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By Hand

Phil Angelides  
Hon. Bill Thomas  
Brooksley Born  
Byron S. Georgiou  
Senator Bob Graham  
Keith Hennessey  
Douglas Holtz-Eakin  
Heather H. Murren, CFA  
John W. Thompson  
Peter J. Wallison  
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.

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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. Goggins

