

Scott McCleskey  
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12 March, 2009

Mr. Michael Macchiaroli  
US Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

Dear Mike,

As you may remember, I was the head of Compliance at Moody's until last September, and I am writing you to flag an issue which I feel the SEC needs to be aware of, certainly with respect to Moody's and probably with respect to the other major NRSRO's. Briefly, the issue is the lack of meaningful surveillance of municipal securities, contrary to statements by Moody's to the public and to Congress which imply that all securities are either monitored in a robust fashion or are flagged as 'point in time' ratings. As I discuss below, I feel that in the current economic environment this failure could have far-reaching systemic consequences. I am writing to urge the SEC to include a rigorous review of public finance rating surveillance in its annual examination of Moody's and the other NRSROs.

While serving as head of Compliance, I became aware that, at the time, virtually no surveillance was being performed on US public finance ratings - debt issued by states, counties, municipalities, school districts, etc. While a few very high profile/frequent issuers (City of New York, etc) were receiving some periodic reviews, the vast majority had received none - in some cases, there were bonds which had been outstanding for 10 or 20 years but which had never been looked at since the original rating. I raised concerns about this, stating that at a minimum we needed to characterize such ratings as 'point in time' ratings so that investors did not assume that the stale ratings were still current. My guidance was, to put it politely, ignored. Indeed, at a meeting in 2008, Michael Kanef advised me and others in a Legal/Regulatory Affairs/Compliance meeting that John Goggins had specifically stated that we were not to mention the issue in any emails or any other written form.

Only after the credit crisis brought additional scrutiny did Moody's take any steps to address the matter (in the second or third quarter of 2008 if I recall correctly). However, this only consisted of designating a small team to review alerts generated by a computer algorithm. As I recall, there was an email (contrary to John Goggins' instructions) from a senior manager stating that the size of the team was in no way adequate to perform the surveillance task, given the universe of ratings to be covered (over 29,000 according to Moody's website). Although my departure from

Moody's came only shortly after this measure began, it was already clear that they would not be adequate. Nonetheless, senior management was unwilling to tell the public that ~~virtually all~~ municipal securities ratings were out of date, contrary to their representations in Congressional hearings and public statements.

This would be bad enough in normal circumstances, but it causes me great concern in the current environment. Municipal authorities have been taking drastic measures - cutting their capital budgets to zero, laying off employees in critical sectors, etc - just to keep afloat. There is a real probability that there will be a wave of municipal defaults in the coming year. In the meantime, the ratings on their debt remain at the same level as when the debt was issued. Investors may think they are holding investment grade bonds when in fact the issuer is teetering on the edge of bankruptcy.

More to the point, municipal securities are widely held throughout the system. They are held by insurance companies (a very large investor in these securities), pension funds, banks, other municipal authorities, hedge funds, and of course individual investors. As such, a wave of defaults on securities with high ratings could have wide-ranging systemic effects on an already weakened financial system. In short, we could have a repeat of the subprime mortgage crisis.

In sum, the surveillance of public debt by Moody's is not adequate to cover the existing 29,000 issuers even under normal circumstances, and would be wholly incapable of reacting as the finances of the issues rapidly deteriorate.

As I have said, senior management at Moody's is well aware of these facts but is unwilling to make the more than a token effort. The decree from Legal to avoid a paper trail is particularly disconcerting, but it is in character with the general approach of Moody's to compliance. While I was there, I found that my guidance was routinely ignored if that guidance meant making less money or enmeshing separation requirements to address conflicts of interest between the ratings side and the business-development side). By early 2008, I was deliberately left out of discussions which had a significant compliance dimension and on which I would have given very strong guidance.

Moreover, senior management directly intervened to reduce the number of experienced Compliance officers in the department, and replace them with analysts and managers from, of all places, the Structured Finance department. Within a week of Michael Kanef's arrival from Structured Finance to be my superior, two of my most experienced compliance officers - with 40 years of experience between them - were fired in spite of my objections. One was immediately replaced by a Structured Finance analyst with no Compliance background (and whom I quickly came to regard as incompetent). The other's position was left vacant for roughly a year, leaving me with no manager to establish the Monitoring and Reporting function. In the meantime, a second Structured Finance analyst was hired, again with no participation from me. Lastly, as I'm sure you are aware, I was replaced by the very manager who had previously been responsible for

the rating of residential mortgage-backed securities. Not only are these individuals inexperienced in Compliance matters, they are profoundly conflicted in that they are reviewing their own prior activities and are making decisions which may or may not sit well with those who will supervise them when they return to Structured Finance. While I do not wish to make this an issue of my own frustrations and departure at Moody's, I believe that the annual examination should also look very carefully at the level of authority and experience of the Compliance Department. This may not be easy, as I am certain that Moody's will attempt have the examiners deal only with Legal Department staff or outside counsel, rather than directly with Compliance.

While the undermining of the Compliance Department is disturbing, it is subsidiary to the main focus of this letter, which is the failure of Moody's to perform adequate surveillance of US public finance securities. For the reasons I note above, I hope you agree that this area requires particular scrutiny during the examination process. Should you or your colleagues wish to discuss this matter with me, I would be happy to do so. I may be reached at the above address, or at [REDACTED].

With best regards

Scott McCleskey