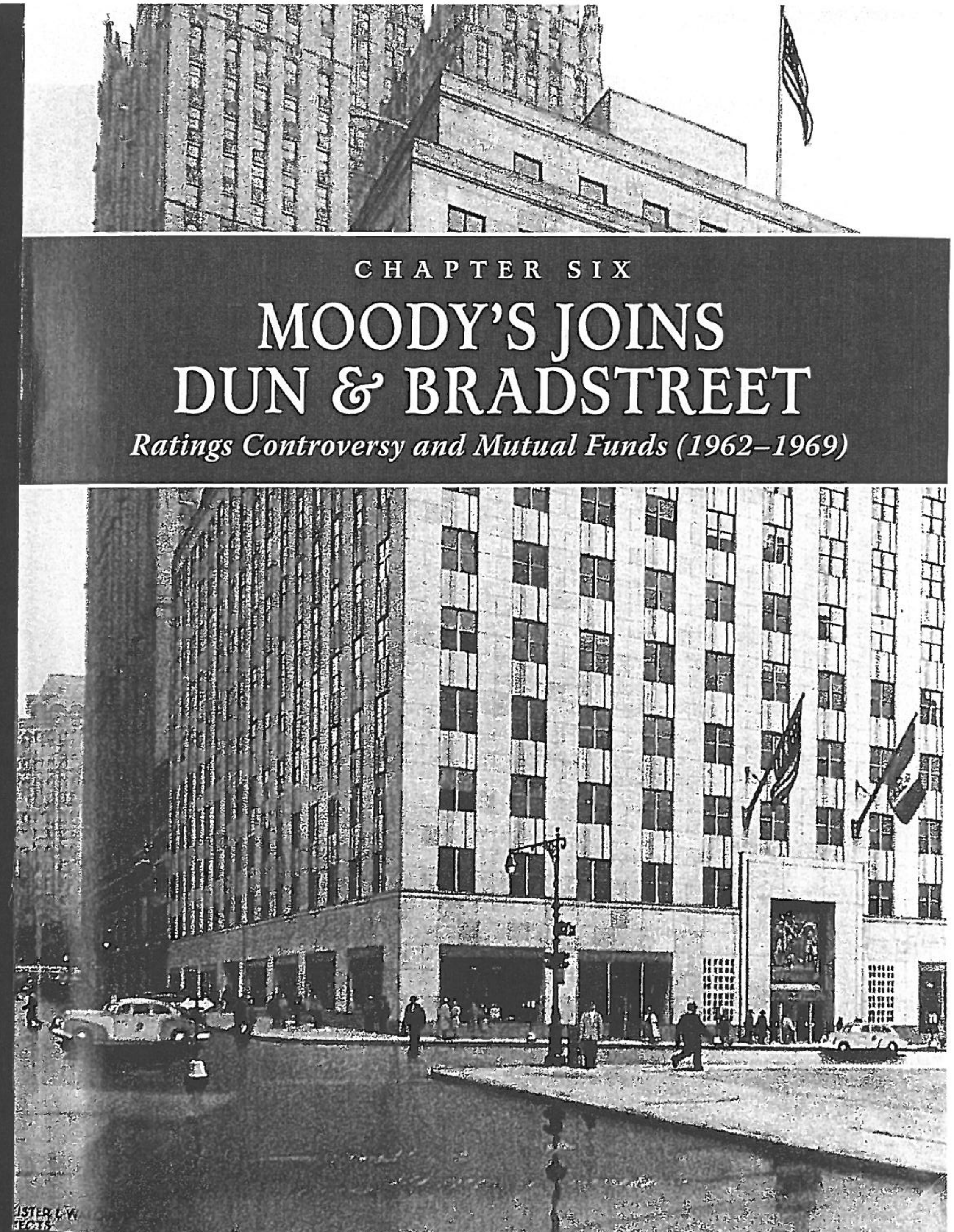
CHAPTER SIX

# MOODY'S JOINS DUN & BRADSTREET

*Ratings Controversy and Mutual Funds (1962–1969)*



WHEN MOODY'S was acquired by Dun & Bradstreet Corporation on March 30, 1962, the union was viewed as a natural fit.

In a joint announcement in New York on December 3, 1961, Moody's president Allan Wallace and D&B chairman J. Wilson Newman said the planned acquisition would "broaden D&B's publications and services in economics, marketing, sales, credit, finance, education, and research." Of course, there was also an ancestral connection between Moody's ratings and those of D&B. And since 1954 Moody's had been headquartered in the D&B building at 99 Church Street in the financial district of New York.

)un & Bradstreet Building, shown
e and overleaf in a rendering
ired by architects Reinhard,
ıeister & Walquist, was completed
'51. According to D&B brochures
lating at the time, the building
'designed and dedicated to the
of gathering information for the
ıotion of trade in America and
ighout the world." Moody's moved
ffices to the D&B Building in
4, so no further move was needed
n the company was acquired by
3 in 1962. As Moody's grew over
years, D&B management moved
ɔwn, then to Short Hills, New Jersey.
ıdy's took over the entire building
ıe early 1990s. In 2007, after more
ı half
entury at 99 Church, Moody's
ved two blocks west to more
cious quarters at 7 World Trade
ıter.

But another key reason for the merger had to do with the immediate needs of Moody's managers. After Moody died in 1958, they faced the problem of how to fund the retirement of long-time executives such as Louis Holschuh and John Sherman Porter, while also supporting Moody's growing investment counseling and publications businesses. The acquisition helped to solve both problems.

Initial overtures were made by Don McCruden, during his tenure as president of Moody's from 1956 until his death in October 1961. The final transaction included exchanges of one share of D&B common stock for each of the 56,400 shares of Moody's publicly traded preferred stock, along with one-third share of D&B common for each share of Moody's common stock, all 60,000 of which were held privately by the Moody's estate and key Moody's managers. Total proceeds of the transaction were estimated at $5.5 million.

Meanwhile, Standard & Poor's had become a public company listed on the New York Stock Exchange in early January 1962. Four years later, S&P became the second major rating agency to be acquired by a large business information and publishing company—on October 19, 1965, the *Wall Street Journal* reported that after discussions with many suitors, McGraw-Hill, Inc. had reached a tentative agreement to acquire the company through a share swap. Under the proposed terms, McGraw-Hill would exchange one share of a new class of $1.20 preferred stock for each of the approximately 1.5 million shares of S&P common stock outstanding. The value of the acquisition was estimated at between $54.5 million (based on the prevailing value of S&P stock) and about $62 million (based on the value of McGraw-Hill stock).

The merger was delayed several months to allow the Department of Justice time to consider concerns stemming from the major





position each company held in its respective fields. McGraw-Hill was one of the largest publishers of books and business periodicals. S&P had recently withdrawn from commercial printing operations; but its revenues from non-printing sources, mainly financial publishing and investment counseling, amounted to $19.1 million in the fiscal year ended June 30, 1965 (more than double Moody's revenues of $7.5 million in 1964). According to Moody's Industrial Manual, the acquisition was completed February 15, 1966 through the issuance of 1,532,823 convertible preference shares (valued at $1.20 each, as planned) for each share of Standard & Poor's common.

Dun & Bradstreet Plan To Acquire Moody's Is Announced by Concerns

A WALL STREET JOURNAL News Roundup

Dun & Bradstreet, Inc., and Moody's Investors Service announced a plan for Dun & Bradstreet to acquire Moody's. The proposal is subject to approval by directors and stockholders of ...

McGraw-Hill Has Plan to Acquire Standard & Poor's

Agreement, Involving Swap of Shares, Requires Approval By Firms' Boards, Holders

Valuation Put at $62 Million

By a WALL STREET JOURNAL Staff Reporter

NEW YORK — McGraw-Hill, Inc., plans to acquire Standard & Poor's Corp., both companies announced.

Under the proposed terms of the acquisi-

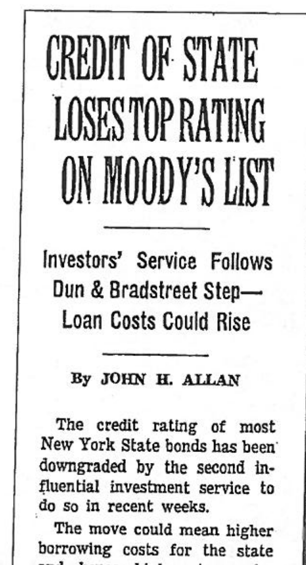
Dun & Bradstreet's acquisition of Moody's was announced in December 1961. The transaction occurred the following March, with proceeds estimated at $5.5 million

In January 1962, S&P completed an initial public offering on the New York Stock Exchange. McGraw-Hill, Inc. announced plans to acquire the firm in October 1965. The acquisition occurred in February 1966.

## DOWNGRADES MAKE NEWS

In mid October 1964, Moody's lowered its ratings on New York State's general obligation bonds to Aa from Aaa. That event marked one of the first rating changes—probably *the* first—to generate controversy and wide news coverage outside the financial news columns. (With the explosive growth of capital market lending, there would be many more such news-making rating actions over the next four decades.)

It is almost certain that Moody's analysts were very surprised by the publicity. The rating downgrade was not announced to the press. Rather, it was disclosed in a notice in the October 19 issue of *Moody's Bond Survey,* which had little circulation outside Wall Street. Yet the *New York Times* ran a front-page story the next day with the headline: "Credit of State Loses Top Rating on Moody's List: Investors' Service Follows Dun & Bradstreet Step—Loan Costs Could Rise."



CREDIT OF STATE LOSES TOP RATING ON MOODY'S LIST

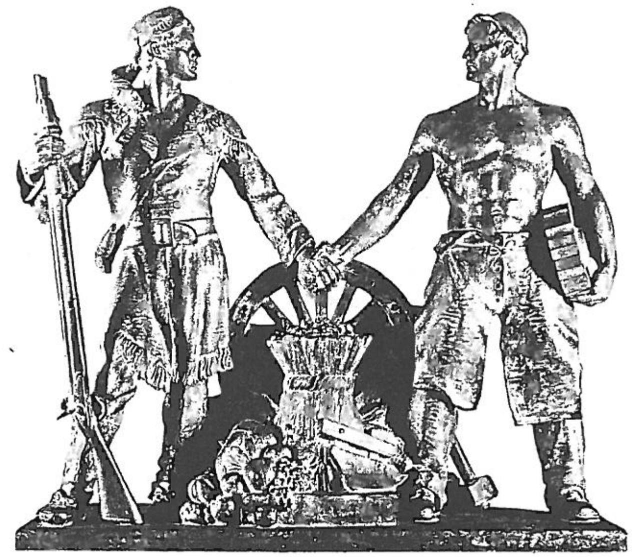
Investors' Service Follows Dun & Bradstreet Step—Loan Costs Could Rise

By JOHN H. ALLAN

The credit rating of most New York State bonds has been downgraded by the second influential investment service to do so in recent weeks.

