BARNEY FRANK, MA, CHAIRMAN

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

SPENCER BACHUS, AL, RANKING MEMBER

May 22, 2008

The Honorable Christopher Cox
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE, Room 10700
Washington, DC 20549

Dear Chairman Cox:

We are writing to ask the Commission to conduct a thorough review of Moody's Investors Service in the wake of a troubling report that the rating agency made a critical error in its analysis and failed to correct that error promptly. As you know, the *Financial Times* yesterday reported that Moody's incorrectly assigned triple-A ratings on certain constant proportion debt obligations (CPDOs)—a synthetic debt security. While Moody's discovered the error in February 2007 shortly after the issuance of the securities, it failed to change the ratings for more than a year, according to the report.

The credit rating industry's reputation has suffered—deservedly, many believe—because of its failure to accurately assess mortgage market risk. The credit crisis will continue as long as investors, particularly those seeking to purchase structured products, lack the confidence in the rating agencies' ability to accurately assess credit risk. Moody's alleged conduct in this matter raises questions not only about its competence, but more importantly its integrity. The Commission must quickly examine this matter and sanction any rating agency for any wrongful conduct it has committed.

In Moody's application for status as a nationally recognized statistical rating organization (NRSRO), the Commission under the Credit Rating Agency Reform Act of 2006 required the firm to disclose—among other things—performance measurement statistics, ratings procedures and methodologies, policies to prevent the misuse of material information, and the existence of, or the explanation of a lack of, a code of ethics. As amended by the Reform Act, Section 15E(b)(1) of the Securities Exchange Act of 1934 requires Moody's to amend its application for registration promptly upon the discovery of any materially inaccurate information contained therein.

These statutory provisions raise a number of questions we ask the Commission to examine promptly. While the Commission should not limit its inquiry to these questions, we ask you to provide us without delay answers to at least the following:

- Did the existence of a significant uncorrected error violate either Moody's own procedures or the Reform Act?

- Did Moody's ever disclose the error to the Commission and, if so, when? If not, is this omission a violation of the Reform Act?

- Does Moody's failure to disclose the error and correct it meet the statutory definition of "material"? Did Moody's have a code of ethics and, if so, was it followed?

- What risk management controls and escalation procedures did Moody's have in place to address this error? Does the Commission review or plan to review these controls and procedures for all NRSROs?

- Why did Moody's retain the CPDOs' triple-A status for nearly one year following the discovery of its error?

We realize that this matter requires further examination before reaching any conclusions. Moody's deserves fairness and will surely answer any and all related allegations on its own. But the urgency and seriousness of this matter cannot be overstated. We believe the Commission possesses sufficient authority to conduct a thorough, comprehensive and expedited examination of these matters. If the Commission determines that Moody's violated the Reform Act, we would expect the Commission to impose all appropriate sanctions.

Although a similar coding error has not been reported at Standard and Poor's, that firm also provided its top rating on securities Moody's would have rated 4 levels lower absent the technical error. This is a troubling disparity that also deserves the Commission's attention.

Please advise the Committee whether the Commission believes it has adequate authority to inspect the NRSROs' risk management controls and escalation procedures. We also request that you provide a response to this letter no later than June 5, 2008, so that the Financial Services Committee can plan hearings if appropriate. We look forward to your findings and appreciate your attention to this matter, consistent with all applicable laws and regulations.

Sincerely,

Barney Frank
Chairman
Financial Services Committee

Spencer Bachus
Ranking Member
Financial Services Committee

Paul E. Kanjorski
Chairman
Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises

Deborah Pryce
Ranking Member
Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises