



Financial Crisis Inquiry Commission
Agenda Item 9 for Telephonic Business Meeting of October 12, 2010
Clayton and Moody's Letters

MEMORANDUM

To: Wendy Edelberg, Executive Director

From: Tom Krebs

Re: Letters regarding testimony of D. Keith Johnson

This memorandum is in response to your request for information relating to two letters received from interested parties, Clayton Holdings ("Clayton") and Moody's Investors Service ("Moody's"), relating to the Commission's hearing in Sacramento, California on September 23, 2010.

The first letter questions the testimony of witness, D. Keith Johnson, the former CEO of Clayton. It was received from Paul Bossidy, Clayton's current CEO. A copy of this letter (the "Clayton Letter") is attached hereto as Exhibit A. A copy of Mr. Johnson's written testimony is attached hereto as Exhibit B.

Mr. Johnson's testimony was the subject of articles in the press including a piece in the business section of the New York Times written by Gretchen Morgenson and published on Monday, September 27, 2010 (the "Times Article"). A copy of the Times Article is attached hereto as Exhibit C. The Clayton Letter itself was the subject of an article on the Huffington Post website written by Shahien Nasiripour published October 5, 2010 (the "HPost Article"). A copy of the HPost Article is attached hereto as Exhibit D.

The second letter (the "Moody's Letter") received by the Commission came from John J. Coggins, the General Counsel of Moody's Investors Service ("Moody's"). A copy of this letter is attached hereto as Exhibit E.

The following is an analysis of the content of the two letters.

The Clayton Letter

The general thrust of the Clayton Letter is that, in certain unspecified respects, Mr. Johnson's testimony was inaccurate and that "several media outlets" have "commented on some of the inaccurate testimony." Further concern is expressed about when and what information Clayton may have shared

with various rating agencies in 2006 and 2007. The Clayton Letter closes with a concern that something Mr. Johnson said in response to a question from the Commission may be misinterpreted to conclude that Clayton “was actively reviewing prospectuses at the time of [its] due diligence reviews” and that the opinions of Mr. Johnson may be interpreted to be the opinions held by Clayton.

After reviewing the Clayton Letter thoroughly, the Staff does not think it supports allegations that Mr. Johnson’s testimony is inaccurate. *Indeed, at no place in the Clayton Letter does Mr. Bossidy reference a direct quote from Mr. Johnson’s testimony and then contest its accuracy.*

The Staff would further point out that Mr. Johnson’s testimony at the hearing confirms information consistently provided to the Staff in numerous interviews with Mr. Johnson, other Clayton employees and former employees, and other sources prior to the hearing. At each of the interviews of Clayton personnel, Clayton was represented by counsel (usually both its outside counsel, Blank Rome, and its general counsel, Steve Cohen). It is presumed that the content of these interviews was shared with Mr. Bossidy. In any event, at no time did the Clayton interviewees or their counsel attempt to clear up any misimpression the Staff was receiving that was later testified to in Sacramento.

Mr. Johnson (and Ms. Beal’s) testimony has the potential to contribute to a finding that Clayton’s clients may be liable to investors under the federal securities laws. This has been a continuing concern for Clayton and its counsel throughout the interview process conducted by the Staff. Throughout the process Clayton has tried to manage what it was telling the Staff and various regulators (e.g. the Massachusetts and New York Attorney Generals’ offices) in a way that kept its customers from getting upset. (You will recall the insistence that Vicki Beal, the other Clayton witness on the Sacramento panel, be allowed to testify if we were going to have Keith Johnson testify).

As previously stated, the Clayton Letter fails to point out a specific statement made by Mr. Johnson and then directly prove its inaccuracy. Instead, it argues against statements which Mr. Bossidy implies Mr. Johnson made (even though he did not) and then attacks those statements. He also argues by innuendo that unspecified facts were testified to by Mr. Johnson which the Staff knew were incorrect.

1. Sharing client specific data. Mr. Bossidy states on several occasions that “Clayton did not share client reports or data “ with the rating agencies. (See p1. Last paragraph, p. 2, 2nd para., 5th para., 6th para. and 7th para.; and p.3, 1st para, and 2nd para.). The Staff *agrees* with this assertion. However, we also do not believe that Keith Johnson or Vicki Beal ever testified that client specific reports or data were shared with the rating agencies. Throughout the interview process they were clear that (i) they only shared combined numbers (nothing client specific) and (ii) sharing specific client information never happened. The Staff never thought otherwise. Indeed, the Moody’s Letter discussed below specifically states that no such information was shared with Moody’s.
2. Timing of sharing of Trending Reports. Mr. Bossidy similarly argues that *when* Clayton shared its story on the Trending Report with the rating agencies is important. He points out that this was not shared with them until after the securitization market had collapsed. Again neither Mr. Johnson nor Ms. Beal testified otherwise. The Complete Trending Report includes results through June 30, 2007. It could not have been shared with them before that date. Both witnesses have consistently said that these meetings took place in the third quarter of 2007. Neither testified that they shared it with the rating agencies before the summer of 2007.

The Times Article reported their testimony as if Clayton let the rating agencies know and the rating agencies ignored this information and went on rating bad mortgages AAA. In point of fact, this may have happened after the summer of 2007 (a few deals were still being done). Regardless, to the extent the Times wrote it up in a way which dissatisfied Mr. Bossidy, his complaint is with the NY Times not the FCIC. See also "New Information" below which indicates Clayton may have shared some of the Trending Report data with the rating agencies prior to June 30, 2006.

3. Innuendo that the FCIC staff knew otherwise. At a number of places in the Clayton Letter Mr. Bossidy makes reference (see page 2, 1st para. and 3rd para. and p. 3, 4th para., and last para.) to prior testimony and documents given to the FCIC staff with the clear innuendo that the FCIC knew the testimony of Mr. Johnson (and Ms. Beal) was inaccurate. Their testimony did not change in Sacramento from the information previously provided to the Staff in interviews. Again, neither Mr. Bossidy nor Clayton's counsel raised any objection to the testimony of these two witnesses when they were interviewed.
4. Sharing of Beta Trending Reports. Mr. Bossidy claims that Clayton did not share "beta" trending reports with the rating agencies. This report aggregates the information Clayton was following for all underwriter clients (it refers to all 911,000 loans Clayton reviewed during the period from 1/1/06 through 6/30/07). Mr. Bossidy admits that Clayton discussed its capabilities in Exception Tracking during its last half of 2007 meetings with the rating agencies (See 2nd para under Fitch; 2nd para under S&P and paras. 2-3 under Moody's), but says that the aggregate report was not shared with them.

The Staff believes Mr. Bossidy to be wrong on this point. Both Mr. Johnson and Ms. Beal, who were at the meetings (Mr. Bossidy was not) have told the Staff this report was shared.

The essence of the report is that banks are waiving a lot of underwriting errors and that the trend was getting worse. This was as or shortly after the securitization market collapsed. The Staff questions the implied assertion by Mr. Bossidy that the Clayton executives showed up with generic reports saying that underwriting standards had been exemplary and that everything was getting better.

Whether the actual trending report was shared with the rating agencies however, is a distinction without much difference. Clayton held these meetings to tout their new exception tracking capability. The Staff doubts that they did this without some hard data on what these reports were showing. In other words, if they didn't share the written report with the agencies, they almost certainly conveyed to them what was in the written report (albeit in general rather than specific terms). The newly produced Moody's information confirms this. See "New Information" below.

5. Clayton's warnings re Trending Reports. Mr. Bossidy claims on page 3 that each of Ms. O'Neill, Mr. Phillips (former Clayton CEO) and Ms. Beal warned the Staff regarding problems with the Trending Reports. Specifically, he says the Staff was warned that the aggregate data in the beta report was flawed because it is not possible to form a meaningful basis of comparison across Clayton clients.

This assertion by Mr. Bossidy is again against the facts consistently described by Clayton employees and former employees in Staff interviews. All Clayton personnel who were interviewed took ownership of the report and stated that they thought it provided useful information. Granted, all described the beta report as a work in progress. However, none suggested that it was fundamentally flawed. That it wasn't perfect came out at the hearing. For example, Deutsche Bank claimed the numbers unfairly portrayed them in a bad light.

6. Prospectuses. Mr. Bossidy closes his letter with an argument that he fears Mr. Johnson's testimony could leave the public with "the mistaken impression that Clayton was actively reviewing prospectuses at the time of their due diligence reviews." The Staff believes this is a stretch and respectfully disagrees.

The Staff would like to point out that Clayton personnel continually made the case that they did not engage in due diligence necessary for compliance with the securities laws. Indeed, it is the principal basis upon which the Staff is of the opinion that underwriter's due diligence in RMBS transactions was systemically flawed and inadequate.

The Moody's Letter

Mr. Coggins of Moody's wrote because, in his words, Moody's believes "it is imperative to call to the [Commission's] attention a series of mischaracterizations and errors contained in [the Times Article] which is now prominently linked on the Commission's website." Mr. Corrigan continues that

"Moody's is certain the Commission would not want these inaccuracies [in the Times Article], which give a misleading view of what the Commission was in fact told, to go uncorrected."

"In short, by sometimes misrepresenting what was actually said at the hearing and other times ignoring pertinent testimony altogether, the [Times Article] conveys the false impression that Clayton approached Moody's in 2006 to sound the alarm bell about 'dubious' subprime loans that were being securitized, but that Moody's turned a blind eye to 'conclusive evidence' of significant loan improprieties in order to protect its own business interests. [T]he [Times Article] also reports, erroneously, that 'the rating agencies had been told that vast numbers of loans were being packaged as securities even though they failed to meet underwriting standards.' These statements—at least with respect to Moody's—are wholly wrong as a matter of fact. They are also wholly unsupported by the testimony of the Clayton witnesses and the accompanying documents posted by the Commission on its website. In fact, Mr. Johnson testified that that Clayton did not approach Moody's until 2007—well after the subprime crisis began to unfold..."

The Moody's Letter then goes on to criticize specific sentences in the Times Article and ask that its letter be made a permanent part of the Commission's record.

Boiled down to its essence, the Moody's Letter takes issue with the reporting of Ms. Morgenson in the Times Article. Mr. Coggins takes issue with the Times Article's description of what was conveyed by Clayton to Moody's when representatives of the two companies met and the characterization of Moody's response to what was said at those meetings. It would appear that if Moody's has a valid complaint, it is with the New York Times and Ms. Morgenson rather than with the Commission.

New Information

Last Friday, October 1, 2010, the day after the date appearing on the Clayton letter, the Staff received a package of documents from Moody's (all marked "Confidential and Proprietary") which described meetings with Clayton held on November 27, 2006, January 11, 2007, May 31, 2007 and July 27, 2007 (and other less formal meetings). The documents contained notes relating to the subject matter of those meetings. See Exhibit F. The notes relating to the January 11, 2007 meeting provide interesting new information regarding when the rating agencies became aware of the trending reports.

In that document it is stated, "Clayton walked Moody's through entire due diligence process, including Exception Tracking and underwriting of a loan file." [MOODY'S – FCIC—0393538]. The notes go on to detail the attendees at that meeting. There are several similar references to meetings between Clayton and Moody's. Of particular note is the July 27, 2007 entry, "Discussed tools available and data we have that Moody's may not be seeing, including Exception Tracking..."[MOODY'S –FCIC—0393539]

Conclusion

The Staff believes that the testimony of Mr. Johnson (and Ms. Beal) to be accurate and consistent with other evidence it has been able to gather (both from Clayton personnel and other sources) regarding these matters. Indeed, neither the Clayton Letter nor the Moody's Letter describes otherwise.

Exhibit A



From the office of Paul T. Bossidy
President & Chief Executive Officer
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September 30, 2010

VIA ELECTRONIC AND OVERNIGHT MAIL

Hon. Phil Angelides
Chairman
Financial Crisis Inquiry Commission
1717 Pennsylvania Avenue, NW, Suite 800
Washington, DC 20006-4614

RE: **September 23, 2010 Sacramento Hearing**

Dear Chairman Angelides:

I write to clarify and correct some of the testimony provided last Thursday during the Commission's hearing in Sacramento, California. As you recall, during a panel entitled "The Mortgage Securitization Chain: From Sacramento to Wall Street," you and your fellow Commissioners questioned Ms. Vicki Beal, a Senior Vice President in Transaction Management at Clayton, as well as Mr. Keith Johnson, the former President and Chief Executive Officer of Washington Mutual's Long Beach Mortgage and former President of Clayton from May 2006 through December 2008. Among the questions posed to Ms. Beal and Mr. Johnson were questions related to Clayton's meetings with various ratings agencies during 2006 and 2007, Clayton's Exception and Trending Reports, and the disclosure of Clayton's work to investors in prospectuses. Following the hearing, several media outlets have written about these topics and commented on some of the inaccurate testimony provided by Mr. Johnson. As the Commission is charged with accurately recording the causes of the current financial and economic crisis, an undertaking Clayton fully supports, it is imperative that the American people are not left with any misimpressions or erroneous conclusions. Accordingly, I will address each of these three topics and ask that you make this letter part of the Commission's permanent record.

Rating Agency Meetings

On several occasions, Mr. Johnson was asked about Clayton's meetings with Moody's, S&P and Fitch. In response to those questions, Mr. Johnson testified that in 2006 Clayton took its Exception Tracking reports to Fitch and S&P, and in 2007, Clayton did the same with Moody's along with the Trending Reports. These statements are inaccurate.

First, at no time did Clayton share any client reports or data, much less the beta Trending Reports, with any rating agency. Let me be clear, Clayton never shared any client reports or data with the rating agencies during a period when the rating agencies were reviewing securities for ratings issuance. Second, Clayton used these meetings solely to market its products. At no point did Clayton set up a meeting with a rating agency in an effort to discuss "concerns" Clayton had about the securitization process and the ratings being issued. Indeed, as detailed below, the only discussions Clayton had with the rating agencies regarding changes to the due diligence process occurred after the securitization market for new issues had collapsed in early 2007. Simply stated, there was nothing Clayton discussed with the various rating agencies prior to the collapse of the securitization market, that to Clayton's knowledge, would have lead the rating agencies to alter their approach.

Pursuant to a request from your staff, Clayton provided a chronology of all of its meetings with the various rating agencies, including the topics discussed and the participants from each firm, along with supporting documents. In addition, Mr. Filippis, Ms. O'Neill and Ms. Beal were interviewed by your staff about these meetings. In order to have an unambiguous record of these meetings, I have set forth for your convenience a summary of those meetings taken from the documents provided and the interviews conducted.

Fitch

Clayton met with Fitch on two occasions in 2006. Mr. Johnson was present for neither meeting. Indeed, the first meeting occurred in January 2006, almost five months prior to Mr. Johnson's employment at Clayton. During that meeting, no client reports or data were shared with Fitch. The second occurred in late November 2006 in the United Kingdom and was not attended by Mr. Johnson. During that meeting, Clayton made a marketing presentation and discussed its products and exception tracking capabilities. At no time did Clayton share any client reports or data with Fitch.

In 2007, Clayton met with Fitch on November 9, long after the securitization market had collapsed. During that meeting, which was attended by Mr. Johnson and other senior Clayton officers, the two firms discussed reforms being considered and proposed by all of the rating agencies, including standardization of due diligence and disclosure of due diligence results to investors. Clayton produced to your staff the presentation materials provided to Fitch, which describe Clayton's exception tracking and trending capabilities using sample data. No client reports or data were shared.

S&P

Clayton met with S&P only once in 2006, on April 26, the month prior to Mr. Johnson's arrival at Clayton. During that meeting, neither Exception Tracking nor trending was discussed nor were any client reports or data shared with S&P.

In 2007, Clayton held two meetings with S&P. The first of which occurred on July 27, 2007, after the securitization market had collapsed. This was a meeting during which Clayton discussed its capabilities. On October 10, 2007, Clayton made a formal marketing presentation to S&P, a copy of which was provided to your staff. Mr. Johnson attended both meetings, along with other senior Clayton officers. Once again, Clayton discussed its capabilities and how Clayton could be part of the reform process being considered by the rating agencies. At neither meeting were any client reports or data shared, and Clayton produced to your staff its materials from the October 10 presentation.

Moody's

Clayton held one meeting with Moody's in April 2006, prior to Mr. Johnson's arrival. No client reports or data were disclosed.

Throughout 2007, Clayton met several times with Moody's. During the first half of 2007, Moody's held several meetings with Clayton as part of Moody's research for a White Paper they were preparing on due diligence. During these meetings with Clayton staff, which did not include Mr. Johnson, Clayton explained its operations and how it conducts a due diligence review, including the use of Exception Tracking. No client reports or data were shared with Moody's during any of these meetings.

In July 2007, once again after the securitization market had collapsed, Moody's held a meeting with Clayton at Moody's offices. Mr. Johnson, along with another Clayton senior officer, attended the meeting. The two firms discussed Clayton's Exception Tracking capabilities, but no client reports or data were shared.

On September 5, 2007, and later on October 17, 2007, the two companies discussed how Clayton's capabilities could be included in reforms being considered. Mr. Johnson and other senior Clayton officers attended both meetings. Once again, no client reports or data were shared.

Clayton produced to your staff all of the presentation materials from each of these meetings. Those materials contain example reports and sample data, and do not contain any actual client data or reports.

Trending Reports

During your questioning of Ms. Beal, you entered into the record and asked Ms. Beal about the "All Clayton Trending Reports," reports specifically requested from Clayton by your staff. Prior to the September 23 hearing, your staff interviewed several senior Clayton officers who were directly responsible for the development of these reports. Specifically, your staff interviewed Frank Filippis, Chairman and Chief Executive Officer from April 2005 through July 2008, Kerry O'Neill, Executive Vice President Due Diligence and Platform Services from May 2004 through December 2007, and Ms. Beal. As detailed below, each of them advised against the Commission's reliance on the Trending Reports.

As Ms. Beal stated in her written testimony, "[b]eginning in 2003, Clayton worked to develop a more comprehensive scoring system for its clients, one which would allow Clayton to expand its exception review system to more specifically identify and track exceptions. The new system was called Exception Tracking and it allowed our clients to better manage exceptions (*E.g.*, show client what portfolio would look like if seller cured what it could) and it allowed for better reporting to clients." Clayton rolled out this system and its Exception Reports to our clients beginning in late 2005 and continuing throughout 2006.

In 2007, Ms. O'Neill's team worked to develop Trending Reports for our clients utilizing the Exception Tracking data that would enable us to identify trends in their deals with various originators that could be potentially useful for them in their own processes. The first step in that process was the creation of "beta" Trending Reports across all clients, as well as individual client beta Trending Reports, with which Ms. O'Neill and her team could work with each client to see if it was even possible to identify statistically significant and meaningful trends. The beta report she created was a data summary of the total number of Event Grades ("EV") 1, 2, 2W, 2T and 3 across all deals that had been reviewed using the Exception Tracking software.

Ms. O'Neill, Mr. Filippis and Ms. Beal informed your staff that the major impediment facing Clayton with respect to developing Trending Reports was the lack of standardization across our clients, both in terms of individual tolerances and scope of review. Additionally, Clayton was faced with variations in the loan products being originated and the underwriting guidelines for those loans. Thus, while each of the Exception Reports contain valid and relevant client-level data for each client's own purpose, when aggregated and measured across our clients, it is not possible to form a meaningful basis of comparison. Given these constraints, Ms. O'Neill stated that she expected it to take several years to complete this project. In short, because of the variation in client processes, scopes and tolerances, we believe that the Commission should not draw any conclusions from the Trending Reports. Should the Commission choose to reference or rely upon the Trending Reports in its findings, we request that the Commission provide these appropriate caveats so that the information is not misleading to the public.

Separately, during the hearing some of the percentages reflected on the Trending Report were inadvertently misstated. Specifically, you asked Ms. Beal about the 28% of EV-3 loans initially graded by Clayton and the final percent that remained EV-3. Both you and Ms. Beal mistakenly stated that the final number of EV-3 loans was 11%. 17%, not 11%, of the total loans reviewed remained as EV-3. The 11% referred to in the report is the percentage of loans that were EV-2W and EV-2T.

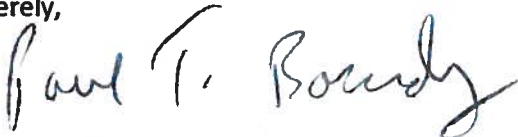
Prospectuses

During your questioning of Mr. Johnson, you asked him about the disclosure statements contained within MBS prospectuses issued by our clients. Mr. Johnson stated that "we looked at a lot of prospectuses and [are] not aware of any information going through the prospectus." Mr. Johnson did not testify as to when and why this review occurred, and in the absence of this information, the public could be left with the mistaken impression that Clayton was actively reviewing prospectuses at the time of our due diligence reviews. As Mr. Johnson and our General Counsel informed your staff, Clayton began to review prospectus in the summer and fall of 2007 in response to specific questions from regulators about whether Clayton's due diligence results were set forth in MBS prospectuses. Prior to those requests, Clayton did not engage in prospectus reviews nor was Clayton asked by any client to review any prospectus prior to its issuance.

Finally, during much of Mr. Johnson's testimony, he used the terms "I", "we", and "ours" interchangeably, as he gave his personal opinions about the collapse of the securitization market and how it could have been prevented. I hope it is clear from this letter, Ms. Beal's written and oral testimony, and from the record previously provided by Clayton to the Commission, both documentary and testimonial, that Mr. Johnson's opinions do not represent those held by Clayton. Rather, they are his alone.

On behalf of Clayton, I thank you and the Commission for your attention to this important matter.

Sincerely,



Paul T. Bossidy
Chief Executive Officer

Exhibit B

Testimony of Keith Johnson
Former President of Clayton Holdings, Inc. and
Former President of Washington Mutual's Long Beach Mortgage
Before the Financial Crisis Inquiry Commission
September 23, 2010

Chairman Angelides, Vice-Chairman Thomas, and Members of the Commission, my name is Keith Johnson. I have been in the financial services and banking industry for 30 years. From 1986 to 2000, I was employed by Bank United of Texas ("Bank United") where I held a variety of executive positions involving finance, capital markets, loan origination, securitization and servicing. In 2000, Bank United was sold to Washington Mutual ("WaMu") where I became the Chief Operating Officer of WaMu's Commercial Segment. In mid-2003, I was asked to assist the existing management of Long Beach Mortgage. In June 2005, while remaining an employee of WaMu, I became the acting President of Long Beach Mortgage for approximately 9 months. In May 2006, I left WaMu and became President and Chief Operating Officer of Clayton Holdings, Inc. ("Clayton") the largest residential loan due diligence and securitization surveillance company in the United States and Europe. I left Clayton at the beginning of 2009 shortly after its sale to a private real estate investment fund.

I thank the Commission for the invitation to appear, and I hope that my testimony will assist in your efforts to better understand the causes of the financial crisis. The Commission has asked me to address several topics related to loan securitization,

mortgage brokers and their related impact to the Sacramento region and other communities in the Central Valley.

In my opinion, this crisis is not the result of a single cause, but a combination of significant factors operating at the same time and feeding each other. Low interest rates, increased housing goals, creative securitization, lack of assignee liability, compromised warehouse lending, flawed Rating Agency process, relaxed and abusive lending practices, rich incentives, shortfalls on regulation and enforcement provided the fuel to inflate home prices and excess borrowings by consumers.

Financial Factories & Securitization

In addition to the factors previously mentioned, improvements in technology, credit scoring and financial engineering transformed traditional lending platforms into large financial factories. Several of these factories were originating, packaging, securitizing and selling at the rate of \$1 billion a day. The quality control process failed at a variety of stages during the manufacturing, distribution and on-going servicing. Traditional regulatory examination procedures were not able to evaluate neither processing exceptions nor their resulting cumulative risk. The lack of accountability and failure by many parties to “present value the pain” allowed for the process to continue. Lastly, the lingering impact of this transformation has been the severing of practical solutions between borrowers facing a financial hardship and the investors with principal at risk.

Many have blamed this crisis on the growth of securitization. I believe that mortgage

securitization process was flawed and abused, but can and will be beneficial to the public, as it provides a vehicle for lenders to sell loans in exchange for the capital necessary to make additional loans. Hopefully, this crisis will lead to reform of common sense improvements to bring back a prudent robust securitization market.

Mortgage Brokers

As it relates to doing business with mortgage brokers, I can share with you my experience at Long Beach and observations while at Clayton.

Unlike most large mortgage companies that contain multiple origination channels, retail, direct mail, telephone and refinance desks, Long Beach was a sub prime lender that relied 100% on mortgage brokers.

Broker originated loans was and can be a viable loan production channel. The model serves a purpose in helping financial institutions reach out to the unbanked and underbanked areas.

However, performance data has shown that the broker model became flawed with greed, fraud and deception. Low barriers of entry, lack of regulatory supervision or enforcement, coupled with rich incentives for production created an environment that contributed to the surge in defaults. During my period of time at Clayton, I was able to observe the operations of close to 40 of the largest mortgage originators and servicers in the United States. Too late to be effective, it became obvious that the only way to correct the broker model was to shut it down and wait for regulatory reform and enforcement.

Recent regulatory changes have been made to improve the broker channel and I would

encourage additional supervision and enforcement. For me, one of the underlying conflicts with the broker model is the question of "whom does the broker work for?" The main problem is that, counter to common perception, mortgage brokers do not represent the borrowers who pay them for advice. Instead, they are more like independent salespeople who are often paid as much by the lenders in addition to the borrowers they represent. When brokers are paid commissions by both parties to a loan transaction, confusion results about whom the brokers actually "work for."

In my opinion, the broker should be acting as a fiduciary of the borrower, and have the responsibility for making sure that the borrower understands and benefits from the transaction by receiving fair terms. A criticism of this approach is that implementing will have an adverse impact on the low to moderate-income applicants. I would suggest to you that the benefits would tilt toward the consumer, with alternatives to encourage financial institutions to invest in low to moderate housing.

Issues impacting Sacramento and Central Valley

As it relates to the Sacramento and other communities in the Central Valley, I have three areas of concern.

Special Servicing

Effective loan servicing, foreclosure avoidance and loss mitigation are necessary to help families work through a financial hardship. Servicer incentive, the borrower's lack of financial literacy and the threat of investor litigation are limiting effective loan servicing.

Current servicing fees provide little to no economic incentive for servicers to spend the time, money and effort working with a borrower to arrive at a fair solution. For some servicers, the most profitable path is to move the loan to foreclosure. Special Servicing should be engaged which has incentives to cure defaults and avoid foreclosure. My recommendation for all future securitizations (including Fannie Mae, Freddie Mac and FHA) is that once a loan goes 90 days delinquent it is assigned to a Special Servicer who will evaluate the collateral and borrower's financial condition and perform a "Lowest Cost Solution" that will take into consideration loan modification, short-sale, deed-in-lieu, foreclosure etc. The Special Servicer will receive a market rate of compensation based on their results.

As for financial literacy, I have worked with many delinquent borrowers and it clear that we have not stressed in our education system skills and knowledge necessary to make financial decisions. There has been much press about the streamlined modification processes offered during the past two years. I have worked with borrowers in educating them and helping them complete the modification checklists. However, the process is still complicated by the lack of borrower's financial knowledge and communication barriers.

The last servicing issue relates to fear of litigation from investors. The legal and loss waterfall structures of legacy securitizations are creating conflicting incentives for investors to resolve delinquent loans via modifications. My recommendation is to follow, the FDIC in their "Low Cost Solution" process for all delinquent loans. The "Lowest

Cost Solution” should be followed regardless of the impact to structured waterfall losses. Servicers who adopt the “Low Cost Solution” methodology should be held harmless from investor litigation.

Foreclosed Inventory of Homes

The second concern for the Sacramento region and other communities in the Central Valley is the increased inventories of abandon homes resulting from foreclosure. Empty homes do not pay the salary of schoolteachers, police and fire departments. The compounding impact of vacant homes is a real threat to the recovery of a community. The issue of unsold inventory is also linked to my third concern for the area, the availability of credit to purchase homes.

Availability of Credit

Home prices are down, inventory for sale has increased, credit standards have tightened and prospective homebuyers will have difficulty meeting the down payment requirements. One suggestion, which I found to work during the 1980’s Texas recession, is to promote an active “Loans to Facilitate the Sale of Foreclosed Homes” program. Ironically, this is a program of relaxed underwriting guidelines. Borrowers would qualify based on their existing rental or housing income being equal to or lower then a fully loaded (principal, interest, taxes and insurance) mortgage payment that amortizes over a 30 year period. The program would encourage minimum down payments, but be willing to offer 100%+ financing that rolls in all the closing costs.

One would argue that relaxed underwriting and 100% loan to value loans put us into this mess, why would we ever use this to pull us out? I would offer these factors as defense, home values have significantly declined reducing the risk on collateral, absorption helps to slow any further price deterioration, communities and neighborhoods become more stable with higher comparables and real estate taxes are being paid to support infrastructure.

Again, I thank the Commission for the invitation to appear. I appreciate the opportunity to share my views, and would be happy to answer any of your questions.

Exhibit C

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September 26, 2010

Raters Ignored Proof of Unsafe Loans, Panel Is Told

By **GRETCHEN MORGENSON**

As the mortgage market grew frothy in 2006 — leading to a housing bubble that nearly brought down the banking system two years later — ratings agencies charged with assessing risk in mortgage pools dismissed conclusive evidence that many of the loans were dubious, according to testimony given last week to the **Financial Crisis Inquiry Commission**.

The commission, a bipartisan Congressional panel, has been holding hearings on the origins of the financial crisis. D. Keith Johnson, a former president of Clayton Holdings, a company that analyzed mortgage pools for the Wall Street firms that sold them, told the commission on Thursday that almost half the mortgages Clayton sampled from the beginning of 2006 through June 2007 failed to meet crucial quality benchmarks that banks had promised to investors.

Yet, Clayton found, Wall Street was placing many of the troubled loans into bundles known as mortgage securities.

Mr. Johnson said he took this data to officials at Standard & Poor's, Fitch Ratings and to the executive team at Moody's Investors Service.

"We went to the ratings agencies and said, 'Wouldn't this information be great for you to have as you assign tranche levels of risk?' " Mr. Johnson testified last week. But none of the agencies took him up on his offer, he said, indicating that it was against their business interests to be too critical of Wall Street.

"If any one of them would have adopted it," he testified, "they would have lost market share."

In the aftermath of the financial crisis, which has required billions of dollars in taxpayer money to bail out Wall Street, ratings agencies have been sharply criticized for failing to properly assess the securities they were reviewing, and federal regulators are investigating the agencies for the role they played in the credit crisis.

The agencies have said that they had closely watched the mortgage market but had not anticipated how quickly it would deteriorate.

“Moody’s aggressively monitored market conditions as the crisis continued to unfold to assess the impact of how the various market participants — including the borrowers, the mortgage servicers, the mortgage originators and the federal government — might respond to the extremely fast-changing conditions,” Raymond W. McDaniel, the chief executive of Moody’s, said in Congressional testimony in April.

Mr. Johnson’s testimony last week, however, cast a new light on that assertion.

Asked about the testimony, officials at Standard & Poor’s and Moody’s said they had worked hard to assess an array of data on the mortgage market in 2006 and 2007. Michael Adler, a spokesman for Moody’s, said the company “considers a range of information from various market participants about factors that could affect the credit quality of the transactions we rate.”

“During this period, Moody’s did in fact observe the trend of loosening underwriting standards, reported on it repeatedly in our research and commentary, and incorporated it into our credit analysis,” Mr. Adler said.

Fitch said it was not aware of a meeting with Clayton.

It has been more than four years since Mr. Johnson and his colleagues at Clayton Holdings started noting that disturbing numbers of mortgages did not meet the lending criteria promised to investors in prospectuses used to market the securities.

Details of what Wall Street firms knew about the loans they were selling to investors, and when they knew it, are still trickling out in regulatory actions and private lawsuits.

The Massachusetts attorney general recently accused Morgan Stanley of deceptive practices in

its financing of mortgage lenders during this period, saying that the firm had knowingly placed dubious mortgages into securitized pools. Morgan Stanley settled with the attorney general in June and paid \$102 million. The facts in that case relied on Clayton reports of loan quality commissioned by Morgan Stanley.

But until Mr. Johnson's testimony last week, it was largely unknown that the ratings agencies had been told that vast numbers of loans were being packaged as securities even though they failed to meet underwriting standards.

Before assembling mortgage pools, brokerage firms hired independent analytical companies like Clayton to sample loans and flag any that were problematic. Clayton was one of two large due diligence companies that watched for loans that did not meet specifications like geographic diversity and the loan-to-value ratios between a mortgage and the home that secured it, as well as the credit scores and incomes of borrowers.

It was a trust-but-verify approach to a lucrative business, a way for Wall Street to look over the shoulders of lenders whose operations they did not control but whose mortgages they were buying nonetheless.

According to testimony last week, from January 2006 to June 2007, Clayton reviewed 911,000 loans for 23 investment or commercial banks, including Citigroup, Deutsche Bank, Goldman Sachs, UBS, Merrill Lynch, Bear Stearns and Morgan Stanley.

The statistics provided by these samples, according to Mr. Johnson and Vicki Beal, a senior vice president at Clayton who also testified before the inquiry commission, indicated that only 54 percent of the loans met the lenders' underwriting standards, regardless of how stringent or weak they were.

Some 28 percent of the loans sampled over the period were outright failures — that is, they were unable to meet numerous underwriting standards and did not have positive factors that compensated for their failings. And yet, 39 percent of these troubled loans still went into mortgage pools sold to investors during the period, Clayton's figures showed.

The **results varied** from firm to firm. At Citigroup, for example, 29 percent of the sample failed to meet underwriting standards over the period, but almost a third of those substandard loans

made it into securities pools.

At Goldman Sachs, 19 percent of loans failed to make the grade in the final quarter of 2006 and the first half of 2007, but 34 percent of those loans were still sold by the firm. Throughout this period, Goldman Sachs was also betting against the mortgage market for its own account, according to documents provided to government investigators.

About 17 percent of the loans financed by Deutsche Bank did not make the grade, but the firm still put 50 percent of them into the securities sold to investors, the Clayton report showed.

Deutsche Bank and Citigroup declined to comment.

A Goldman Sachs spokesman said the percentage of deficient loans that went into its pools was smaller than Clayton's average, indicating that the firm had done a better job than its peers.

Because these loan samples were provided to the Wall Street investment banks that commissioned them, they could see throughout 2006 and into 2007 that the mortgages they were financing and selling to investors were becoming increasingly sketchy.

The results of the Clayton analyses were not disclosed to investors buying the loan pools. Instead, Wall Street firms used the information to pressure the lenders issuing the most troubled loans to accept a lower price for them, according to prosecutors who have investigated these cases.

A more proper procedure, analysts said, would have been for lenders like these — New Century Financial and Fremont Investment and Loan among them — to buy back the problem loans and replace them with higher-quality mortgages. But because these companies did not have enough capital to do that, they were happy to sell the troubled mortgages cheaply to the brokerage firms.

Since Wall Street firms were paying lower prices for the troubled loans, they could have passed along those discounts to customers, reducing investor risk. But Wall Street charged investors the same high prices associated with better-quality loans, thereby increasing their own profits on the problematic securities, according to a law enforcement official and executives with Wall Street companies. To be sure, the prospectuses detailing the types of loans in these pools contained brief warnings that some of the mortgages might not meet stated underwriting

standards. But few investors probably realized that huge portions of the pools had failed to meet the benchmarks.

The Clayton figures took into account only small samples of the loan pools that were sold to investors. The 911,000 loans Clayton analyzed over the 18-month period were roughly 10 percent of the total number of mortgages in the securities it was contracted to review.

As a result, it is very likely that many of the loans that were not sampled also failed to meet underwriting standards but were packaged into the securities anyway.

Exhibit D

Tom Krebs

From: Bob Hinkley
Sent: Monday, September 27, 2010 10:14 AM
To: Bob Hinkley; Bob Hinkley; Bruce McWilliams
Cc: Tom Krebs; Tom Borgers; Victor Cunicelli; Jon Armstrong
Subject: Huffington Post article

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[New Proof Wall Street Knew Its Mortgage Securities Were Subpar: Clayton Execs Testify](#)

During a little-noticed hearing this week in Sacramento, Calif., a firm hired by Wall Street to analyze mortgages given to borrowers with poor credit, which were then packaged and sold to investors during the boom years, revealed that as much as 28 percent of those loans failed to meet basic underwriting standards -- and Wall Street knew all along.

Worse, when the firm flagged those loans for potential issues, Wall Street banks ignored its recommendation nearly half the time and likely purchased those loans anyway -- selling them to unwitting investors who were never told that the biggest home loan due diligence firm in the country had found potential defects in these mortgages.

The revelations give a better picture of what many have likely known for years: Wall Street firms knew they were buying lead yet passed it off as gold to investors who had no knowledge of the alchemy behind the scenes. But it also has real-world implications: the data released Thursday could bolster pension funds and other investors in their pursuit to force Wall Street banks to take back the bogus mortgages they peddled. An untold number of lawsuits have been filed in the wake of the subprime mortgage crisis and subsequent housing market collapse. Thus far, Wall Street has been winning that battle.

Clayton Holdings, a Connecticut-based firm that analyzes home mortgages for banks, hedge funds, insurance companies and government agencies, provided its data Thursday to the [Financial Crisis Inquiry Commission](#), a

bipartisan panel created by Congress to investigate the roots of the worst financial crisis since the Great Depression. The FCIC held its last public hearing in Sacramento, the home of the panel's chairman, where two current and former top Clayton executives testified under oath about the firm's role in the mortgage securitization chain.

During the height of the boom in 2006 and the period prior to its immediate end during the first six months of 2007, Clayton inspected home loans for Wall Street firms and government-backed mortgage giant Freddie Mac. Clayton looked at loans that the companies wanted to purchase from mortgage originators like New Century Financial, Countrywide Financial, and Fremont Investment & Loan. The company examined 911,039 mortgages, documents show.

Clients included Bank of America and JPMorgan Chase, the nation's two biggest banks by assets which together have about \$4.4 trillion; Citigroup, Deutsche Bank, Goldman Sachs, Morgan Stanley, Bear Stearns and Lehman Brothers. Clayton controlled about 50 to 70 percent of the market, Keith Johnson, the firm's former president, told the crisis panel.

Clayton, though, typically looked at roughly 10 percent of the pool of mortgages available for purchase, Vicki Beal, a senior vice president at the firm, said in response to a question by panel chairman Phil Angelides. But during the frenzied last months of the boom, when lenders and securitizers were trying to sell off as much as they could before the market collapsed, that figure reached as low as 5 percent.

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Of the 911,000 loans that Clayton scrutinized, 72 percent either met the mortgage seller's standards and other guidelines set by the buyer of the mortgages, typically Wall Street firms, or they had off-setting factors that allowed Clayton to give them a passing grade, like if the borrower who took out the mortgage put a lot of money down or had a very high income.

But 28 percent failed to meet those standards. Of those 255,802 mortgages that Clayton flagged for what were a variety of reasons, Wall Street ended up waiving 100,653 of them, or 39 percent of those loans that did not meet basic standards. And Wall Street firms didn't share this with investors.

"This should have raised red flags," said Guy Cecala, publisher of [*Inside Mortgage Finance*](#), a leading trade publication and data provider.

"To our knowledge, prospectuses do not refer to Clayton and its due diligence work," Beal told the FCIC in prepared remarks. "Moreover, Clayton does not participate in the securities sales process, nor does it have knowledge of our loan exception reports being provided to investors or the rating agencies as part of the securitization process."

Johnson said that Clayton "looked at a lot of prospectuses" -- documents given to potential investors outlining what comprises the deal -- and that the firm wasn't aware of any disclosure to investors of Clayton's "alarming" findings, Johnson said.

The reports Clayton generates are "the property of our clients and provided exclusively to our clients. When Clayton provides its reports to its clients, its work on those loans is generally completed -- Clayton is not involved in the further processes of securitizing the loans and does not review nor opine on the securitization prospectus," Beal said.

During questioning by Angelides, Beal acknowledged that, because the firm was checking roughly 10 percent of the mortgages Clayton's clients were looking to purchase, one could say that Wall Street firms waived in as many as 1 million loans that Clayton had initially rejected.

Angelides told the current and former Clayton executives that it appeared that securities issuers -- Wall Street firms -- didn't examine the other 90 to 95 percent of loans that comprised a pool waiting to be securitized and sold to investors. Johnson agreed with him.

Furthermore, Johnson said that he heard that some market participants operated under a "three strikes, you're out rule" -- if bad loans were flagged by Clayton, sellers and issuers would have Clayton take out another 5 to 10 percent sample to check the pool again. Angelides hinted that when done three times, it would be incredibly unlikely that Clayton would again discover those individual questionable loans, and that they'd find their way into securitization deals. Johnson agreed.

"What the standard practice, supposedly, and best practices call for is if you do a sampling and you show problems, you go back and take a bigger slice and keep going until you find out the true extent of the issue and the problem," Cecala said.

That didn't happen.

"If issuers had been scrutinizing all the collateral in a security and only putting in loans that met actual underwriting and documentation requirements, a lot of these deals wouldn't have gotten done," said Cecala. "But as a practical matter that didn't happen. Most of the loans that were originated got thrown in securities one way or another."

Johnson told the crisis panel that he thought the firm's findings should have been disclosed to investors during this period. He added that he saw one European deal mention it, but nothing else.

The firm's findings could have been "material," Johnson said, using a legal adjective that could determine cause or affect a judgment.

It's unclear whether the firms ended up buying all of those loans, or whether Wall Street securitized them all and sold them off to investors.

"Clayton generally does not know which or how many loans the client ultimately purchases," Beal said. That likely will be the subject of litigation and investigations going forward.

"This should have a phenomenal effect legally, both in terms of the ability of investors to force put-backs and to sue for fraud," said Joshua Rosner, managing director at independent research consultancy Graham Fisher & Co.

Original buyers of these securities could sue for fraud; distressed investors, who buy assets on the cheap, could force issuers to take back the mortgages and swallow the losses.

"I don't think people are really thinking about this," Rosner said. "This is not just errors and omissions -- this appears to be fraud, especially if there is evidence to demonstrate that they went back and used the due diligence reports to justify paying lower prices for the loans, and did not inform the investors of that."

Beal testified that Clayton's clients use the firm's reports to "negotiate better prices on pools of loans they are considering for purchase," among other uses.

Nearly \$1.7 trillion in securities backed by mortgages not guaranteed by the government were sold to investors during those 18 months, according to *Inside Mortgage Finance*. Wall Street banks sold much of that. At its peak, the amount of outstanding so-called non-agency mortgage securities reached \$2.3 trillion in June 2007, [according to data compiled by Bloomberg](#). Less than \$1.4 trillion remain as investors refused to buy new issuance and the mortgages underpinning existing securities were either paid off or written off as losses, Bloomberg data show.

The potential for liability on the part of the issuer "probably does give an investor more grounds for a lawsuit than they would ordinarily have", Cecala said. "Generally, to go after an issuer you really have to prove that they knowingly did something wrong. This certainly seems to lend credibility to that argument."

"This appears to be a massive fraud perpetrated on the investing public on a scale never before seen," Rosner added.

New York Attorney General Andrew Cuomo, who's running for governor, reportedly launched an investigation and granted Clayton immunity in exchange for information on what Wall Street knew and when, according to press reports in January 2008. A spokesman for the state prosecutor didn't return a Friday call seeking comment.

Clayton, for example, analyzed about 10,200 loans for Bank of America. It found problems in 30 percent of them. Of those, the bank waived about a quarter.

For Credit Suisse, Clayton found that 37 percent of the 56,300 loans it reviewed failed to conform to standards. It waived a third of those.

Clayton discovered that 42 percent of the pool of loans Citigroup wanted to buy didn't meet standards, and that nearly a third of those were waived anyway. Citi is the nation's third largest bank by assets and is still owned by taxpayers.

JPMorgan Chase and Goldman Sachs had rejection rates of 27 and 23 percent, respectively. JPMorgan's waiver rate was 51 percent. Goldman Sachs, often derided for its practices during the boom and bust, had a waiver rate of 29 percent, far below the 39 percent average Clayton experienced.

Among the firms with the worst records are Morgan Stanley, Deutsche Bank and Freddie Mac.

About 35 percent of the 66,400 loans Deutsche wanted to buy were marked for having some kind of deficiency; the bank waived half of them. Morgan's 63,000 loans had a rejection rate of 37 percent; 56 percent of them were waived in. Clayton rejected 35 percent of the loans government-owned Freddie Mac wanted to buy. The firm, one half of the mortgage duo now owned by taxpayers and costing the Treasury hundreds of billions of dollars, waived 60 percent of those loans.