The move could mean higher borrowing costs for the state and hence higher taxes for

Moody's downgrading of New York State bonds (to Aa from Aaa) made front-page news in The *New York Times,* October 20, 1964.

## D&B'S SCULPTURAL IDENTITY: "CREDIT—MAN'S CONFIDENCE IN MAN"

IN THE LATE 1930s, Dun & Bradstreet Corporation commissioned sculptor Georg John Lober (1892–1961) to create the bronze bas relief that graced the entrance to the Dun & Bradstreet building—then the Moody's building—at 99 Church Street in New York for more than 50 years. It served first, however as the main feature of the D&B exhibit at the New York World's Fair in 1939.

Lober got to work the following year to create a three-dimensional sculpture on the same theme. The sculpture (shown above) was first placed at the former Dun & Bradstreet Building at 290 Broadway. It was then moved to the lobby of D&B's new building in 1951, when the bas relief became a prominent fixture overlooking Church Street. A replica of the bas relief is now on display in Moody's new headquarters at 7 World Trade Center, New York (20th floor).

Lober designed both works to symbolize the contribution of D&B and other credit agencies to the growth of commerce in America. As such, it depicts an allegorical scene around the year 1841—the founding year of The Mercantile Agency, D&B's predecessor and the first major credit reporting firm in America. The man with the rifle represents the pioneers of the American West; the man on the right represents the artisans of the East who forged the plows, guns, and tools used by the early frontiersmen. The wagon wheel behind them is a reminder of the covered wagons that carried settlers west. The wheat, corn, and vegetables at the foot of the wheel stand for the fruits of their labors.

The men are clasping hands to signify the bond of confidence between the two elements of American commerce, as facilitated by reliable credit information. That pictorial message is further reinforced by a inscription below the men, which is a quote from a speech by Daniel Webster in the Senate at Washington in 1834:

> *Commercial credit is the creation of modern times and belongs in its highest perfection to the most enlightened and best governed nations. Credit is the vital air of the system of modern commerce. It has done more, a thousand times more, to enrich nations than all the mines in the world.*

**Governor Rockefeller's response to the New York State downgrade: "We think this is only a temporary situation."**

The *Times* reported that D&B's municipal unit had already sent a confidential report to clients a month earlier. D&B had lowered its New York State rating to "better good grade" from "prime" (the top rating), while S&P's municipal bond rating committee later decided to retain the state's AAA.

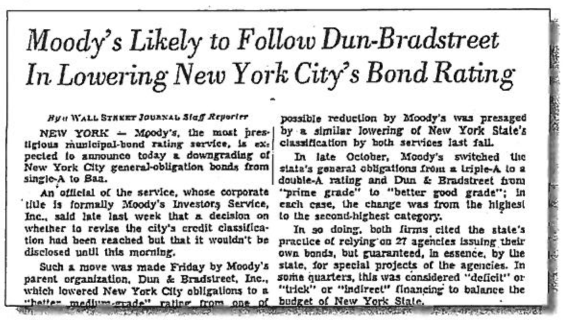
Citing Moody's as "the most influential bond rating service," the *Times* reported that the agency was most concerned about the increasing borrowing through state agencies, rather than by the state itself. The New York Housing Finance Agency, for example, had been given power to issue more than $2 billion of debt for construction of housing, university, and mental health facilities. "In the case of agency debt," Moody's said, "the state has only a moral and not a legal obligation to vote funds for debt service."

Viewed in retrospect, responses to the rating changes were predictable. Through a spokesperson, Governor Nelson Rockefeller said, "We think this is only a temporary situation." State Controller Arthur Levitt, who had been critical of the state's financing methods, had no comment at the time. But when New York's next issue, some $35 million of housing bonds, was sold in mid-October, Mr. Levitt complained that the Moody's and D&B downgradings had resulted in "a substantial increase" in the state's net interest cost. Bankers in the municipal market disagreed with that assessment, but public awareness that lower ratings can mean higher financing costs was spreading fast.

## NEW YORK CITY'S RATINGS FALL

The public ratings controversy escalated the following year, when the *Times* reported on July 19, 1965 that Moody's would likely follow D&B in lowering New York City's general obligation bond ratings. Moody's did lower the city's rating to Baa from A, while D&B had lowered its New York City rating to "better medium grade" from "good grade" and S&P held its rating at single-A. Mayor Robert Wagner criticized the rating cuts, calling the city's economy "strong and vibrant." As municipal interest rates began their steady rise in the inflationary environment of the 1960s, city comptroller Abraham Beame said the lower rating could

*The New York Times,* July 19, 1965.



*Moody's Likely to Follow Dun-Bradstreet In Lowering New York City's Bond Rating*

By a WALL STREET JOURNAL Staff Reporter

NEW YORK — Moody's, the most prestigious municipal-bond rating service, is expected to announce today a downgrading of New York City general-obligation bonds from single-A to Baa.

An official of the service, whose corporate title is formally Moody's Investors Service, Inc., said late last week that a decision on whether to revise the city's credit classification had been reached but that it wouldn't be disclosed until this morning.

Such a move was made Friday by Moody's parent organization, Dun & Bradstreet, Inc., which lowered New York City obligations to a "better medium-grade" rating from one of possible reduction by Moody's was presaged by a similar lowering of New York State's classification by both services last fall.

In late October, Moody's switched the state's general obligations from a triple-A to a double-A rating and Dun & Bradstreet from "prime grade" to "better good grade"; in each case, the change was from the highest to the second-highest category.

In so doing, both firms cited the state's practice of relying on 27 agencies issuing their own bonds, but guaranteed, in essence, by the state, for special projects of the agencies. In some quarters, this was considered "deficit" or "trick" or "indirect" financing to balance the budget of New York State.





result in "millions of dollars out of the pockets of our people."

In an editorial two days later, however, the *Wall Street Journal* praised Moody's, commenting that the downgrading "tells no little about what's wrong with government in that metropolis, and for that matter furnishes a distilled example of political ills more generally besetting the nation." "In its new budget," the *Journal* explained, "New York is starting to borrow not for capital expenditures but to finance current operations, a step which certainly demands reassessment of its credit standing."

Then city finance administrator Roy M. Goodman was reportedly angered when S&P decided in July 1966 to downgrade New York's general obligation bonds to BBB from A, in line with assessments by Moody's and D&B. In its July 26 story on the S&P downgrade, the *Times* commented that Moody's tended to be "a bit more conservative" than its competitors. "Sure we're conservative," commented Robert C. Riehle, head of Moody's municipal ratings, adding: "That's our mission in life."

The *Times* noted further that while wide differences in ratings of the two major agencies were rare, S&P had on one occasion rated a tax-exempt issue two notches higher than did Moody's. An S&P representative said "It could be our municipal people have better digestive systems than Moody's."

A year later, Goodman went to Washington to ask the Federal Reserve Board and the Federal Deposit Insurance Corporation to establish a new system for rating municipal bonds. Goodman charged that "The whole municipal bond-rating system . . . is a horse-and-buggy system in a jet age."

On December 6, 1967, the *Wall Street Journal* reported that New York City's finance minister had appeared before a Congressional committee in Washington to urge the creation of a government-supported bond rating service to compete with Moody's and S&P.

## CONGRESS INVESTIGATES

In December of 1967, mainly in response to the repeated failure of New York City to improve its ratings, The Joint Economic Committee of the U.S. Congress began holding a series of hearings "to examine the rating agencies' methods and their impact."

Goodman appeared before the committee complaining that the private rating services had "assumed almost Biblical authority throughout the American investing economy, influencing banks, trustees, and individuals to an unwarranted degree." Their "inaccurate" ratings, he further charged, were contributing to the "choking" interest rates being

**Congress Urged to Act On Bond-Rating Service Replacing Private Firms**

**New York City Finance Officer Suggests Systems Financed by Cities, Banks, Buyers, Dealers**

By a WALL STREET JOURNAL Staff Reporter

WASHINGTON—New York City's finance administrator urged long-range steps to replace private municipal bond-rating systems with new rating services financed jointly by cities, banks, investors and securities dealers.

Appearing before Congress' Joint Subcommittee on Economic Progress, Roy M. Goodman charged that "inaccurate" ratings by private rating companies are contributing in part to "choking" interest rates being charged to local governments on debt issues.

Mr. Goodman, who has sharply criticized them before, said the private services "have assumed almost Biblical authority throughout the American investing economy, influencing banks, trustees and individuals to an unwarranted degree."

paid by local governments on debt issues.

"The whole municipal bond rating system . . . is a horse-and-buggy system in the jetage."— New York City finance administrator Roy Goodman

Goodman called for a private research organization to undertake a study of rating agency quality and practices. He also suggested that cities, banks, institutional investors, and securities dealers should join forces to finance a new bond rating service "free from political interference and conflict of interest." The service, he said, should use computers and other modern tools that the current rating agencies cannot use because their business in "unprofitable" and they lacked the resources to modernize.

John K. Pfeiffer, head of S&P's municipal department, responded to Goodman's proposals by saying that "If he has any better criteria for arriving at ratings he should let us know." Moody's Reihle said Moody's would welcome such a service. Several groups, including the Brookings Institution, were said to be considering setting one up, but nothing came of it.

The hearings continued intermittently through the end of 1968. Observers, including a 20th Century Fund group set up to study the municipal ratings business, later agreed that the hearings provided "an unusually detailed review of the [rating] system and its impact on the market." But none of the legislation proposed in Congress was enacted and no specific recommendations for improving the bond rating system were made.

The rating agencies, however, did respond. In a later interview, Claire Cohen, who had been a D&B municipal bond analyst at the time, recalled that the congressional hearings "determined that rating agencies had inadequate personnel, inadequate funding, and inadequate coverage of small communities." She added that "The only way the agencies could do their job responsibly was by charging for the ratings."

## RATING FEES AND REFINEMENTS

On January 24, 1968, Standard & Poor's placed full-page ads in financial news media announcing that it would begin to charge for municipal ratings, at a rate of between $500 and $2,500 per bond. The agency cited growing losses from its subscriber-supported ratings operation, stemming mainly from the rapid growth of municipal bond issuance. The S&P ad further acknowledged that "revenue derived

*The Wall Street Journal*, January 24, 1968

### *Standard & Poor's Will Charge to Rate New Municipal Issues*

**Firm Asserts Revenue From Service Never Met Costs; Moody's Keeps Free Grading**

*By a* WALL STREET JOURNAL *Staff Reporter*

NEW YORK—After March 1, Standard & Poor's Corp. will rate new municipal issues

our ratings has never covered the cost of supporting the staff required." The new policy is "a step forward in providing more expert service to the municipal bonds industry," the statement continues.

