MEMORANDUM FOR THE RECORD

Event: Interview with Josh Rosner (Graham Fisher)

Type of Event: Interview

Date of Event: March 24, 2010

Team Leader: Brad Bondi

Location: Phone interview

FCIC Commission Staff
- Brad Bondi
- Greg Feldberg

FDIC Staff
- Josh Rosner, Graham Fisher

MFR Prepared by: Greg Feldberg

Date of MFR:

Summary of the Interview:

This interview may have been off-record.

- Should focus on Moodys
    - Shifted from investor-focused to revenue-focused
    - Most variable models, widest deviation
    - Reconvened ratings committee without substantive changes and came out with different results
    - Most dramatic culture change, ramp up in revolving door
    - Further away from empirical ratings models
- Rating agencies: They had to build models more and more that were sort of disconnected from reality.
    - They could have 12, 15 models to look at the same deal. When they realized that a model needed to be fixed, they would do so, but they wouldn't go back

to look at the securities they had rated with a different model. It allowed for this ongoing deterioration in variability.

- They did not take those assumptions and then use those same assumptions for a regular surveillance/rerating process. You continue to create opportunities to deviate from your original assumptions. The lack of resources in surveillance which stems from the difference in compensation. Reform: Say they can charge a million dollars, and $2-20,000 for surveillance… they have to do that combined over the life of the deal. Over 10 years, that would be $1.2 million. They should be required to accrue that based on the performance of the various tranches. Deal performs—they get paid. Instead, with upfront payment, who's going to spend money on the surveillance.
    - Say that they can't work for company you rated until at least one year has passed.
    - Ask them to disclose employees that have left. They say they don't keep any records. They are loathe to try to answer that question.
- Models should be reviewed by an independent committee that reports to the Board. The models are driven by revenue. Office of Chief Statistician, report to independent board members. These are nationally recognized NSRSOs, and not one has a PhD-level statistician running their modeling process.

- R&R would be the place to go. The Oxford analysis of structured securities. **Sylvan Raines**.
- **Gerry Fons.** Not a structured finance guy. Ran Moodys bond default studies. Now at K3, Jules Krohl, hopes to be a new rating agency.
- 36CFR1256.56: Privacy is a joke. His firm doesn't do structured ratings, never did. Second, just as the issuer-pays model has conflicts, the investor-pays model has similar conflicts. It was just as frequently I would have a large investor in FNM threaten to pull commissions, as with an issuer. 36CFR1256.56: Privacy There's a conflict that needs to be considered in either case. His success is more than questionable.
- You hear a lot of people say that competition is not the answer in a required business. If one agency got it right you only need one. Given the way they are paid, you are creating the requirement that there are ratings, and that drives issuers to the most lenient name.

- There are only three. DBRS is much smaller.
- Q: Where did C get most of its RMBS for CDOs?
    - The ASF needs to change its stripes. The fact that FDIC could not see deal documents leading up to the crisis is a big part of the crisis. Confidentially it would be CFC, and IndyMac. I could get an answer. ASF is completely captured by the sell side. Period. They really don't want functioning and transparent markets, clearly. They don't want standardized pooling and servicing agreements. Structured securities are structured so that there is a consistency and comparability to them. If you have a standard structure, and standard legal documentation, it becomes standardized. What you had is 300 P&S agreements. They did not have time to read 300 300-page documents, so they walked away from the market. Here we are, we still don't have a stable definition of default. We still don't have a pre-issuance set of data. They still don't want that. After one month, we should have an update on loan-level collateral. They still don't want that. Because they have buy-side and sell-side folks, they have been able to sell themselves as uncompromised. At the end of the day, if there can't be a consensus between the buy side and the sell side, the buy side should dictate the terms.
    - The administration doesn't have a space for the buy side. **Off-the-record:** The PWG has been tasked to write a paper on the future of securitization. What regulators would you think they should have tasked? I would think the FDIC as a receiver of assets, and the SEC for transparency. Instead they tasked the OCC and Fed, who are clearly on the sell-side.
    - On the securitization side, let me send you a white paper that was created by the association of MBS investors to counterbalance the ASF, which they feel had stymied transparency. This just came out. It was ratified last Friday and included in a letter sent to the SEC on their TRACE proposal.
- Q: What were the aggregate fees to the rating agencies with regard to CDO structuring? I don't think there's a way to get to that. Moody's will say how much they received for structured product ratings for each period.
    - Typically it was 2% of the issue is the pre-issuance fee. $2,000 to $20,000 p.a. was the surveillance fee. The price didn't seem to be tied to how complex the deal was, it was how big a customer you are. [C made 1% fee as the structure, so CRA made twice as much?]

  - They didn't necessarily even have to do their own work. A lot of the time the agencies would rely on outside counsel for the issuers. They wouldn't even bring in their own counsel to do the due diligence. They had no cost, very little expense. The margins were astounding.
  - Also with FNM and FRE: At the CRAs, we saw a massive increase in FNM/FRE business with no similar increase in G&A expense. You could see they weren't spending on the new revenues on internals.
- There were a lot of good deals, there were deals that were less than justifiable basis to take advantage of markets. There were companies designing deals so that they could get synthetically short them, which meant the issuer had to find a way to short them. That seems reprehensible, but those are responsible buyers. If you're creating a product with the intention that it will fail, you're designing a car so that it crashes—then you're telling the person to go out and sell it. You've got a problem.
- [Not all CDOs were that way]. I don't think most of this was nefarious at all. It was an over-reliance on models. It was reliance on the cliché that home prices never go down. It was bolstered by academic literature that we had viscerated the way mortgages had been done for 100 years. **Standard DTI was 33-36; FICO; 90-days delinquent we would say get out, deadbeat, we decided we would modify the loan**. We wouldn't tell investors it was modified, even though modified securities even in the best of times had a 20% redefault rate. Part of the problem with retention of risk is that if the banks had really understood what they were buying, they wouldn't have choked. It was not mal-intent that caused this crisis. It was a deterioration in underwriting standards. **Rating agencies looked at these as credit risk instruments, whereas these were liquidity risk instruments**. I question whether there should be credit ratings on bespoke products, because liquidity is the primary risk.
  - The liquidity risk is that it may pay off over time, but given the lack of transparency, you saw prices fall way below the value. Both MBS and CDOs. **The investor can't assess the cash flows; he doesn't know how much servicer is advancing, even today**. When it hits the fan, he runs for the door.
- Information that one of the states has been trying to get through subpoenas, and the subpoenas are being fought. **They're having trouble getting pretty much any information from the rating agencies**. The stuff that I would be seeking…
- **CDOs—**I would point out that the most glaring problem, the reason deals came to market, was that the investors didn't have the ability to say this is crap, I'm not

buying it. They over-relied where they shouldn't have. **At the end of the day, a trading desk calls and says, I've got a deal in three hours, in the equity world, I need to do due diligence. In equity you have 20 days, in debt you have two weeks.** Here you get the weighted averages… the weighted averaged LTV, DTI, coupon, of a pool that wasn't even finalized. That's where it got gamey. That's the first area that should be looked at.

- **Look at the pre-issuance circulars and reports by the rating agencies**. Where they may have looked similar, the deals looked exceedingly different. For MBS. But that's where the CDOs end up referencing. If your assumptions are wrong for the MBS…