Neal, though, testified that Deutsche was one of its tougher clients when it came to checking mortgages. Because of its rigorous guidelines, that's likely why the German lender had such a high rejection rate, she said.

These firms were among the biggest issuers of so-called non-agency mortgage-backed securities in 2006 and the first half of 2007. Goldman issued about \$65 billion in these securities, *Inside Mortgage Finance* data show. JPMorgan issued about \$61 billion. Morgan Stanley sold about \$49 billion, followed closely by Deutsche which sold \$46 billion and Credit Suisse which issued \$40 billion. Bank of America and Citigroup were next, selling \$37 billion and \$35 billion, respectively, data show.

Spokesman for Citi, Morgan, Deutsche, and Goldman declined to comment. Representatives for Freddie Mac and JPMorgan didn't respond to requests for comment.

Exhibit E



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September 30, 2010

By Hand

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Brooksley Born
Byron S. Georgiou
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Heather H. Murren, CFA
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Financial Crisis Inquiry Commission
1717 Pennsylvania Avenue, NW
Washington, DC 20006-4614

Re: September 27, 2010 Article Published in *The New York Times*
Misconstruing Commission Testimony

Dear Members of the Commission:

On behalf of Moody's Investors Service ("Moody's"), I write regarding an article published by *The New York Times* on September 27, 2010, entitled "Raters Ignored Proof of Unsafe Loans, Panel Is Told." This article concerns testimony provided to the Commission on September 23, 2010 by D. Keith Johnson (former President and Chief Operating Officer) and Vicki Beal (Senior Vice President) of Clayton Holdings, Inc. ("Clayton"). Given the Commission's important non-partisan mission to examine the causes of the financial crisis that has gripped the country and to report your findings to Congress, the President, and the American people, Moody's believes it is imperative to call to your attention a series of mischaracterizations and errors contained in that article, which is now prominently linked on the Commission's website. Moody's is certain the Commission would not want these inaccuracies, which give a misleading view of what the Commission was in fact told, to go uncorrected.

In short, by sometimes misrepresenting what was actually said at the hearing and other times ignoring pertinent testimony altogether, the *New York Times* article conveys the false impression that Clayton approached Moody's in 2006 to sound the alarm bell about "dubious" subprime loans that were being securitized, but that Moody's turned a blind eye to "conclusive evidence" of significant loan improprieties in order to protect its own business interests. The article also reports, erroneously, that "the ratings agencies had been told that vast numbers of loans were being packaged as securities even though they failed to meet underwriting standards." These statements—at least with respect to Moody's—are wholly wrong as a matter of fact. They are also wholly unsupported by the testimony of the Clayton witnesses and the accompanying documents posted by the Commission on its website. In fact, Mr. Johnson testified that Clayton did not approach Moody's until 2007—well after the subprime crisis began to unfold—and that the purpose of Clayton's approach was not to sound any alarm, but to discuss a data tracking product that it wanted to sell to Moody's. Hearing Video at 3:27:57, 3:27:23.

Certain of the most blatant errors contained in the article, and Moody's corrections thereto, are set forth below. In support of the Commission's truth-seeking mandate, Moody's respectfully requests that these responses be made a permanent part of the Commission's record.

- **“As the mortgage market grew frothy in 2006 - leading to a housing bubble that nearly brought down the banking system two years later - ratings agencies charged with assessing risk in mortgage pools dismissed conclusive evidence that many of the loans were dubious, according to testimony given last week to the Financial Crisis Inquiry Commission.”**

This contention that Moody's was presented with "conclusive evidence" of "dubious" loans by Clayton in 2006 is demonstrably false.

First, Mr. Johnson himself testified that while Clayton approached other rating agencies in 2006, it did not approach Moody's until 2007. Hearing Video at 3:27:52.

Second, the so-called "conclusive evidence" referenced in the article *did not exist until mid-2007*, and therefore could not have been "dismissed" by Moody's (or anyone else) in 2006. That "conclusive evidence" is data contained in a Clayton document entitled "All Clayton Trending Reports 1st Quarter 2006 – 2nd Quarter 2007" (the "Trending Report"), which, according to Mr. Johnson, is a product Clayton wanted to sell to Moody's. The Trending Report, which is available on the Commission's website, is dated 2007 on its face, and contains tracking data collected through the second quarter of 2007. Indeed, Mr. Johnson testified that it took Clayton "until 2007 to be able to produce [the] report." Hearing Video at 3:38:18. As the Commission is aware, Moody's first negative subprime rating actions began as early as November 2006. The difference between 2006 and 2007 is, of course, critical in any analysis of the events surrounding the subprime crisis. By mid-2007, Moody's already had taken numerous and significant downward rating actions on securities exposed to subprime collateral. Indeed, by that time the subprime crisis was the focus of the entire financial and regulatory community, including Congress, which was holding hearings on the subject.

Third, the 2007 Trending Report, which seems to reflect rejection and waiver rates, is not "conclusive evidence" of "dubious" loans. The fact that a loan is rejected, or that such rejection is waived, would not necessarily alter any quantitative or qualitative analysis of that loan. To illustrate, assume a hypothetical originator's underwriting guidelines require a FICO score of at least 650 for a given loan product, and that a loan with a FICO of 635 is rejected by Clayton and waived into a securitization pool. The fact of the rejection and waiver would not alter any of the underlying

characteristics of the loan reflected on the loan tape delivered to Moody's for analysis. The loan tape would reflect a 635 FICO, and Moody's model would analyze the credit implications of that FICO score without regard to the rejection or waiver. Further, if the originator had a regular practice of waiving rejections in the absence of appropriate compensating factors, such practice presumably would result in poor performance of the originator's loan pools over time, relative to other originators. Moody's qualitative consideration of originator performance, as described in Moody's letter to the Commission Staff dated August 25, 2010, was intended to capture just such differences in performance.

- **“Mr. Johnson said he took this data to officials at Standard & Poor's, Fitch Ratings and to the executive team at Moody's Investors Service.”**

This statement implies that Mr. Johnson testified that Clayton took evidence of dubious loans to the executive team at Moody's. This is not so. Rather, Mr. Johnson's testimony affirmed Chairman Angelides' understanding that Clayton went to the rating agencies because it had a “product to sell.” Hearing Video at 3:26:47. Specifically, Mr. Johnson testified that Clayton had developed a “great product to show clients how their manufacturing quality is” and that he believed this product would be useful for rating agencies in “assign[ing] tranche levels of risk.” Hearing Video at 3:27:06, 3:27:30. As Mr. Johnson explained to the Commission, Clayton was offering to sell a “management tool,” not offering an admonition about exceptions to underwriting guidelines. Hearing Video at 3:27:17. Moreover, to the extent Clayton approached any rating agency with its proposed product in 2006, Mr. Johnson could only have been referring to the *type* of data Clayton intended to be included in its product, and not any actual data, because, as he testified, it took Clayton “until 2007 to be able to produce [the] report.” Hearing Video at 3:38:18.