Moody's Investment Service Inc., the other major rating concern, doesn't charge municipalities. Bond men say they rely more heavily on Moody's ratings than on Standard & Poor's and find Moody's letter grades to be the more conservative of the two.

Brenton W. Harries, vice president of Standard & Poor's, said the company lost $150,000 to $200,000 on its municipal rating service in 1967. He explained that S&P chose to charge for the service rather than withdraw all together. Moody's policy precludes rating certain



from our published services that carry our ratings has never covered the cost of supporting the staff required."

S&P noted that annual issuance of tax-exempt bonds had risen to a record $14.2 billion in 1967, up from just $2.9 billion in 1949, the year the agency began rating municipals. S&P vice president Breton Harries said that the company lost $150,000 to $200,000 on its municipal rating service in 1967. The agency chose to charge for the service, he added, to avoid withdrawing from the market altogether.

The S&P ad stated further: "Our basic procedure will be the same, but more time will be spent on arriving at a rating. Rating charges will be contingent on complexity, not size of issue. We will start to operate the way lawyers do and be paid for time spent on analysis."

At the time, some bankers worried that bond issuers would only use Moody's free ratings; but word on the Street was that Moody's would charge, too. Roy Goodman commented, "It isn't the number of services, but the quality of the ratings."

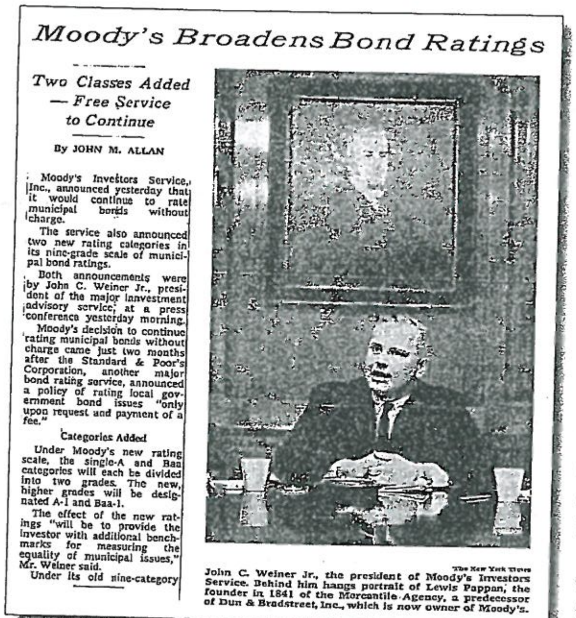
Sentiment was then strong at Moody's against any move to break from the long-standing practice of offering ratings purely as a public service, particularly among those who had started with the firm before its acquisition by D&B. At the same time, management was keenly aware of the need to respond to growing market demands and government pressures for improvements in the rating system.

Many bankers felt that the agencies should upgrade municipal rating services by employing more analysts. One among them was George E. Barrett, Jr., a vice president at New York's First National City Bank. Quoted in a *Wall Street Journal* article on January 2, 1968, however, he expressed a different priority for the rating agencies. "They do a tremendous job within their economic limitations," he said, "but I wish there was a way to cover finer gradations."

John C. Weiner, Jr. was president of Moody's from June 1967 to mid-1969. He joined the firm as a senior investment counselor in 1956 and served as executive vice president in 1965 to 1967.

Barrett was echoing sentiments of both municipal bond buyers and bond sellers, who had requested finer rating gradations in the A and Baa range. They pointed to the fact that some 85 percent of municipal bonds were rated in those categories. Further, because many banks and other institutions were prohibited by internal guidelines or government regulations from investing in bonds rated speculative grade (that is, below Baa), there was a growing need for better understanding as to where each issuer stood relative to a potential downgrade below investment grade status.

On March 25, 1968, Moody's president John C. Weiner, Jr. announced that Moody's would continue to rate municipal bonds without charge (except in the case of small private placement issues, which both agencies had long rated for a fee on request). Weiner also announced that Moody's would refine its A and Baa municipal rating categories by adding a "1" to distinguish better credits (i.e., A1 and Baa1). S&P added similar refinements in September. S&P also initiated a continuing effort



# Moody's Broadens Bond Ratings

*Two Classes Added — Free Service to Continue*

By JOHN M. ALLAN

Moody's Investors Service, Inc., announced yesterday that it would continue to rate municipal bonds without charge.

The service also announced two new rating categories in its nine-grade scale of municipal bond ratings.

Both announcements were by John C. Weiner Jr., president of the major investment advisory service, at a press conference yesterday morning.

Moody's decision to continue rating municipal bonds without charge came just two months after the Standard & Poor's Corporation, another major bond rating service, announced a policy of rating local government bond issues "only upon request and payment of a fee."

Categories Added

Under Moody's new rating scale, the single-A and Baa categories will each be divided into two grades. The new, higher grades will be designated A-1 and Baa-1.

The effect of the new ratings "will be to provide the investor with additional benchmarks for measuring the equality of municipal issues," Mr. Weiner said.

Under its old nine-category

The New York Times

John C. Weiner Jr., the president of Moody's Investors Service. Behind him hangs portrait of Lewis Pappan, the founder in 1841 of the Mercantile Agency, a predecessor of Dun & Bradstreet, Inc., which is now owner of Moody's.

Moody's did not follow S&P in charging for bond ratings in 1968, but it did respond to investor requests for finer rating gradations. On March 25, Moody's president John C. Weiner announced that the agency would add a 1 to its A and Baa ratings to identify better credits in those categories as warranted.

to upgrade and mechanize its rating procedures, especially through computer applications.

In December of the same year, The Investment Bankers Association published a study of municipal ratings that was generally complimentary of both Moody's and S&P. Overall, the study concluded, "the agencies have so conducted themselves that their rating systems viewed as a whole have earned the respect accorded them." The study cautioned, however, that investors should not be over-reliant upon municipal bond ratings, and called on the agencies to establish clear methodologies and standards for their rating assignments.

The study also warned that there was a need for diversity of opinion from at least two if not more rating agencies. It was widely feared, according to the report, that S&P's municipal rating operation would not last, again leaving Moody's with a monopoly.

## MOODY'S MUTUAL FUNDS

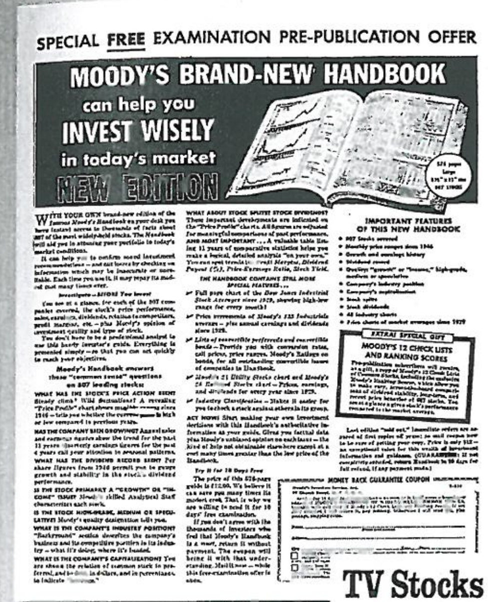
Among the advantages of Moody's new position as part of Dun & Bradstreet was the added impetus from its parent for entering new lines of revenue-generating business and building up existing lines. Accordingly, a publication called *Moody's Insurance Stock Survey* was introduced in 1965 as a complement to *Moody's Stock Survey.* The next year, *Moody's Creative Analysis*, a computerized service for investment research, was introduced. Both services proved ill-timed, however, and were quickly abandoned.

Nevertheless, Moody's revenues more than doubled during the 1960s, reaching the $12 million mark by the end of the decade. The growth was spurred by a continuing rise in bond issuance and expansion of the financial markets generally, which fueled demand for Moody's manuals, weekly surveys, and especially its stock

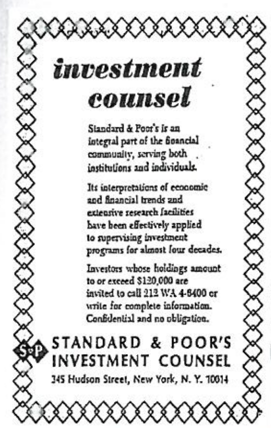


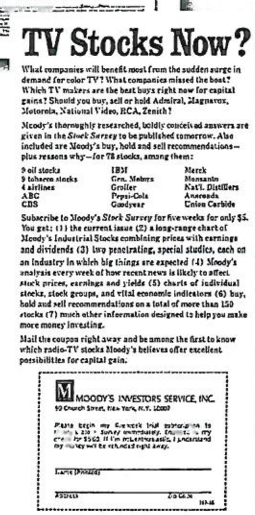
## RATING AGENCY ADVERTISING IN THE 1960S

AS THE U.S. STOCK MARKET continued to rise through the mid-1960s, Moody's services and advertising were geared increasingly toward individual investors. All the ads shown here appeared in the *New York Times* between 1962 and 1965. Many ads were designed to attract subscribers to *Moody's Handbook of Common Stock* and *Moody's Stock Survey.* Some featured opportunities in "hot" sectors, such as TV stocks. The ad for Moody's Insurance Stocks only ran in 1962, since the service was introduced and discontinued that year. During the same period, both Moody's and S&P ran ads in the *Times* promoting their investment counseling services.








Holland B. Idleman was president of Moody's from 1963 to June 1967. He served briefly as chairman in 1969.

handbooks. The latter, targeted at individual investors, were frequently advertised in The *New York Times*. (See box facing page.)

Moody's revenues were also being supported by the personalized advisory services that Moody's had built up since the 1930s. It was in this area that Moody's managers saw the greatest growth opportunity, not only by expanding the firm's investment advisory services, but by going into the business of managing money.

*Moody's Considers Going Into Mutual Fund Field*

By a WALL STREET JOURNAL Staff Reporter

NEW YORK—Moody's Investors Service, a subsidiary of Dun & Bradstreet Inc., is considering going into the mutual fund field.

Holland B. Idleman, Moody's president, said the step "would be a very logical move in rounding out" the concern's "present line of investment advisory services." He indicated that the company hadn't decided whether it might acquire an existing fund or start a new one.

A mutual fund pools the money of investors and in turn invests those funds in securities. Technically known as an open-end investment company, it stands ready to redeem outstanding shares when presented by the investor.

Moody's issues ratings on the quality of securities and publishes descriptive handbooks about corporations' finances.

*The Wall Street Journal*, November 11, 1966

In November 1966, Moody's president Holland B. Idleman announced that Moody's was eyeing entry into the mutual fund field. He said the step "would be a very logical move" in rounding out the agency's existing line of investment advisory services. He added that Moody's was registered with the SEC as an investment advisor and planned to enter the business by acquiring an existing fund or starting a new one. Implementation of those plans moved quickly.

In March 1967, the $85 million Lazard Fund Inc. said it was planning to merge into Moody's. Raymond Troubh, an associate of Lazard Freres, which was serving as the fund's investment advisor, said that Lazard wanted to make the fund open-ended but did not want to create the sales organization necessary for continuous offering. That function would be handled by Moody's.

*The Wall Street Journal*, March 27, 1967

Lazard Fund Planning To Merge Into Moody's

Terms of Proposal Not Disclosed; $85 Million Lazard Fund Will Be Open-Ended if Approval Is Given

By a WALL STREET JOURNAL Staff Reporter

NEW YORK—Lazard Fund Inc., an invest-
nt management firm, said it is planning to
rge into Moody's Investors Service Inc.
ller, there had been reports the two were
ussing a merger.
aymond Troubh, an associate of Lazard
s,' which serves as the investment ad-
of the Lazard Fund said, "For some time
been obvious to us that the interest of
reholders of Lazard Fund would best
ed by having the fund open-ended with
uous offering of its shares and an op-
for its shareholders to participate in
purchase and dividend reinvestment
have made that decision and don't
reate the sales organization neces-
continuous offering of Lazard Fund

end fund stands ready to redeem
all times. Mr. Troubh said Lazard
n talking to Moody's for about a
uldn't comment on terms of
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A proposed new issue of Moody's Fund Inc., a no-load, growth and income fund, had already been announced in January 1967; it was launched on May 1. Around the same time, the Lazard Fund, a no-load growth fund, was renamed Moody's Capital Fund Inc. In June, Moody's ran ads in financial media announcing that shares in both funds "can now be sold by investment dealers to the public." Information and prospectuses were available from Moody's Advisors & Distributors, Inc., a new unit set up to provide management and services for the funds. William I. LaTourette was president of both Moody's funds, and both were managed by former Lazard Fund manager Ronald E. Dinsmore.





## MOODY'S MUTUAL FUNDS

IN NOVEMBER 1966, Moody's president Holland B. Idleman announced that the agency was considering a move into the mutual fund business. Moody's Fund Inc. was announced the following January and tombstone ads for the new offering ran several times thereafter. The Lazard Fund announced in March that it would merge into Moody's, with the result that Moody's Capital Fund was launched a few weeks later. Both funds were available from Moody's Advisors & Distributors by June of 1967.

*A registration statement relating to these securities has been filed with the Securities and Exchange Commission but has not yet become effective. These securities may not be sold nor may offers to buy be accepted prior to the time the registration statement becomes effective. This advertisement shall not constitute an offer to sell, or the solicitation of an offer to buy, nor shall there be any sale of these securities in any State in which such offer, solicitation, or sale would be unlawful prior to registration or qualification under the securities laws of any such State.*

PROPOSED NEW ISSUE

2,000,000 Shares

MOODY'S FUND, INC.

Capital Stock

(Par Value $1)

INVESTMENT OBJECTIVES

Moody's Fund, Inc. is a diversified investment company with the primary objective of providing a reasonable return from securities of good quality. While emphasis will be on income, the search for sound opportunities for possible growth of capital will also be an important consideration.

Proposed offering price $15 per share

The proposed offering price on single transactions of less than $25,000 is $15 per share of which 8.5% represents underwriting commissions.

*A copy of the Preliminary Prospectus describing the Fund may be obtained from each of the undersigned as may lawfully offer these securities in this State by writing or using the coupon below.*

| Kidder, Peabody & Co. Incorporated 20 Exchange Place New York, N. Y. 10005 | Paine, Webber, Jackson & Curtis 25 Broad Street New York, N. Y. 10004 | Shearson, Hammill & Co. Incorporated 14 Wall Street New York, N. Y. 10005 |
|---|---|---|

Gentlemen: Please send me a Preliminary Prospectus describing Moody's Fund, Inc. W

Name.............................................

Address..........................................

.......................................Tel...............

MOODY'S CAPITAL FUND, INC.

and

MOODY'S FUND, INC.

Shares in these mutual funds can now be sold by investment dealers to the public. Information and prospectuses are available from Moody's Advisors & Distributors, Inc., 28 Park Place, New York, N. Y. 10007.

June 21, 1967

## SAVING MOODY'S

Anyone familiar with Moody's current operations will know that the firm would not stay in the mutual fund business for long. In fact, the venture only lasted two years.

The Moody's funds turned in poor performance in 1968, at a time when net asset values of most mutual funds were rising. In early 1967, LaTourette resigned and Moody's president J. C. Weiner assumed presidency of both funds. Dinsmore was named executive vice president of Moody's Advisors & Distributors.

In 1969, D&B decided that Moody's would abandon the investment management business altogether, a move that did not sit well with several Moody's managers. Weiner, who had served as Moody's president since 1967, believed the change of direction was a mistake and left the company to open his own investment advisory firm (JCW Investments). Several managers decided to stay on with Moody's investment advisory operations as they were sold off to other firms. But one well-respected analyst, Albert C. Esokait, decided to stay with Moody's, where he became senior vice president and head of Moody's corporate rating activities.

**In 1969, D&B decided that Moody's would abandon the investment management business altogether, a move that did not sit well with several Moody's managers.**

As these changes were occurring, Holland Idleman returned briefly to serve as Moody's chairman. He soon decided to accelerate his retirement plans as it became certain that Moody's investment counseling business would be sold. To fill the gap in upper management, George E. Keefe, the D&B Senior Vice President to whom Moody's reported in the late 1960s, took the helm.

On December 29, 1969, Keefe sent out a memo to all employees saying that D&B president Hamilton B. Mitchell had asked him to assume the general management of Moody's. He emphasized that "strong efforts would be made to strengthen and enlarge the scope of other present Moody's services and actively explore possibilities for adding new services."

Looking back in a 1989 interview, Keefe said that that he viewed "the selling off of Moody's Advisors and the new orientation towards publications and ratings as a positive step that saved Moody's from bankruptcy."

D&B had begun to realize, he explained, that "it simply did not have the amount of money that would have been required to gear up Moody's advisory services and funds to compete with the large Wall Street brokerage houses." Also, new officers at D&B saw a potential conflict of interest between rating bonds and managing money. "We thought it would be a sticky situation and decided to opt out," said Keefe.

Overall, Keefe attributed the impetus for the changes at Moody's to Hamilton





### Smith-Barney Equity Fund Plans Acquisition

**Share Swap for Moody's Capital Fund's Assets Set; Both Are No-Loads With Growth Goals**

*By a* WALL STREET JOURNAL *Staff Reporter*

NEW YORK — Moody's Capital Fund Inc. and Smith, Barney Equity Fund Inc., two no-
load mutual funds with capital-growth
said they agreed in principle for Smith,
Equity to exchange its shares for
Moody's Capital Fund's assets.

The exchange would be based on th
tive net asset values of the two funds wi
agreement is closed. Last Sept. 30, the
fund had $30.2 million in assets and the
Barney fund $46 million. Final terms a

ject to approval by directors and shareholders of each fund.

Moody's Advisors & Distributors Inc., a unit of Dun & Bradstreet Inc., said it is withdrawing as investment manager of Moody's Capital Fund Inc. and also of Moody's Fund Inc., another no-load fund with $5 million in assets. Moody's Fund directors said they would recommend to shareholders as a new investment manager Smith, Barney Advisors Inc., a subsidiary of Smith, Barney & Co. and investment manager for Smith, Barney Equity Fund.

### Donaldson-Lufkin Unit Buys Counseling Service From Dun & Bradstreet

**Former Partner of State Street Research Will Head Moody's Alliance; Another Plan Ended**

*By a* WALL STREET JOURNAL *Staff Reporter*

NEW YORK—Donaldson, Lufkin & Jenrette Inc. said its new subsidiary, Moody's Alliance Capital Corp., completed the previously proposed acquisition of the investment counseling business formerly conducted by Moody's Investors Services, owned by Dun & Bradstreet Inc.

Peter H. Vermilye, formerly a partner of State Street Research & Management Co., Boston, was named president and chief executive officer of Moody's Alliance.

Agreement in principle between Donaldson-Lufkin and Dun & Bradstreet was announced last October. It has been learned that plans have been abandoned for the securities firm to acquire the distribution and management services of Moody's Advisors & Distributors Inc., a subsidiary of Moody's Investors.

Donaldson-Lufkin officials wouldn't comment on the change in plans and Moody's Advisors couldn't be reached for information about whether it intends to sell the distribution and management services to another buyer.

Donaldson-Lufkin declined to disclose the terms of the acquisition or other details of the transaction, because the firm is currently in registration with the Securities and Exchange Commission in connection with its decision to offer its shares to the public.

According to the announcement, Moody's Alliance will operate from existing offices in New York, Chicago, Los Angeles and San Francisco, and a newly opened office in Boston.

Moody's Investors also publishes Moody's Manual in several versions and various surveys and reports covering stocks and bonds. The agreement with Donaldson-Luftkin didn't cover these publishing activities.

### MOODY'S EXITS THE MUTUAL FUND BUSINESS

DUN & BRADSTREET decided in 1969 that Moody's should get out of the mutual fund business. Moody's funds had performed poorly in an up market and there was concern over the conflict of interest between the agency's fund operations and its rating activities. The investment counseling portion of the business was sold in 1970 to a Donaldson, Lufkin & Jenrette subsidiary that later became Alliance Capital. The funds themselves were acquired by units of Smith, Barney & Co.

Mitchell, to whom he wrote: "Your decision to reorganize Moody's was perceptive and courageous. And the support that you gave me in carrying on with the plan was largely responsible for the successful results."

## MOODY'S ALLIANCE CAPITAL

What turned out to be the difficult job of unwinding Moody's investment management business fell to Keefe, and to D&B vice president and general counsel Richard D. Simmons.

In October 1969, Donaldson, Lufkin & Jenrette Inc. (DLJ) and D&B agreed in principle for the brokerage house to buy Moody's investment counseling services. In an announcement, DLJ said the acquisition would help the firm to offer services to Moody's clients in the under-$5 million bracket.

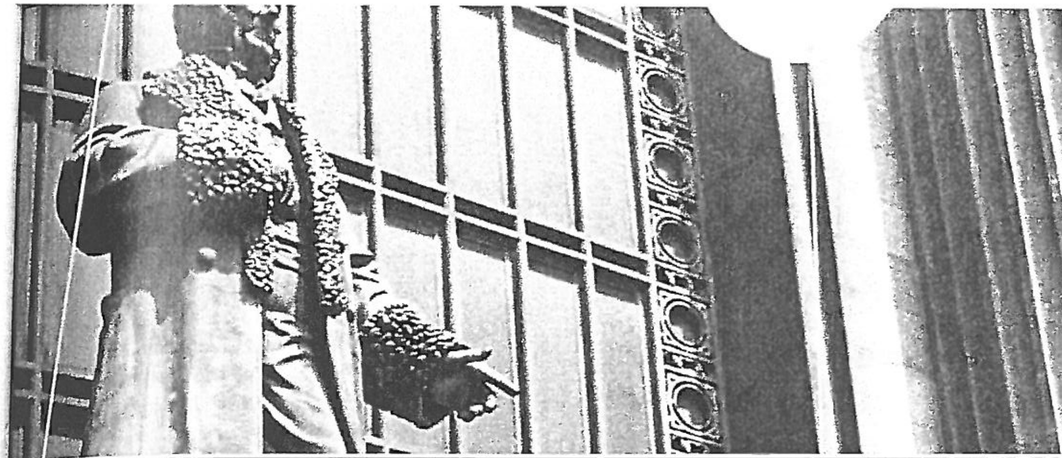
In January 1970, DLJ announced that it had set up a new subsidiary, Moody's Alliance Capital Corporation, which had completed the acquisition of Moody's investment counseling business for an undisclosed amount. Peter H. Vermillye, formerly a partner of State Street Research & Management, Boston, was named president and CEO of Moody's Alliance. The firm would soon change its name to Alliance Capital.

Although D&B had made a firm decision to get out of the mutual fund business, both Moody's funds continued to operate at a loss for several years. In October 1971, an agreement was finally announced that Moody's Capital Fund Inc. was to be merged into Smith, Barney Equity Fund, Inc.—the former with assets of some $30 million, the latter about $46 million. Both were no-load funds with similar growth objectives.

At the same time, directors of Moody's Fund Inc. (then with some $5 million of assets) announced that they would recommend to shareholders that Smith, Barney Advisers, Inc. be appointed to succeed Moody's management.

As all this was going on, both Keefe and Simmons were serving on the boards of directors of the Moody's funds. In the meantime, Keefe had much else to worry about at Moody's, where the year 1970 turned out to be a very eventful one.





CHAPTER SEVEN

# PENN CENTRAL

*The Enron of the Seventies (1970–1977)*

*Overleaf:* Former New York City Mayor Robert Wagner joins Jacqueline Onassis beneath a statue of Cornelius Vanderbilt as they and other notables gather outside Grand Central Terminal for a rally to keep the famous station from being torn down.

Penn Central Railroad, which owned the property, had declared bankruptcy in June of 1970, thereby defaulting on $2.6 billion of long-term debt. The company wanted to erect an office tower on the site to help recoup its losses and repay its debts.

No tower was built above Grand Central; but for bondholders, the Penn Central default would be a wake-up call similar to that following the Enron crisis of 2001. The event would lead to a renewed focus on credit risk by capital market participants, and it would stimulate a new level of professionalism across the rating industry.

FOR THE U.S. capital markets, and particularly for the rating agencies, the decade of the 1970s opened with a bang. On June 21, 1970, Penn Central Company, the holding company for Penn Central Transportation Company, operator of the nation's largest railroad, filed for bankruptcy after the U.S. government refused a widely expected bailout.

On the same day, Penn Central and its 28 affiliates defaulted on $2.6 billion of long-term debt, with the result that the default rate for corporate bond issuers spiked to a four-decade high of 2.6 percent in 1970—up from zero in 1969. The operating company also missed payments on $82 million of commercial paper notes.

Ratings-wise, Moody's was in the clear. Bonds issued by the Penn Central entities were rated in the lower speculative grades well before default, and Moody's was not then in the business of rating commercial paper. The problem was that, through May 1970, a Moody's sister-company, D&B's National Credit Office (NCO), had a "prime" rating on commercial paper issued by Penn Central Transportation Company. The rating, NCO's highest, had only been "reserved" three weeks before Penn Central's bankruptcy filing, leaving investors with positions made before that time with defaulted notes. Compounding NCO's problems, two additional firms rated "prime" by NCO—Four Seasons Nursing Centers of America and King Resources Company—fell into payment difficulties shortly after the Penn Central crisis.

Meanwhile, Standard & Poor's—the only other company then providing commercial paper ratings—had lowered its Penn Central rating below prime status just a few days before the crisis. However, because S&P had begun rating commercial paper in 1969 and had only 27 ratings outstanding when Penn Central defaulted,

**Penn Central Files Bankruptcy Petition For Rail Unit After U.S. Reneges on Aid**

**Division to Be Reorganized, Operations Will Continue; Other Arms Not Affected**

A WALL STREET JOURNAL *News Roundup*

Penn Central Co. filed a bankruptcy petition covering its railroad subsidiary, Penn Central Transportation Co., operator of the nation's largest rail line.

Penn Central's directors emphasized that the petition relates solely to the railroad subsidiary and doesn't apply to the parent company or to the Pennsylvania Co., another subsidiary that manages Penn Central's extensive real estate interests, nor to the company's many other affiliated and subsidiary companies.

The petition was filed in Federal court in Philadelphia, and Judge C. William Kraft Jr. signed the order approving the petition. The action was taken under Section 77 of the Bankruptcy Act. Unlike some bankruptcy actions, which contemplate liquidation, this procedure provides for a reorganization of the company and continuance of its operations.

The court order permits the transportation company to retain possession of its properties, to continue operation of the railroad system and to conduct other business, pending the appointment of trustees by the court. The trustees must be approved by the Interstate Commerce Commission.

Directors of the Penn Central said the action was taken "because of a severe cash squeeze" and inability to acquire additional working capital.

**Plan Was Abandoned**

The Penn Central's cash crisis stems largely from the Government's refusal last Friday to guarantee massive loan aid for the troubled concern. The Administration had abandoned its plan to guarantee $200 million of

it's doubtful that the railroad can raise any new money.

A Federal judge, before selecting trustees, must give 15 days notice of a hearing and then after selecting the ... proval from the IC... days notice of a h... cess takes as long... mean a two-month... ing.

In the meantime... road just has to pr... bills promptly."

The railroad nor... lion a day in freigh... has slowed down, t... shippers have stret...

It is understood... road doesn't plan t... with other railroads... wasn't immediately... these charges wou... Central expects to ... terline charges co... have to pay out.

An added probl... wary of Penn Centr... traffic away from t... more its much nee...

Nixon Adminis... bowing to Congres... down the loan guar... prehensive about t... tion, particularly ... community.

"We'll just have ... cial said. He added that ... banks aren't in danger of being seriously injured, there may be "serious repercussions" in the commercial paper market. One Government authority cautioned that this "object lesson" might make it especially difficult for railroads and other transportation companies to raise funds through such short-term notes in the future.

Eugene F. Schenk, president of the National Credit Office of Dun & Bradstreet Inc., said

wasn't proper for the Federal Government to try to "bail out" particular private companies that happened to be in financial trouble, that there was "a good chance" the Government ...

... the blame for the effort's failure on partisan political opposition. If the Defense Department had gone ahead with guaranteeing the initial $200 million bank loans, one official surmised, the temptation to "leave us out on a limb" might well have become overwhelming to Congressional Democrats. They probably would have delayed the legislation to permit further

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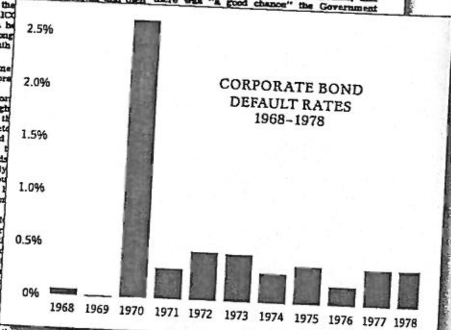



*The Wall Street Journal,* June 22, 1970



critical attention turned to the D&B failure. "Second guessing investment advisers is an old game," wrote *Wall Street Journal* reporter David McClintick, "but questioning the reliability of Dun & Bradstreet ratings is something new."

D&B then had commerciel credit ratings on 2.8 million companies in the U.S. and Canada, from General Motors to the corner drugstore, while its NCO unit maintained commercial paper ratings on 653 firms when the Penn Central crisis broke. D&B managers said that NCO was "taking steps to review every case and redouble all precautions."

**The Credit Checkers**

**Critics Claim Ratings By Dun & Bradstreet Sometimes Are Faulty**

**Penn Central Notes Received Highest Classification; Service Defends Accuracy**

**Importance of Fast Reports**

By DAVID MCCLINTICK
*Staff Reporter of* THE WALL STREET JOURNAL

It looked like a good investment to the University of Kentucky. The Penn Central Transportation Co. had been having some problems. But the university's investment adviser liked the Penn Central's commercial paper, or unse-

*The Wall Street Journal* August 13, 1970

## NO MORE "PENN CENTRALS"

Congressional hearings—the first ever to address the quality of credit ratings on the corporate side of the business—began shortly after the crisis, and soon revealed NCO's incompetence. A chastened NCO continued to provide commercial paper ratings for a year after the Penn Central default, but behind the scenes NCO and Moody's were working together to develop an improved service.

Still shaking off strong criticism, D&B announced at the end of August 1971 that it had merged National Credit Office into Moody's to form the NCO-Moody's Commercial Paper Division of Dun & Bradstreet. The new division reported directly to George Keefe, and Keefe was told that profitability and market share were decidedly secondary considerations. There were to be no more "Penn Centrals."

**Dun & Bradstreet to Revise Commercial Paper Ratings**

*By a* WALL STREET JOURNAL *Staff Reporter*

NEW YORK – Dun & Bradstreet Inc. said it's bringing out new rating classifications for commercial paper. The company's still shaking off criticism of its "prime" rating for the paper of the Penn Central Transportation Co. unit of Penn Central Co., just prior to the railroad going into bankruptcy proceedings.

The concern's NCO-Moody's Commercial Paper Division said it will begin breaking "prime" paper into prime-1, prime-2, and prime-3. It will continue the "not rated" category for paper that doesn't meet usual standards. Until now

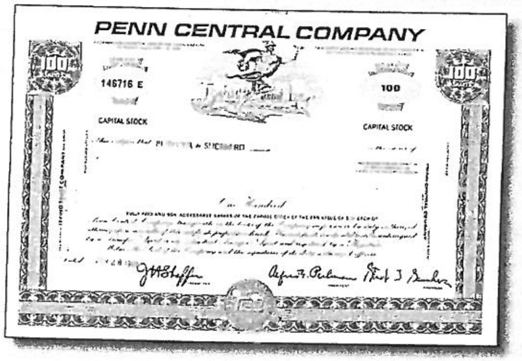
*The Wall Street Journal* August 31, 1971

Keefe had a close familiarity with the commercial paper markets and NCO's ratings failure. He had been with D&B since 1931 and for several years was responsible for overseeing NCO's operations. Now at Moody's, he got support to invest heavily in the new unit (soon to become Moody's Commercial Paper Department).

