevy told the Society of Business Economists in London....
>
> "I am not going to be prescriptive today but I will say this: strong independent professional oversight of the credit professionals within the rating agencies...and of the operation of the ratings function is absolutely essential if market and regulator confidence is to be restored with respect to the effective management of the conflict of interest inherent in the rating agencies' business models," McCreevy told the audience in London.

Now consider the harebrained statements from the SEC, via Bloomberg:

> The U.S. Securities and Exchange Commission may propose new rules for credit-rating companies to help evaluate securities following investor losses related to subprime mortgages, the agency's chairman said.
>
> The rules would increase disclosure about ``past ratings" to help determine whether rankings successfully predicted the risk of default, SEC Chairman Christopher Cox said at a securities conference in Washington today. The regulations may also address the differences between ratings on structured debt and rankings for corporate and municipal bonds.
>
> Investors could then use the enhanced disclosure to ``punish chronically poor and unreliable ratings," Cox told reporters after his speech. ``The rules that we may consider would provide information to the markets in a way that facilitates" comparisons, he said.

Punish chronically poor and unreliable ratings? What in God's name is that supposed to mean? The market already disagrees plenty with published ratings. Has Cox ever looked at the AAA ABX index? And all of this patently obvious repudiation by the market of rating agency grades has had zero effect on their behavior. Even the specter of monoline credit default swaps of MBIA and Ambac priced at distressed levels still has not embarrassed them into making downgrades. Why? ***They are paid by the issuers!*** What investors and the market thinks has zero effect on their bottom line. If months of horrific press won't induce them to clean up their act (the reforms proposed by S&P are similarly cosmetic), a mere tabulation of past performance certainly won't.

In case you think I am being unfair, consider this excerpt from the Wall Street Journal story:

> SEC Chairman Christopher Cox said the potential rules "would require credit-rating agencies to make disclosures surrounding past ratings in a format that would improve the comparability of track records and promote competitive assessments of the accuracy of past ratings."
>
> He added that the SEC "may propose rules aimed at enhancing investor understanding" about the differences between how ratings are treated for standard municipal and corporate debt, as compared with innovative financial instruments crafted by Wall Street banks.

Translation: the problem isn't that the ratings are bogus, it's the investors' fault that they don't understand that the ratings are bogus. So we'll try harder to educate those dumb investors.

Just as the EU is having to do the heavy lifting on antitrust with Microsoft, so too will they with rating agency reform. The US seems unwilling to take steps that will reduce a company's God-given right to its profits, no matter how much their actions cost the greater economy.
Posted by Yves Smith at 1:40 AM
Topics: Credit markets, Regulations and regulators

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7 comments:

Francois said...

One can only shake his head in disbelief. On the other hand, I would love to get the contact info of the dudes that provide them with the weed they smoke: it's gotta be strong grade-AAA stuff man, the real deal!

I truly fail to see how these people, ensconced in the rigid ideological universe of "Thou shall not regulate" and "Thou shall never ever inconvenience corportations", regardless of the consequences, can be different from the Iranian ayatollahs or the Komissars from the Politburo.

February 9, 2008 3:12 AM

Anonymous said...

I just read through this very boring and IMHO stupid fluffy/bogus CC for Moody's, which sounds like a group of preppy punks on a golf course waiting for a snack to be served and more vodka; highly un-impressive questions and dumb replies -- suggestive of a culture at home at the country club, but out of touch with reality!

Moody's Corp. Q4 2007 Earnings Call Transcript

posted on: February 07, 2008 | about stocks: MCO

http://seekingalpha.com/article/63698-moody-s-corp-q4-2007-earnings-call-transcript

Raymond W. McDaniel, Jr. - Chairman and Chief Executive Officer
Thanks, Linda. I will now briefly summarize developments in the regulatory area. We continue to have

active communications with regulatory authorities in the U.S. and International. As discussed last quarter the issues related to subprime residential mortgage and securitization have prompted significant focus by policy makers and regulators on the financial services sector including specific attention to the role and performance of rating agencies.
A broad agenda was set by the G7 finance ministers and central banking authorities in their October 2007 meeting with the G7 asked the Financial Stability Forum or FSF to provide updates and recommendations by April 2008 on four topics. Including one about the role of credit rating agencies and evaluating structured finance products. This agenda has acted as a catalyst and encouraged global regulatory authorities in central banks to coordinate activities in time lines in order to provide their views to the FSF. These authorities include the BIS Committee on the Global Financial System and the International Organization of Securities Commissions or IOSCO.

... And that process while it makes independent recommendations for behavioral processes and conduct at rating agencies, which IOSCO would expect us to implement, is also feeding into the broader process of review the rating agencies by the financial stability forum by the presents working group here in the U.S. and so there are independent efforts going on, which are funneling into an integrated review at the international level or pan national level.

Lucas Binder - UBS
Hi, guys. Couple of quick questions. Can you.... Ray you gave an update on IOSCO, but can you talk a little bit about where things are domestically with the SEC and the state's attorney general? And then also are you within Moody's analytics is their plan still break out that can be in research revenue breakdowns?
Raymond W. McDaniel, Jr. - Chairman and Chief Executive Officer
Sure. With respect to the SEC and the various state's attorney general, we... the SEC is continuing with what is now is normal inspection and review process that is new pursuant to the reform act and the propagating rules, but they have been in contact with us and we've been responding to inquiries and request for information from the SEC pursuant to that. And they have had particular interest I think not surprisingly in processes around structured financing and making sure that they understand those and are comfortable with the information that we are giving them there. And it's a similar story with the state's attorney general in that we are responding to information request making all the information that is being requested available on its timely basis as we can and those inquiries continue.

Craig Huber - Lehman Brothers
All right. Can you just give me more color then why you think costs in the upcoming first quarterly roughly $20 million higher? That number is not dramatic enough?

Catriona Fallon - Citigroup Investment Research
Okay. And then can you give us some directional you now if you have to actual numbers that's fantastic, but directional ideas on the margins for this different types of relationships?
Raymond W. McDaniel, Jr. - Chairman and Chief Executive Officer
No I don't think we are going to be able to make margins available on relationship versus transactional business, so I just don't have that available.
Catriona Fallon - Citigroup Investment Research
Okay. Thanks so much.
Raymond W. McDaniel, Jr. - Chairman and Chief Executive Officer
Okay

Raymond W. McDaniel, Jr. - Chairman and Chief Executive Officer
Okay, well thank you everybody for joining and for your detailed and enthusiastic questions. We look forward to speaking with you after the first quarter. Thanks.
February 9, 2008 4:52 AM

Anonymous said...

Ok, so lets see what those kids are saying:

http://www.fsforum.org/home/home.html

FSF sets out policy directions for strengthening the resilience of the financial system (February 2008)

The FSFís Working Group on Market and Institutional Resilience has sent an interim report to G7 Finance Ministers and Central Bank Governors.

http://www.fsforum.org/publications/FSFWGG7Interimreport5Febfinal.pdf

Where market discipline fails,
expanding the scope of regulatory coverage must be considered. But not every market failure in financial systems has an appealing or effective regulatory solution. Additional regulations can also create new areas for regulatory arbitrage or promote moral hazard where they stretch the resources of supervisors and regulators too far. Authorities therefore need to be careful that their efforts to correct one market distortion do not create a new one.

>> 3. The uses and role of credit ratings
• Investors, many of whom have relied inappropriately on ratings in making investment decisions, must obtain the information needed to exercise due diligence. Investment guidelines should recognise the uncertainty around ratings and differentiate products according to their risk characteristics.

Huh...thats it....whad a buncha crap! These are the shills that are in charge of offering FINANCIAL STABILITY? Oh great, everyone can relax!

The whole problem seems to hing on investors not doing DD and then falling for those bogus ratings from the rating agencies. Thank God for full disclosure and transparency, now we can get back to re-packaging derivatives into more interesting securities that wont need to be rated or disclosed.....which sends me to my notes, e.g, here is some transparent full disclosre:

J/P/Morgan Chase Commercial Mortgage Securities Trust 2007-C1 · 8-K · For 12/20/07 · EX-4
Filed On 1/4/08 4:29pm ET · SEC File 333-140804-06 · Accession Number 914121-8-8
http://www.secinfo.com/dRSm6.t7.c.htm

Forget about off balance sheet derivatives and entities, the new game is all about: "Book-Entry Certificates and Registered (Certificated) Receipts, Insured Custodial Receipts, Variable Rate Demand Obligations,certificated depositary interest -- all packaged into hyper-dimensionalal REMIC Certificates that will end up being Privately Issued Mortgage-Backed Securities and you aint never gonna know what country or what vault has what.