- **“But none of the agencies took him up on his offer, he said, indicating that it was against their business interests to be too critical of Wall Street. ‘If any one of them would have adopted it,’ he testified, ‘they would have lost market share.’”**

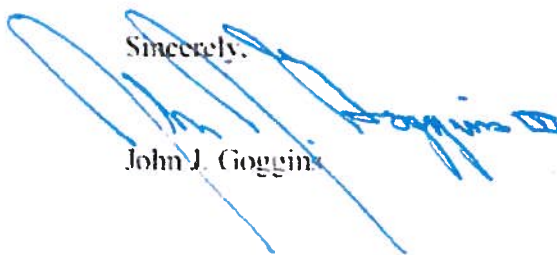
Through this passage, the article implies that the rating agencies “indicat[ed]” to Clayton that “it was against their business interests to be too critical of Wall Street,” and thus refused critical evidence of poor underwriting. **To be clear, Moody's never met with Clayton regarding an offer to provide “conclusive evidence that many of the loans were dubious,” either in 2006 or at any time thereafter, and thus Moody's did not refuse any offer of “conclusive evidence” from Clayton in 2006 or at any time thereafter.**

In fact, Mr. Johnson did not testify that Moody's or any rating agency gave him any such “indicat[ion].” Apparently, the supposition is that of the reporter, but it is unfounded. Mr. Johnson's testimony makes clear that Clayton did not come forward to the rating agencies with “evidence” of wrongdoing, but rather with a product to sell—a data tracking report. There are many possible reasons why a rating agency might choose not to purchase Clayton's product, including one raised by Ms. Beal herself. Ms. Beal testified that the Trending Report was a “beta version” based on data that had not been “scrubbed,” and that it did not compare “apples to apples.” Hearing Video at 3:29:58, 3:30:05, 3:30:06. Chairman Angelides aptly noted that the report was not “standardize[d]” and “wasn't reflective of each institution.” Hearing Video at 3:30:09, 3:30:11. Further, simply knowing that rejection and waiver rates are higher for one issuer than another is not particularly useful information without also knowing the relative “tightness” or “looseness” of underwriting standards at both institutions. A high rate of waivers from an institution with extremely tight underwriting standards could result in a pool that is less risky than a pool with no waivers from an institution with extremely loose underwriting standards.

* * *

Once during 2006, and on a handful of occasions in 2007, Moody's met with Clayton personnel. The purpose of those meetings was to understand Clayton's post-closing deal monitoring services and Clayton's due diligence processes generally, and, in 2007, to explore various strategic alternatives, including possible investments in Clayton's business. To the extent that such meetings involved any discussion of Clayton's proposed product, such discussions certainly did not involve any actual data. In other words, Clayton did not, as the article suggests, approach Moody's in 2006, 2007 or at any other time to reveal "conclusive evidence" that almost half the mortgages Clayton sampled failed to meet "crucial quality benchmarks," and Clayton did not testify otherwise.

Sincerely,



John J. Goggin

Exhibit F

Moody's Investors Service

Supporting
Materials**What does Clayton know about information our clients requested from us related to Moody's:**

- 2005** – Request from Lehman for **Moody's credit grade** which is based on a combination of the borrower's mortgage (or rental) payment history, bankruptcy/foreclosure history Tab 1
- 2006** – Request from several clients (including Lehman, HSBC, Merrill, Greenwich, UBS) for **Moody's data capture** to pick up loan characteristics not furnished on tape that could lift sub-prime loans into Alt-B status Tab 2
- 2007** - Request from several clients (including Credit Suisse, Soc Gen, Countrywide, Morgan Stanley, Merrill Lynch, Goldman) to include **Moody's Expanded Loan Characteristics In Subprime, 6/07** in their custom scripts Tab 3

Clayton/Moody's presentations in 2007:

- January 11, 2007** – Clayton office, Shelton, CT – Moody's requested meeting with Clayton. Purpose was that Moody's was to prepare white paper on due diligence. Clayton walked Moody's through entire due diligence process, including Exception Tracking and underwriting of a loan file. Tab 4

Attendees from Moody's included: David Teicher, Managing Director; Maggie Liu, Analyst; Rachel Peng, Analyst; and another analyst

Attendees from Clayton included: Paul Marchese, SVP; Kerry O'Neill, EVP; Vicki Beal, SVP; Cindy Amberg, SVP; Jake Peterson, Manager

- January 29, 2007** – ASF Conference, Las Vegas, NV – General discussion on market, exploring opportunities to evaluate effect of surveillance on RMBS.

Attendees from Moody's included: Warren Kornfeld, Managing Director, Michael Drucker, Analyst

Attendees from Clayton included: Kevin Kanouff, President, Clayton Fixed Income Service

May 31, 2007 – Moody's office, NYC – Murray Markowitz w/Moody's requested meeting with Clayton compliance. Purpose was that Moody's wanted to have their team understand the process for testing high cost, predatory lending regulations within the due diligence process. Conversation led into general discussion of state of underwriting guidelines, what was going on in the market. Trending Reports and Clarity were reviewed at this meeting. Warren Kornfeld, Managing Director w/Moody's mentioned that they would be interested in "partnering/working with" with Clayton; that they would follow up with us to learn more about Trending Reports and Clarity.

Attendees from Moody's included: Murray Markowitz, Vice President – Senior Analyst; Warren Kornfeld, Managing Director; ~15 analysts and several remote callers from Moody's NJ office

Attendees from Clayton included: Paul Marchese, SVP; Vicki Beal, SVP; Jeff DeMaso, Sr. Regulatory Compliance Counsel; Grant Beal, Vice President, Strategic Initiatives

July 18, 2007 – ASF Sunset Seminar on Mortgage Fraud Prevention, NYC – Moody's senior analyst, Murray Markowitz, discussed with Clayton (Grant Beal) their interest in following up with us on Clarity and Trending Reports and indicated he would set up a meeting in the future.

July 27, 2007 – Moody's office, NYC – Discussed tools available and data we have that Moody's may not be seeing, including Exception Tracking; briefly mentioned NY Attorney General subpoena.

Attendees from Moody's included: David Teicher, Managing Director; Murray Markowitz, Vice President, Maggie Liu, Analyst

Attendees from Clayton included: Keith Johnson, President; Paul Marchese, SVP

Ideas on ways Clayton and Moody's could work together going forward:

- Share due diligence data w/ Moody's;
 - This would be in the form of our current final due diligence reports, reporting on:
 - size of due diligence sample
 - grading of loans and exception detail on deal level
 - statement of accuracy of data tape
 - This could also be in the form of language that goes into the prospectus

Tab 6

- Standardize due diligence data captured and uploaded to Moody's:
 - Work together to develop the data fields and output format required

Tab 8

- Work together to develop an independent benchmark/grade for loans that equalizes for guidelines:
 - Leverage Clayton data to help differentiate Moody's in the marketplace

- Incorporate InterCept into Moody's rating models

Tab 9

- Utilize Clayton's InCyt platform to monitor performance of loans in securities:
 - Ingest every deal into InCyt and leverage this data warehousing and business intelligence platform to analyze loan and deal performance

- Use InFront, Clayton's suite of surveillance and due diligence trending reports, to monitor industry trends

Tab 10

Index of Supporting Materials

- Tab 1 - Document describing Moody's credit grade developed in 2005 at the request of Lehman
- Tab 2 - Document describing Moody's data capture developed in 2006 to identify Alt-B loans
- Tab 3 - Screenshot of new screen added to CLAS in 2007 for certain clients looking to capture additional fields based on Moody's June 2007 announcement of expansion of loan characteristics in Subprime RMBS ratings analysis
- Tab 4 - Presentation materials from meeting on January 11, 2007
- Tab 5 - Presentation materials from meeting on May 31, 2007
- Tab 6 - Sample due diligence Loan Disposition Summary
- Sample due diligence Portfolio Summary Report
- Sample due diligence Loan Level Tape Comparison Report
- Tab 7 - Proposed language for enhanced disclosures in the prospectus regarding data integrity and underwriting exceptions
- Tab 8 - Screenshots of new screens under development to more fully address Moody's June 2007 announcement of expansion of loan characteristics in Subprime RMBS ratings analysis
- Tab 9 - InterCept product sheet
- Sample InterCept report
- Tab 10 - InFront report from July 2007 detailing surveillance trends
- Sample report of due diligence exception trends