Keefe began bringing in a new team of analysts, mainly from D&B's commercial credit division, to help improve Moody's commercial paper and corporate bond rating activities. Included were Samuel Gordon, Thomas Williams, Frederick Pastore, James Bray, John Niebhur and many others who would become fixtures at Moody's over the next decade and beyond. Working with Sam Gordon, Keefe introduced a new set of symbols and new analytics for commercial paper beginning in 1972. He saw to it that analysts working on the new system clearly understood where their

### THE PENN CENTRAL DEFAULT

SHOCK WAVES were felt across the capital markets when Penn Central Company, operator of the nation's largest railroad, filed for bankruptcy in June of 1970. The company and its affiliates defaulted on $2.6 billion of bonds and $82 million of short-term notes (commercial paper). As a result, the US corporate bond default rate for 1970 shot above 2.6 percent, more than 50 times higher than its 0.05 percent average over the previous quarter of a century.




Moody's had rated Penn Central bonds speculative grade well before the default and did not then rate commercial paper. But Moody's sister company National Credit Office had its top rating on Penn Central's short-term notes days before the company filed for bankruptcy. After severe criticism from investors and Congress, the D&B unit was merged into Moody's—and a new era of improved credit rating standards began at Moody's and across the ratings industry.

interests lay. And for most of the remainder of the decade, he oversaw and personally approved (or disapproved) all of Moody's commercial paper rating actions.

NCO had rated commercial paper on a five-tier scale—"prime" if the issuer's capital funds (assets minus liabilities) exceeded $25 million, "desirable" if capital funds exceeded $10 million, "satisfactory" if funds were above $5 million. Companies were rated "fair" if not solid enough to merit the first three rankings, and "not recommended" below that. The ratings were assigned by a single analyst who, owing to disability, worked out of his home in Westchester County, north of New York City. NCO charged issuers $100 annually for each rating.

Moody's new system was simpler. It did away with the earlier designations and instead broke the "prime" rating in to three categories—Prime-1, Prime-2, and Prime-3—adding a fourth category, Not Prime. Key to the system, the Not Prime designation is intended to signal that an issuer so rated is unlikely to have sufficient cash or alternative financing strategies available to meet all of its short-term debt in a pinch, including commercial paper. The other three categories rate the issuer's ability to finance short-term debt repayment under conditions of financial stress, with Prime-1 being the safest category.

Keefe's overriding aim was to create a system whereby Prime-rated issuers





would never default on commercial paper. On its face, that would seem too tall an order. Nevertheless, the system has worked reasonably well. In cases where an issuer's rating declines toward Not Prime, the borrower is generally priced out of the short-term markets, soon leaving no commercial paper to default. In fact, as billions, then trillions of dollars worth of commercial paper has flowed through the U.S. and global markets each year, very few Prime-rated issuers have defaulted.

According to a recent Moody's study, a worldwide total of 52 corporate issuers defaulted on approximately $6 billion of commercial paper between 1972 and 2004. Thirty-four of those issuers were not rated by Moody's. Of the remaining 18 defaulting issuers, 12 were rated Not Prime; only six were rated in one of the Prime categories at the time of default. Over the same 35-year period, Moody's assigned ratings to more than 3,500 issuers of commercial paper. (See "Short Term Rating Performance and Commercial Paper Defaults, 1972–2004" *Moody's Special Comment*, 2004.)

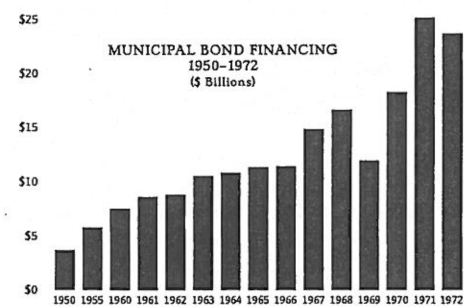
Prime-1
Prime-2
Prime-3
Not Prime

Moody's introduced its Prime/Not Prime commercial paper rating system in 1972. The same symbols were later used to rate all forms of short-term corporate debt.

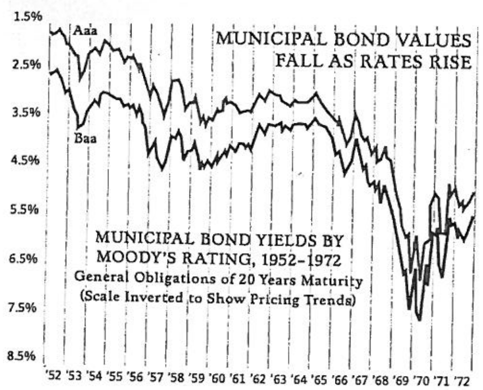
## GEORGE KEEFE: "AN ORIGINAL PIECE OF WORK"

When George Keefe took over as head of Moody's in December 1969, his principal challenge was to improve the firm's profitability despite the rising costs of providing ratings. In the corporate bond market, issuance had been running at high levels through the end of the 1960s. But in 1970 new issue volumes would rise to a record $22.4 billion, up from $13 billion a year earlier. As a result, the amount of unpaid work Moody's was obliged to do in rating corporate bonds almost doubled.

Issuance in the municipal market was also strong, rising to nearly $18 billion in 1970, up from around $8 billion in 1960. At the same time, inflation and migration out of cities to the suburbs were pressuring municipal credit strength, making the rating process more difficult and time consuming. A sharp rise in interest rates also increased municipal bond financing costs, making their link to credit ratings all the more obvious, and controversial. Rates




Issuance of municipal bonds in the U.S. markets rose sharply during the late 1960s, placing a strain on rating agency analytic staff. After a hiatus in 1969, issuance continued to mount in the early 1970s.




Bond prices plummeted as municipal yields rose sharply beginning in 1965. That, coupled with rising financing needs, strained the credit quality of municipalities across the United States. It also added to the challenges and costs of monitoring municipal ratings.

on Aaa-rated municipal bonds, for example, rose to 6.5 percent in 1970, more than double their levels just three years earlier. (Prices of municipal bonds dropped in tandem—see chart at left.)

As a result, although Moody's revenues continued to rise to $13 million in 1970, the company finished the year with a net loss of $2.4 million. Keefe saw the problem coming, and within a few months of his arrival at Moody's, had focused his energies on finding a solution.

George Keefe, said Richard D. Simmons, the D&B lawyer then working with Keefe on the sale of Moody's mutual funds, was "an original piece of work." In his 2005 autobiography, *Post Mortem*, Simmons recalls that Keefe "*was* Moody's to anyone within the larger corporation." Working for him, Simmons adds, "was like World War II. You'd hate like hell to have missed it, but you sure wouldn't want to go through it again."

In fact, though it may have seemed otherwise to Simmons, during most of the decade that he was associated in one way or another with Moody's, it was Keefe who reported to him. Keefe would be named president of Moody's in August 1971. Three years later, Simmons, then just 38 years old, would succeed Keefe as president. When John A. Brenner became president in 1976, Simmons moved back to D&B and assumed responsibility for overseeing Moody's operations for several years before he moved on to become president of *The Washington Post*. Meanwhile, Keefe had continued on with Moody's, first as chairman, then as a consultant to Moody's, reporting to Simmons until his retirement in 1979.

During all that time, Simmons recalls, he learned a great deal from George Keefe:

> He trained me to probe, to question, to never be satisfied with some broadly generalized response to a question and, actually, to never be satisfied with less than the best. George, more than any other person . . . made me a business man. Perhaps not one who would win any popularity contests (except, strangely, with some of my closest associates in later life) but one who knew how to make a buck and grow a company.

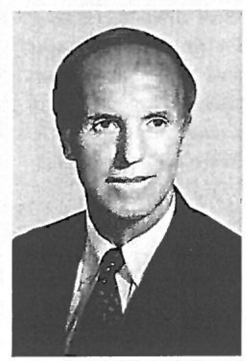




## MOODY'S PRESIDENTS IN THE 1970s

**George E. Keefe** assumed general management of Moody's in 1969 while still serving as the executive vice president at D&B, to whom Moody's reported for most of the late 1960s. A thirty-year veteran of D&B, Keefe was named president of Moody's in 1971. He was Moody's chairman from 1973 to 1975, then remained a consultant to the agency until his retirement in 1979. Under Keefe, Moody's tightened its focus on credit rating and began charging fees for bond ratings in 1970.

**Richard D. Simmons** served as Moody's president from 1973 to 1975. Moody's reported to Simmons when he was a D&B executive vice president through the early 1980s, when he moved to The Washington Post Company, where he served as president through 1991. While serving as D&B General Counsel in the early 1970s, Simmons played a central role in extending Moody's ratings to the Eurobond markets.



**John D. Lockton** was Moody's president in 1976 during the height of New York City's financial crisis.

**John A. Brenner**, Moody's president from 1976 through 1981, did much to build up the firm's computer support operations.

## CHARGING FOR MUNICIPAL BOND RATINGS

Among Keefe's first steps at Moody's was to begin charging for municipal bond ratings. In April 1970, following S&P's move two years earlier, he announced that Moody's would charge a rating fee for new municipal issues effective May 15. For general obligation bonds, fees ranged from $600 to $1,350, depending mainly on the size of the community. For municipal revenue bonds, charges ranged between $850 and $2,500, depending on the work involved.

*The New York Times,*
April 16, 1970

**MOODY'S RATING FEE ON TAX-EXEMPTS SET**

Moody's Investors Service, Inc., the oldest and largest securities-rating agency, announced yesterday that it planned to charge for rating new tax-exempt bond issues starting May 15.

The company, a subsidiary of Dun & Bradstreet, Inc., will charge fees ranging from $600 to $1,350 to rate the general obligation bonds of states and cities and other local governmental bodies. It will charge from $850 to $2,500 for revenue bond issues.

The fees for general obligations will be based on population; fees for revenue bonds will be based on the amount of work involved in processing the issue.

Moody's has rated bond issues without charge since 1918. The new charge structure will apply only for rating new issues.

o help cover rising analytic costs, Moody's began charging fees for municipal bond ratings in May f 1970. Fees for corporate bond atings were initiated in October the ame year. Both moves were widely ccepted on Wall Street.

With municipal rating fees in place, Keefe looked to D&B's municipal bond rating unit (which was also housed at 99 Church Street) for analytic support. A year later, in August 1971, D&B began the process of merging its municipal bond rating operations into Moody's. Jackson Phillips, who had been with the D&B unit since 1968, was named vice president of Moody's and director of the combined municipal-service operation. Over the next year, Moody's ended the D&B rating service altogether, reducing the available ratings on many municipal bonds from three to two, those assigned by Moody's and those by S&P.


Jackson Phillips

When the reorganization was announced in May 1972, *The Wall Street Journal* reported that Moody's had revamped its municipal bond research division "in an effort to provide more detailed information on state and city bonds." Moody's "new municipal bond research division," as the *Journal* referred to it, then had three sections: one for ratings on new issues, one for rating reviews and research, and one for educational services. At the same time, Moody's said it would review ratings of 600 major municipalities which were frequent borrowers, including New York State and New York City.

## FEES FOR CORPORATE BOND RATINGS

The introduction of rating fees in the corporate sector was a bit more problematic. Congressional investigators had criticized D&B's commercial paper ratings; but there had been no criticism of corporate bond ratings of the kind that had been leveled against their municipal counterparts, and no public outcry for the agencies to improve the quality of analysis in the corporate sector. Nor had any





rating agency yet charged corporate issuers for rating their bonds.

Nevertheless, in late September 1970, Moody's announced that it would start charging for corporate bond ratings beginning October 15, taking in "all taxable bonds, including corporates and U.S.-dollar denominated foreign obligations."

***Moody's to Charge for Corporate Ratings, But Rival Standard & Poor's to Hold Off***

By a WALL STREET JOURNAL Staff Reporter

NEW YORK — Moody's Investors Services Inc., which last May started assessing a fee to rate municipal bond offerings, announced it is going to start charging to rate corporation debt issues as well.

However, Standard & Poor's Corp., its principal rival, said it doesn't have any such plans. "We've considered it and rejected it," Brenton W. Harries, a group vice president of the McGraw-Hill Inc. subsidiary, said.

Ironically, it was Standard & Poor's that first imposed municipal rating fees in March [illegible] porate bond ratings without charge at this time."

At Dun & Bradstreet, commercial paper ratings are handled by National Credit Office, another unit.

Under its new fee policy, Moody's said it will rate issues under a specific agreement with an underwriter in the case of a negotiated offering or the issuer, where competitive bidding is involved.

**May Rate on Its Own**

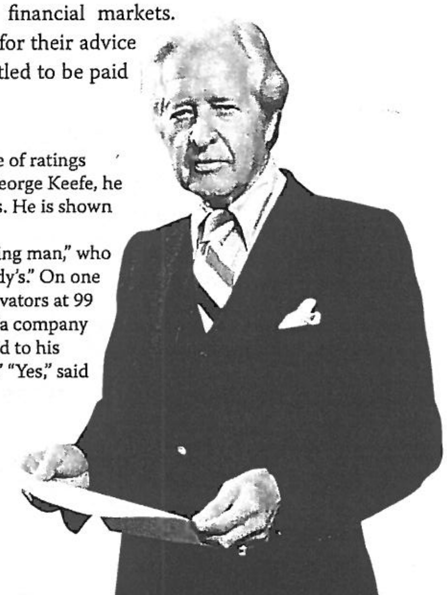
Moody's, though, left open the possibility that it may rate some issues on its own. "If no

*The Wall Street Journal,*
October 1, 1970

Citing the rapid increase in corporate bond issuance, Moody's said that it could not depend on income from publication sales to defray the cost of its evaluations. "The expansion of corporate financing, the more complex aspects of corporate bond rating and problems of recruiting, training and retraining of skilled personnel needed for this effort have contributed to rising costs," Moody's explained. The agency added that rating corporate bonds had become ever harder "due to scientific advances, a large scale expansion of corporate debt, more complex corporate structures and rapidly changing industrial patterns."

In October, Moody's began charging corporate issuers 0.01 percent of the principal amount of each bond offering—from a minimum of $600, for a $6 million issue, to $5,000, for an issue of $50 million or more. The fee was for the work of credit research and distribution of the ratings, which "helped issuers to move their paper."

Surprisingly, the move caused little stir in the financial markets. "Everybody else in the investment community charges for their advice and services, so I certainly believe Moody's is also entitled to be paid



### ALBERT A. ESOKAIT

AL ESOKAIT was Moody's senior vice president in charge of ratings operations beginning in the mid-1960s. Working with George Keefe, he was instrumental in the introduction of issuer rating fees. He is shown here holding Moody's first rating fee application form.

Keefe recalled that Esokait was a "hard and demanding man," who was known — and feared — on Wall Street as "Mr. Moody's." On one occasion, as Keefe told the story, he was in one of the elevators at 99 Church Street as two men entered. One was the CEO of a company rated by Moody's. The other, apparently his assistant, said to his boss: "Gee, you really told that Al Esokait a thing or two." "Yes," said the CEO, "and he told me *more* than a thing or two."

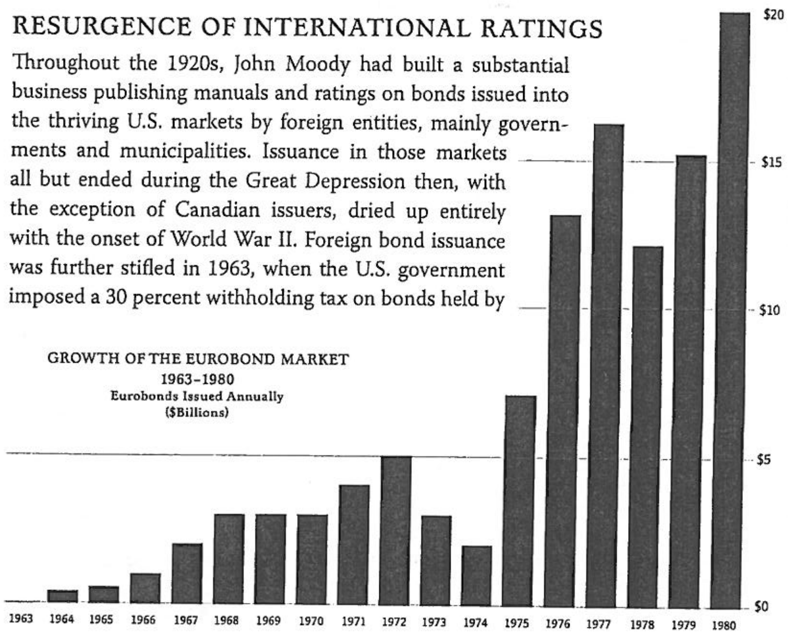
for its work," said Richard C. Dunham, executive vice president of F.S. Smithers & Co. "If the fees enable Moody's to support a sophisticated and up-to-date evaluation of market credits," he added, "it should be of great benefit to both issuing companies and public investors."

In a 1989 interview, George Keefe recalled that he—along with most of the other officers then at Moody's and D&B—viewed the decision to charge as a positive step. "It was the means to finance the analytics that Moody's needed to stay competitive," he explained. "Just charging for the books was not enough." Moreover, said Keefe, "NCO had started charging for ratings years ago and it was never seen as a conflict of interest." He added that "D&B had sold its credit ratings for nearly one hundred years and no stigma ever attached to them."

Asked for its response, S&P said it didn't have any plans to charge rating fees for corporate bonds. "We've considered it and rejected it," said Brenton W. Harries, a group vice president. Nevertheless, S&P extended its practice of charging for municipal bond ratings to the corporate sector in 1974.

## RESURGENCE OF INTERNATIONAL RATINGS

Throughout the 1920s, John Moody had built a substantial business publishing manuals and ratings on bonds issued into the thriving U.S. markets by foreign entities, mainly governments and municipalities. Issuance in those markets all but ended during the Great Depression then, with the exception of Canadian issuers, dried up entirely with the onset of World War II. Foreign bond issuance was further stifled in 1963, when the U.S. government imposed a 30 percent withholding tax on bonds held by




The Eurobond market, consisting of dollar-denominated bonds issued outside the United States, was introduced in 1963. Some $3 billion of new Eurobonds were being issued annually in the late 1960s, before new issuance began to surge in 1975.





non-U.S. residents. The same year, however, saw the formation of the Eurobond market, comprising dollar-denominated bonds sold outside the United States. By the end of the decade, more than 100 Eurobonds were being issued annually, raising around $3 billion each year.

In the market's early years, all Eurobonds were sold without ratings. But in December 1970, Moody's became the first agency to rate Eurobonds when it assigned a double-A rating to a planned $20 million overseas offering of 15-year debentures by Richardson-Merrell Overseas Finance N.V., a foreign subsidiary of the New York-based drug, chemicals, and toiletries manufacturer.

The agency also made it known that it was prepared to rate new and outstanding Eurobonds of other American firms, a move that was welcomed on Wall Street. "It should be a boon both to the U.S. corporate borrowers and to European investors to have the Moody's system available," said an analyst quoted in the *Wall Street Journal* on December 10. The analyst added that "there really hasn't been a reliable yardstick for measuring the quality of [Eurobond] issuers."


*Moody's Begins Rating Some U.S. Issues Abroad*

By a WALL STREET JOURNAL Staff Reporter

NEW YORK — Moody's Investors Service Inc. has begun to rate debt securities offered in Europe by U.S. companies.

In its first such move, the prestigious service, assigned a double-A classification to a planned $20 million overseas offering of 15-year debentures by Richardson-Merrell Overseas Finance N.V., a subsidiary of the New York-based drug, chemicals and toiletries manufacturer. The sale is scheduled later this week.

Moody's said it will rate new foreign offerings of bonds and debentures, provided they are payable in U.S. dollars, of other U.S. concerns. It also will accept requests to grade similar older securities already outstanding, an official added.

The step is expected to lend added stability to the multibillion Eurobond market. "It should be a boon both to the U.S. corporate borrowers and to European investors to have the Moody's system available, as there really hasn't been a reliable yardstick for measuring the quality of issues," one analyst said.

Moody's, a unit of Dun & Bradstreet Inc., first indicated its interest in the Eurobond field early last October, when it instituted a charge for rating corporate bonds offered in the domestic public market.

Officials at Standard & Poor's Corp., another major credit service, couldn't be reached for comment late yesterday.

*The Wall Street Journal*
December 10, 1970

Moody's next significant step into the Euromarkets began in March of 1974. With the support of George Keefe, Richard Simmons, along with Jackson Phillips and Moody's utility analyst Peter Jadrosich, made a trip to Europe to meet with potential rating customers, including representatives of three governments, seven governmental organizations, three municipalities, eleven corporations, and six investment banking firms.

The team returned to New York with formal rating requests from two European issuers and signs of interest from several others. In a memo to D&B management sizing up potential revenues, Keefe concluded that "this could be the most important 'junket' in Moody's long history." It would be another decade until ratings by Moody's or any other agency would even begin to approach the international coverage that John Moody had achieved in the 1920s, but this was an important start.

In June 1974, Simmons, along with Moody's industrials analyst Richard Davis (whom Simmons termed "a young sparkplug who did much to change Moody's dull and stolid reputation"), made a trip to Japan to meet with local companies. On March 3, 1975, as a result of that trip, Moody's assigned a Aaa rating to a proposed $50 million Eurobond offered by Japan Development Bank. The issue was sold in the Euromarkets a week later, carrying the first-ever rating on a Eurobond sold by a non-U.S. issuer.