Oh but wait, it gets better, not only will you not know whats what or what its called, but then you can add this to the mix (andthe fact that this are cross-border and can spin any direction in any time zone 24X7): □□ LENDING OF PORTFOLIO SECURITIES. Consistent with applicable regulatory □requirements, the Fund may lend its portfolio securities to brokers, dealers □and other financial institutions, provided that such loans are callable at □any time by the Fund (subject to certain notice provisions described in the □Statement of Additional Information), and are at all times secured by cash or □money market instruments,......
February 9, 2008 5:17 AM
littleredridinghood said...

"Oh Grandma, what a long comment you have!!"
February 9, 2008 7:04 AM

Anonymous said...

The US Securities and Exchange Commission (SEC) has stepped up its inquiry into Merrill Lynch's accounting of its sub-prime mortgage investment portfolio at the same time as federal prosecutors have opened a criminal investigation into the Wall Street firm.
February 9, 2008 12:53 PM

Independent Accountant said...

The SEC will have all the success in fixing the rating agencies, it's had with the CPA profession since 1976: none at all.
February 9, 2008 11:28 PM

Karolus said...

Conflicts of interest embedded within the Nationally Recognized Statistical Rating Organizations' rating process:

A testimony from holders of defaulted sovereign bonds.

Dear Mr. Secretary,

In the recent past you have stated that it would be necessary to examine the role of credit rating agencies (nationally recognized statistical rating organizations, NRSROs), including transparency and potential conflicts of interest.

1. Identified conflicts of interest

Because ratings are deeply embedded in financial investment regulation, the NRSROs have in fact been handed an oligopoly; because they are paid by the issuers of the securities they rate, not by investors, they suffer a conflict of interest; and because their ratings are deemed mere opinions and thus protected as free speech, the NRSROs are unaccountable.

Over the years NRSROs have often come under very strong criticism in these respects. The ENRON debacle was a case in point.

2. Habitual defense of NRSROs

When this happens, one finds the NRSROs usually claim that although the ratings they attribute always fully reflect the information which has been disclosed to them, they cannot be held responsible for not reflecting any items which may have been withheld from them.

3. Testimony from the French: the Russian Federation is in default

In 1999 a French government survey found 316000 bondholders of defaulted pre-1917 Russian bonds. France's highest jurisdiction, the Conseil d'Etat, has repeatedly found that the rights of bondholders against the Russian Federation are not extinct. Bondholders estimate the present value of monies outstanding to be well in excess of US$ 100 billion.

I am writing to you because I believe I can bring relevant information to those whose task it is to examine the role of the credit rating agencies.

French bondholders believe the NRSROs' habitual defense as quoted above to be fallacious, and I would like to bring to your attention one very precise, verifiable and irrefutable instance which I believe will prove my point.

I realize this instance might seem somewhat removed from the causes of the current market turmoil, however I believe it stems from the very same conflict of interest which lies embedded in the rating process and which has led to the unjustifiably inflated ratings which the main NRSROs attributed to many Collaterized Debt Obligations and various asset-backed securities before these suffered the sudden downgrading process which sparked the current sub-prime crisis; which is why I respectfully bring it to your urgent attention.

The instance is the unjustified "investment grade" rating attributed to the sovereign issues of the Russian Federation, a government which has consistently refused to honor the debt of its predecessor internationally recognized government prior to 1917, in flagrant violation of the successor government doctrine of settled international law.

By refusing to settle its predecessor government's debt the Russian Federation has thus notoriously defaulted on its obligations, a default which has been officially notified to the main NRSROs.

All three major agencies publish their rating rules and definitions; for example Standard and Poor's state, in particular, that their ratings are, among other things, an evaluation of the issuer's willingness to pay its financial obligations (see exhibit A), a willingness all too clearly absent in the case of the Russian Federation:

Indeed, while the Russian Federation punctually pays both capital and interest on modern-era Russian Federation bonds listed on the Luxembourg exchange, it never has done so on pre-1917 Russian bonds, which have thus remained unserviced since 1918, despite the fact that no agreement has ever been reached with the bondholders, that the debtor is now notoriously affluent, that France's highest jurisdiction (Conseil d'Etat) has repeatedly ruled that the rights of the bondholders against the Russian Federation are not extinct, and that the defaulted bonds have been continuously listed on the regulated section of the Paris exchange (until NYSE-Euronext's French subsidiary Euronext Paris S.A. definitively struck them off the list on October 24th 2007 - that is only three months ago - for no stated reason).