**"It should be a boon both to the U.S. corporate borrowers and to European investors to have the Moody's system available."**

*The Wall Street Journal*
October 22, 1975

## Standard & Poor's Begins Rating Non-U.S. Bonds

*By a* WALL STREET JOURNAL *Staff Reporter*

LONDON—Standard & Poor's Corp. has begun rating bonds sold entirely outside of the U.S. market.

"The development of a public rating system could be an important factor in increasing the liquidity and expanding the resources of the Euromarket," Brenton W. Harries, president, said. "We would hope that our ratings will facilitate the wider distribution of issues both at the time of initial sale and in the secondary market," he added.

Standard & Poor's, a unit of McGraw-Hill Inc., initiated its new service

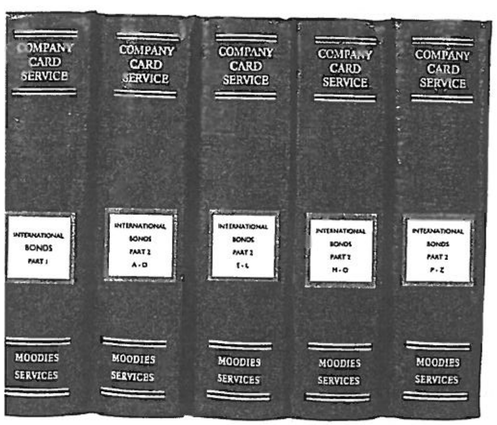
The first rating on a Eurobond sold by a European issuer—a Aaa rating on a proposed $35 million Eurodollar bond issue by Barclays Bank International—was assigned by Moody's on June 16, 1975. Standard & Poor's entered the market in October, when it assigned a AA rating to a pending $20 million sale by Societe Nationale dex Petroles d'Aquitane. The same issue had already received a Aaa rating from Moody's.

## MOODIES CLOSES IN LONDON

Ironically, just as Moody's was pioneering ratings in the Euromarkets, the European operation that John Moody founded in London in 1925 closed its doors for good after a fifty-year run. The subsidiary, Moody's Investors Service Ltd., had remained profitable right through World War II.

When Moody's was acquired by D&B in 1962, the London concern was renamed Moodies Investments Ltd. and became a separate unit within the D&B group of companies. (Later, the company name changed to Moodies Services, Ltd., operating out of Moodies House, 6-8 Bonhill Street, London.)

According to Bohdan Kekish, an officer at Moody's in New York during the period, the Moodies unit operated successfully through the early 1970s under managing director Henry Kyne. At the time, for example, Moodies offered products such as Moodies International Bond Service. Part of Moodies Company Card Service, it was designed to meet the demand for "handy and easily accessible information" on bonds sold in the Euromarkets. On separate, regularly updated cards filed in a loose-leaf binder, subscribers received "concise details of every salient fact of interest to holders of, and dealers in, bonds, excepting prices and yields." The service did not provide credit ratings, but it did offer information on individual Eurobonds and on a wide range of countries active in the international markets, from Argentina to Yugoslavia.




The European subsidiary founded by John Moody in 1925 became a separate subsidiary of Dun & Bradstreet when D&B acquired Moody's in 1962. Under the name Moodies, the unit continued to publish financial data such as *Moodies Company Card Service*.





## Dun & Bradstreet Set To Close British Unit That Publishes Data

*By a* WALL STREET JOURNAL *Staff Reporter*

LONDON—Dun & Bradstreet Cos. said it is closing a British subsidiary that publishes financial and commercial information, Moodies Services Ltd.

The subsidiary, which offered many of the same services as Dun & Bradstreet's differently spelled U.S. unit, Moody's Investors Service Inc., began losing money in 1975 as a result of a contraction in the British stock broker community, an official said.

Recently, the losses have been running at an annual rate equivalent to more than $200,000, he said. "No considered forecast gave any hope of reducing the resultant

*The Wall Street Journal*
January 7, 1976

Nevertheless, in January of 1976, D&B shut down the subsidiary, citing a contraction in the British stock broker community and "losses running at a rate of $200,000 annually."

The irony was that ten years later, to meet the growing demand for ratings in Europe, Moody's would open another subsidiary in London. Although it had the same name as the original (Moody's Investors Service Ltd.), few remembered the history of either Moody's first European subsidiary or its Moodies offshoot when the agency reopened its doors in London in 1986.

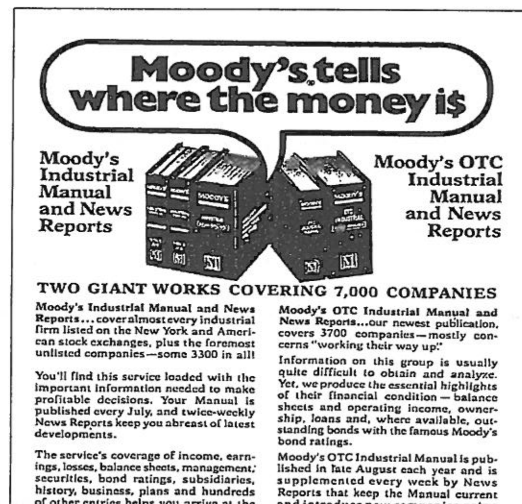
## A RASH OF SERVICE EXTENSIONS

Along with developments in the traditional bond rating business in the 1970s, both Moody's and S&P were fast expanding services into new areas—albeit with mixed success.

In August 1970, *Moody's OTC Industrial Manual* was introduced, splitting off from Moody's burgeoning industrials manual the coverage of smaller companies

### MOODY'S OVER-THE-COUNTER MANUAL

*Moody's OTC Industrial Manual* was termed a "smashing success" in 1970, the year it was introduced, and it continued to contribute to Moody's revenues for years thereafter. Ads like the one at right ran frequently in financial media during the 1970s. They emphasized that the OTC manual more than doubled Moody's coverage in the industrials sector with the addition of 3,700 small-cap companies whose securities were issued only over-the-counter (i.e., not on the New York or American stock exchanges).



whose equity securities were traded over-the-counter (that is, not listed on the major stock exchanges). Termed a "smashing success" by Keefe, the new manual helped to boost revenues that year. But soon after Richard Simmons became president of Moody's, he determined that the company should be doing a better job in all its publishing operations, including the manuals.

"We had a nice group of folks who handled the very dull jobs involved in producing the Manuals and the oftentimes more difficult job of selling them to libraries, corporations, law offices and municipalities," Simmons later recalled. But in 1974, he was looking for someone who could "provide a new look for a business I thought was still mired in the 19th century." Simmons recalls further that he could find no immediate solution until "good fortune again shined down." He learned that William O. Dwyer, a former associate at the law firm Satterlee Stephens Burke & Barke, had left his position at Fairchild Publications and was looking for a job.

lliam O. Dwyer ned on as senior e president and blisher of Moody's 1975. He would come president 1981 and play ey role in the 's history, first in ody's international ansion, then in ilizing the agency ing a difficult od in the mid 0s.

Dwyer signed on as senior vice president and publisher of Moody's in August 1975. That year, he oversaw implementation of computerized typesetting, a move that reduced costs and smoothed production flow for better organization of all Moody's publications. Under Dwyer, Moody's also introduced its "Corporate Visibility" program, offering companies the option of purchasing more detailed coverage in its manuals. But Dwyer's greatest contribution would begin several years later, when, as president of Moody's from 1981 through 1988, he headed the agency's expansion into the fast-growing global debt markets.

Standard & Poor's, meanwhile, was taking the lead in extending rating coverage into the insurance markets. Using its AAA–D bond rating symbols, the agency introduced a new system for rating the claims-paying ability of insurance companies. The first such ratings were assigned in 1971. Moody's would not enter the field until 1987, with the introduction of its Insurance Financial Strength ratings.

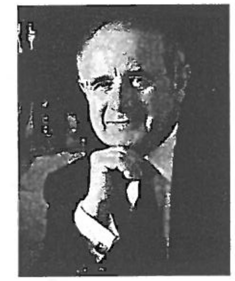
In 1973, Moody's began rating bonds issued by finance companies, and the next year introduced preferred stock ratings using a new set of symbols. The scale was parallel to long-term bond ratings, but used all lowercase letters in quotation marks—"aaa" through "c"—to acknowledge the different characteristics of preferred stock.

In 1974, Moody's became the first agency to rate bonds issued by bank holding companies. Congress passed the Bank Holding Company Act in 1968, allowing banks to form holding companies that could issue corporate bonds, but it took





several years before banking groups began to issue bonds and for the rating agencies to determine the right analytics for rating them. Banking analyst Sam Gordon headed up the analytic effort at Moody's beginning in 1973.



After joining Moody's from D&B Credit in the early 1970s, Sam Gordon played a key role in creating Moody's Prime short-term rating system as well as the analytics for the agency's bank holding company debt ratings. Gordon was vice president and head of Moody's Industrials Group when he retired in 1989.

In the opening days of 1974, it was announced in *Bond Survey* that Moody's had decided "after an extended study, to initiate a rating system for the long-term debt of bank holding companies." With $4 billion of debt already outstanding, it was expected that the holding companies would be "calling upon the investing public for additional large sums of debt capital in the years ahead." Moody's stated that it would not rate the debt securities of banks or those of bank holding companies that did not have subsidiaries. But for a fee, Moody's did start rating the debt of holding companies that had at least $40 million of equity and whose bonds qualified for investment grade ratings. Further, only holding companies with equity of at least $150 million would qualify for Aaa ratings.

The first ratings were assigned in the January 10, 1974 issue of *Bond Survey*: $200 million worth of debentures to be offered on January 15 by Bankers Trust New York Corporation were rated Aaa; $40 million of debentures to be offered the same day by Mercantile Bancorporation were rated Aa. By early 1979, Moody's had rated the long-term debt of 47 bank holding companies, with 10 of them rated Aaa and the two lowest rated Baa.

S&P began rating bonds of bank holding companies in 1975. That year, the agency also began rating mortgage-backed securities. S&P thus gained the distinction of having assigned the first ratings in the structured finance market, which would eventually account for half of all revenues in the global rating business. More cautious in the market's early years, Moody's would not begin rating structured financings until the early 1980s.

## COMPETITION AND "NRSROS"

As the debt markets continued to replace banks as the favored source of capital, and as demand for ratings grew in tandem, more companies entered the global rating business throughout the 1970s.

The Canadian Bond Rating Service began to issue ratings on Canadian dollar bonds in 1972. BankWatch, established by Keefe, Bruyette & Woods, a financial institutions research firm, started rating banks and bank holding companies in 1974. McCarthy, Crisanti & Maffie began rating bonds in the U.S. markets in 1975. Mikuni & Company, headquartered in Tokyo, started rating bonds in the Japanese markets the same year. In 1976, Chicago-based equity research firm Duff & Phelps