The agencies have a specific rating for such circumstances - which Standard and Poor's call "SELECTIVE DEFAULT" or SD - (exhibits B and D), which quite clearly applies to the Russian Federation; although Standard and Poor's will very probably remind us that:

"The sovereign is also regarded as having resolved its default in the rare instances, usually relating to a change in regime, in which governments repudiate certain types of obligations altogether and either reject creditor efforts to get compensation or, many years after the default, make token payments to creditors as settlement. Historic examples involving repudiations of foreign currency bonds include the Soviet Union in 1917, China in 1949, and Cuba in 1960. Had Standard and Poor's rated these sovereigns at the time, it would have lowered the ratings to "D" to reflect the debt repudiation. However, even if there is no resolution of a default through the courts or by the parties involved, Standard and Poor's eventually removes the default ratings based upon the diminished prospects for resolution and the lack of relevance of the default ratings in the context of the market. Standard and Poor's forward-looking sovereign ratings typically refer only to debt that the present government acknowledges." (exhibit C).

The result of such policies is that despite its notorious default the Russian Federation has been attributed "investment grade" ratings by all three major agencies, instead of the obviously justified DEFAULT.

Indeed, at one stage, while placing the ratings of the Russian Federation under review for possible upgrade, Moody's actually wrote that "the government's improved willingness and ability to meet its debt servicing obligations is matched by its improved willingness and capacity to increase tax collections and close tax loopholes" (exhibit E), thus openly negating the Russian Federation's unwillingness to face its internationally recognized obligations.

Yet Moody's is even less entitled than Standard and Poor's to make such a statement since, contrary to Standard and Poor's, it does dot make provisions by claiming to rate only the debt that the present government recognizes.

3. Investors suffer severe prejudice from attribution of unjustifiably high ratings

The natural inference from Standard and Poor's above disclaimer is that in order to "resolve its default" all a revolutionary sovereign need do is repudiate its obligations, reject creditor efforts to get compensation, and wait until "Standard and Poor's eventually removes the default ratings based on the diminished prospects for resolution". It must in addition be noted that the removal of the default rating, which Standard and Poor's claims to be justified by the "diminished prospects for resolution and the lack of relevance", is precisely what irrevocably leads to diminished prospects for resolution and lack of relevance, since it enables the defaulted and unwilling debtor to emerge from the process with a rating normally only associated with willingness to pay and thus to tap markets on accessible terms without having honored its previously outstanding debt.

The end result of such a disclaimer is to negate both the default and the unwillingness to pay of a solvent debtor, although he has defaulted and is unwilling to pay. Thus, by removing the only argument which could have led the defaulted sovereign debtor to the negotiating table, NRSROs deprives bona fide creditors of any means of making good on their bona fide claims, which they cannot take through the judicial system since sovereigns are very often protected by sovereign immunity.

As stated above, the prejudice is well in excess of US$ 100 billion.

4. Rating policies viewed as disingenuous and fuelled by conflict of interest

In view of the massive profits which NRSROs stand to gain from attributing investment grade ratings to such defaulted issuers as the Russian Federation - as demonstrated below - bondholders views NRSRO justifications, disclaimers and policies with respect to the Russian Federation's ratings as disingenuous.

It has been made blatantly clear above that contrary to the argument they habitually put forth in their defense it is not through lack of knowledge, but on the contrary despite irrefutable knowledge of a default, and in violation of their own published criteria, that after considerable contortions the agencies have attributed the Russian Federation with what are in our view unjustified "investment grade" ratings instead of the deserved "default" ratings. As a result, past, present and future investors are being very seriously misled on issues worth hundreds of billions of dollars, as they have recently been in the case of certain asset-backed securities.

Why is this so?

It is common knowledge that both public and private issuers from the Russian Federation have issued stocks and bonds in increasingly massive quantities over the past decade in international markets. Obtaining an investment grade rating is, for a new issuer, a prerequisite for any significant placing of bonds in international markets; therefore the prospect of these issues, particularly in bonds, has represented massive potential windfall profits for the agencies, whose revenue will in this respect be a percentage of the capital amount of the issues rated.

As is well known, it is not the custom for a rating agency to attribute a better rating to any private issuer of a given country than the rating attributed to that country's government. French bondholders believe that therefore, had the agencies attributed to the Russian Federation government the "DEFAULT" rating it quite obviously deserves, the agencies would as a consequence have forfeited all the anticipated revenue stream from subsequent private Russian issuers, since by virtue of the above custom these issuers would have been rated at best "DEFAULT" and could not, therefore, have accessed international markets; they would not have requested ratings, and the NRSROs would have been deprived of a revenue stream in the hundreds of millions of dollars.

We believe this conflict of interest to be endemic. In the case of sovereigns it develops with particularly disastrous results for the investor.

5. US holders of defaulted Chinese bonds hold similar views

A very similar situation lies with the unjustifiably inflated ratings attributed to the People's Republic of China, despite its default on pre-1949 Chinese bonds, of which I am sure you are aware; this situation, which directly affects the interests of many US citizens for amounts in the hundreds of billions of US dollars, is described in extremely well researched and prepared documents which are available on the website of Global Securities Watch:
www.globalsecuritieswatch.org

6. Need to revoke NRSRO recognition

It is both within the Securities and Exchange Commission's power and its mandate to revoke recognition from NRSROs who have engaged in wrongful pratice.

7. Further need for regulation

We believe the mechanism described above is very similar to that which has led to the attribution of inflated ratings to collaterized debt obligations, and to the current sub-prime crisis; although its effects are far more harmful to the investor in the case of sovereign ratings, since the holder of defaulted sovereigns has no legal means of seizing any underlying assets through the courts, because of sovereign immunity.

In our view the actions of the credit rating agencies distort the true credit risk endemic to certain rated obligations, including sovereign obligations of the government of the Russian Federation and of the People's Republic of China, and thereby pose a hidden danger to U.S. and foreign institutions and individual investors.

Holders of defaulted Russian bonds believe continuation of what they view as wrongful practices by the rating agencies, which directly contribute to misstatement of risks and resultant investor losses, is antithetical and inimical to the interests of the public, both in the US and abroad. They believe unified legislation is warranted in order to remedy the continuation of practices described herein, provide relief to defaulted creditors from the injurious actions of the credit rating agencies, and preserve the integrity and transparency of international capital markets.

They strongly advocate for appropriate regulation of the NRSROs in order to put an end to such questionable practices, and so that the Russian Federation should be appropriately rated as a defaulted sovereign until full settlement of their claim.

I remain at your disposal to provide any documentary evidence to back up the above statements and remain,

Sincerely yours,

XXX

Visit www.empruntsrusses.winnerbb.com

Exhibit A:

Extract from "Standard and Poor's criteria/Sovereign ratings: a primer":
"Sovereign credit ratings reflect Standard & Poor's Ratings Services' opinions on the future ability and willingness of sovereign governments to service their commercial financial obligations in full and on time."
(Full text at: http://www2.standardandpoors.com/spf/pdf/fixedincome/SovRatingsPrimer.pdf)

Exhibit B:

Extract from "Standard and Poor's criteria/Sovereign ratings: a primer":
"An obligor rated "SD" (Selective Default) has failed to pay one or more of its financial obligations (rated or unrated) when it came due. An "SD" rating is assigned when Standard & Poor's believes that the obligor has selectively defaulted on a specific issue or class of obligations but it will continue to meet its payment obligations on other issues or classes of obligations in a timely manner."
(Full text at: http://www2.standardandpoors.com/spf/pdf/fixedincome/SovRatingsPrimer.pdf)

Exhibit C:

Extract from "Standard and Poor's criteria/Sovereign ratings: a primer":
"The sovereign is also regarded as having resolved its default in the rare instances, usually relating to a change in regime, in which governments repudiate certain types of obligations altogether and either reject creditor efforts to get compensation or, many years after the default, make token payments to creditors as settlement. Historic examples involving repudiations of foreign currency bonds include the Soviet Union in 1917, China in 1949, and Cuba in 1960. Had Standard and Poor's rated these sovereigns at the time, it would have lowered the ratings to "D" to reflect the debt repudiation. However, even if there is no resolution of a default through the courts or by the parties involved, Standard and Poor's eventually removes the default ratings based upon the diminished prospects for resolution and the lack of relevance of the default ratings in the context of the market. Standard and Poor's forward-looking sovereign ratings typically refer only to debt that the present government acknowledges."
(Full text at: http://www2.standardandpoors.com/spf/pdf/fixedincome/SovRatingsPrimer.pdf)

Exhibit D

Extract from "Moody's Sovereign Ratings: A Ratings Guide":
"What Do We Mean By "Default?
Moody's defines default as any missed or delayed disbursement of interest and/or principal. We include as defaults distressed exchanges where: (1) the issuer offers bondholders or depositors a new security or package of securities that amount to a diminished financial obligation (such as preferred or common stock, debt with a lower coupon or par amount, or a less liquid deposit either because of a change in maturity or

currency of denomination, or required credit maintenance facilities) and (2) the exchange has the apparent purpose of helping the borrower avoid default.
Moody's also classifies as a default when an issuer delays payment for credit reasons even when payment is ultimately made within the grace period provided for in an indenture or deposit agreement. Our rationale for including grace period defaults is simply that a contractual payment was not made when due.
It is important to keep this definition in mind, because many commentators use "default" in a much narrower sense, that is, in the legal context of a creditor actually declaring a debtor in default on a particular obligation, resulting in a judgment by a court in favor of the creditor. Anyone who examines the post-World War II period will quickly recognize the significant practical difference between what we mean by default, and what a judge might determine to be a default in a legal proceeding."
(Full text at:
http://www.moodys.com/moodys/cust/research/MDCdocs/09/2002500000424902.pdf?search=6&searchQuery=rating+policy&click=1)

Exhibit E

Extract from Moody's press release, September 8th 2005:
"The creditworthiness of the Russian Federation continues to benefit not only from growing revenues and foreign currency reserves flowing from high commodity prices but also from prudent fiscal management and proactive debt management. The government's improved willingness and ability to meet its debt servicing obligations is matched by its improved willingness and capacity to increase tax collections and close tax loopholes. State finances are, as a result, more secure."
(Full text at:
http://www.moodys.com/cust/event/getdocument.asp?evdocid=2300000000043&event=2200000000102
February 19, 2008 2:41 PM

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Powerful trade bodies back rating industry change **Duncan Kerr**

02 Apr 2008

Two of the most powerful European investment industry bodies, representing institutional investors holding over €20 trillion ($31 trillion) of assets, are backing moves by an advisory group to the European Commission to force through change in the ratings industry, although they have stopped short of demanding greater regulatory oversight for the sector.

In response to a Committee of European Securities Regulators' consultation paper on the role of credit rating agencies in structured finance, the **European Fund and Asset Management Association** and the **UK's Investment Management Association** broadly agreed with most of CESR's assessment and proposals on improving transparency, monitoring and conflicts of interest.

The development comes five days after the International Organization of Securities Commissions, the umbrella body for the world's securities bodies, warned ratings agencies that it plans to strengthen an existing code of conduct to enhance the integrity and independence of the ratings process after months when it has been called into question. In its response to the CESR consultation paper, EFAMA, which represents investors from 20 European Union member states with over €16.5 trillion of assets under management, said it agrees with most of CESR's assessments and proposals, particularly in the areas of transparency, monitoring and conflicts of interest.

It said: "An update of the IOSCO code of conduct to strengthen certain provisions in these areas will also have our support. However, there is no consensus as to the question whether the (reviewed) IOSCO code of conduct is a sufficient regulatory response or whether binding legislation is needed."

The IMA, which represents UK-based institutional investors managing close to £3 trillion (€3.8 trillion) of assets, was more critical of the ratings agencies on specific points, but nonetheless broadly agreed with CESR on much of its assessment and proposals to force change, although it warned against imposing some form of formal regulation on the industry.

In its response, published yesterday by CESR, the IMA said it "strongly agrees with maintaining the current self-regulatory regime" principally because the "costs of regulation would far outweigh any benefits, particularly leading investors and regulators to place too much reliance on what are merely opinions."

The IMA added: "It is not clear that there is a market failure. Investors regard ratings as merely an opinion and the more weight regulators put on an opinion the more difficult it is for the credit analyst to change, thus slowing down opinion forming. Ratings are just one input into investors' decision making process and as with all opinions, can be wrong."

Financial market regulators have been some of the fiercest critics of the ratings industry, with high-profile figures such as Michel Prada, France's chief securities official and chairman of IOSCO' technical committee, consistently rebuking them for their part in creating the complex securities at the heart of credit crisis and resultant multi-billion dollar losses.

The response from EFAMA and the IMA – only two of 22 responses from prominent investment, banking, insurance and corporate treasurer industry bodies – comes seven months after the EC requested CESR review the role of credit rating agencies as part of its annual report on their compliance with the code-of-conduct set out by the IOSCO.

CESR said the purpose of the consultation paper was to seek comments on the conclusions it has drawn from its market survey and evidence gathering from the main ratings agencies Standard & Poor's, Moody's, Fitch Ratings and DBRS. The consultation also sought views on the aspects of the self-regulatory regime compared with a possible formal regulatory regime.

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SEC readies report on credit rating agencies

Stephanie Baum
23 Apr 2008

The US Securities and Exchange Commission will issue a report this summer following an examination of credit rating agencies and their roles in the credit crunch as they prepare new rules governing their behavior.

SEC chairman Christopher Cox told the US Senate Committee on Banking, Housing and Urban Affairs that the focus of the SEC's research is to determine whether the ratings agencies violated their conflict of interest rules to determine their clients' credit ratings.

Cox told the committee that the SEC is looking at requiring more transparency for underlying assets of securities.

The agency may also require that all companies have access to underlying data to prevent companies funded by investors from having a competitive disadvantage, he added.

Cox said: "We expect the results of these staff examinations will provide significant and useful new information that will help not only the SEC, but also issuers and users of credit ratings in this country and around the world to address the problems we have seen with ratings of sub-prime related products."

Cox said 40 SEC staff were involved in examining credit rating agencies. He observed that ratings agencies increased the volume of structured finance deals they evaluated between 2004 and 2006, which grew more complex in line with the underlying securities for the loans.

Lax loan underwriting standards coupled with the rise of credit risk transfer markets to increase risk protection and revenues contributed to the credit crunch, said Cox.

Credit ratings agencies have been working to repair their image following the onset of the credit crunch.

Although they initially gave structured products tied to the sub-prime mortgage market top AAA ratings, they later changed their positive assessments and downgraded them, wiping away their value.

Moody's Investor Services, Fitch Ratings and Standard & Poor's are retooling some of their policies in an effort to restore market confidence.

Separately, the Securities Industry and Financial Markets Association has assembled a task force to review credit ratings issues.

Boyce Greer, Fidelity president of fixed income and asset allocation, and Deborah Cunningham, Federated Investors chief investment officer will serve as co-heads of the group.

AllianceBernstein, JP Morgan Chase, Citigroup, Vanguard and Schroders will also take part.

The task force will help advance a dialog between its members and rating agencies, initiated last year. The group will also work with government officials, legislators and regulators.

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SEC re-examines regulatory reliance on credit ratings **Shanny Basar**

15 Feb 2008

Christopher Cox, chairman of the US Securities and Exchange Commission, said the SEC is investigating alternatives to the regulatory reliance on credit ratings due to the "shortcomings" of the agencies such as Moody's Investors Service, Fitch Ratings and Standard & Poor's in the sub-prime crisis.

Since 1975, the SEC has used credit ratings to distinguish among grades of investment safety in various regulations under federal securities laws. In addition, a number of federal, state, and foreign laws and regulations use credit ratings in the same way.

Cox said: "We are also re-examining the wisdom of the legislative and regulatory provisions that have granted a central role to the rating agencies in our markets. The recent market disruptions highlight the limitations of this arrangement."

He was appearing before the US senate committee on banking, housing and urban affairs, which held a hearing on the state of the US economy and financial markets. "I have also directed the staff to develop proposals for new, more detailed rules under the new Credit Rating Agency Reform Act that respond directly to the shortcomings we have seen through the sub-prime experience," Cox said.

The SEC may consider rules that would require credit rating agencies to make disclosures regarding past ratings as early as this spring.

The regulators have been examining the role played by the ratings agencies in the sub-prime market turmoil since last summer as the agencies were publicly criticized for the inaccuracy of their ratings of sub-prime residential mortgage-backed securities and collateralized debt obligations.

Cox said he expects to receive preliminary reports from these examinations in the coming months, with a final report in the early summer. The reports will focus on whether the agencies diverged from their stated methodologies and procedures in order to publish higher ratings, and whether their role in the process of bringing asset-backed securities to market impaired their ability to be impartial.

In addition to the SEC's examinations, the President's Working Group on Financial Markets is reviewing the role of credit rating agencies in lending practices, how their ratings are used, and how securitization has changed the mortgage industry and related business practices.

The SEC also wants to increase the transparency of the key publicly traded financial institutions in their disclosures to markets and investors. In December last year the regulator wrote to 25 financial institutions highlighting specific disclosure issues that the firms should consider in relation to their exposure to off-balance-sheet entities and certain structured finance products.

The Division of Enforcement has more than three dozen sub-prime investigations underway, reviewing potential violations of securities laws by underwriters of mortgage-backed securities. Cox said: "Because these law enforcement investigations are underway, specific details remain confidential. It has not yet been determined in any particular case whether or not securities laws were broken."

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SEC is urged to step up policing of rating firms

The Wall Street Journal
16 Apr 2008

Senator Charles Schumer met with Securities and Exchange Commission Chairman Christopher Cox to press the agency to increase its policing of conflicts of interests that may have contributed to bond-rating companies' missed calls in the housing market.

The meeting was scheduled by Cox to brief the New York Democrat on the SEC's progress in considering new rules to more tightly regulate the rating companies, according to a person familiar with the matter.

The companies—McGraw-Hill Cos.' Standard & Poor's, Moody's Corp.'s Moody's Investors Service and Fimalac SA's Fitch Ratings—have been forced to downgrade thousands of mortgage-related investments after their initial calls about the US housing market proved too optimistic in the last 18 months.

"There has to be a lot more done about conflicts of interest" at rating companies, Senator Schumer said Tuesday evening. "I suggested to chairman Cox either prohibitions" that would limit some of these conflicts "or some really tough disclosures" that would tell investors how ratings were reached.

Senator Schumer also asked the SEC to investigate whether Moody's on occasion switched ratings analysts from specific deals at the request of Wall Street bond issuers and altered its approach on certain deals after bond issuers complained.

A *Wall Street Journal* article Friday showed how the company increased its market share in mortgage bonds while improving its relationships with many bond issuers.

The SEC has been looking at a range of possible rules that would apply to rating companies, including a new scale for measuring mortgage-related and other structured-finance bonds. It is also considering conflict-of-interest issues in ratings and whether various securities rules should temper their reliance on bond ratings.

An SEC spokesman declined to comment on the meeting's specifics, but he said that Cox is "soliciting input from several members of Congress on the proposals the commission expects to consider as early as next month under the commission's newly given oversight of credit-rating agencies."

A Moody's spokesman said the company has "no objection" to the SEC's continued examination of rating companies or any specific questions it has about Moody's.

—Aaron Lucchetti, (212) 416-3705, aaron.lucchetti@wsj.com; and Kara Scannell, (202) 862-9223, kara.scannell@wsj.com.

OpRisk & Compliance

Daily news headlines: 25 April 2008,

New transparency rules for credit rating agencies

SEC to introduce new rules to increase accountability of CRAs

WASHINGTON – The US Securities and Exchange Commission (SEC) is to introduce new rules aimed at increasing the accountability of credit rating agencies (CRAs). The new rules would involve banning ratings agencies from consulting with investment banks whose products they rate. SEC chairman Christopher Cox told the Senate Banking Committee that as part of its investigation into how securities such as collateralised debt obligations (CDOs) – which CRAs were blamed for exacerbating the subprime crisis by giving low-risk ratings to high risk and ultimately illiquid products – were rated, his staff had seen "that the ratings process used to rate these products may have been less quantitatively developed than was generally believed".

The rules are aimed at increasing the accountability of ratings agencies by requiring the CRAs to release the information used to rate subprime mortgage-backed securities to allow consumers to judge how the agencies operate and to compare the performance of the various agencies.

The new rules will be introduced “in the near future”, according to Cox.

Source: **OpRisk & Compliance**