bend over backward to make treasurers feel comfortable with their scrutiny if not their ratings," the trade publication reported, concluding: "Trying harder to win corporate goodwill works."

PETITION TO THE GORILLAS

Meanwhile, Moody's continued to publish unsolicited ratings, and they continued to be unpopular. In November 1993, for example, *Mortgage-Backed Securities Letter* ran a story titled "Moody's Unsolicited Ratings Arouse Ire." Many on Wall Street were incensed, the publication reported, over Moody's unsolicited rating on a transaction labeled Fremont Small Business Loan Mater Trust Series A. The security had been sold several months earlier, so Moody's rating had been assigned retroactively. But the unsolicited opinion coincided with the pricing of a similar Fremont deal that was "subsequently repriced 15 basis points wider at a cost to the issuer of $600,000."

MOODY'S UNSOLICITED RATINGS AROUSE IRE

November 1993
ortgage-Backed Securities Letter Investment
ol. 8, No. 46
1993 by Investment Dealers' Digest, Inc.

recent Moody's "Special Comment" entitled "The Feeding Frenzy in Commercial Real Estate and Its Impact on Credit Quality," (MBSL: 11/8) elicited a flurry of stinging comments on Wall Street, especially in light of the agency's unsolicited rating in the same week of Fremont Small Business Loan Master Trust Series A, which was issued in April. The unsolicited Fremont opinion coincided with the pricing of Fremont SBLT Series B, which was subsequently repriced 15 basis points wider at a cost to the issuer of $600,000.

s not the first time Moody's has done an unsolicited ting: in 1992 it offered its view on a $350 million Chrys- r Financial Corp. Small Business Loan at A3, versus the licited Standard & Poor's and Duff & Phelps triple-A ratings; in August Moody's rated CIT Group Manufactured Housing Loans at double-A2, versus S&P's solicited triple and in May 1993 it rated a $133 million Union Federal

November 1993 article in *Mortgage-Backed Securities Letter* highlighted the controversy over Moody's unsolicited rating assignments in the MBS market. Again, the implication was that Moody's was low-balling ratings to attract issuer rating requests.

Again, the implication in this and several other cases was that Moody's was intentionally low-balling its unsolicited opinions so as to force issuers to request its ratings. With a paid relationship in place, there would be hope that the issuer could provide the information needed for a higher rating, and thus a substantial savings on the cost of future funding.

But that, Moody's insisted, was not the case. As John Bohn put it in a 1995 interview with *Institutional Investor* magazine, "We're in the integrity business: people pay us to be objective, to be independent, and to forcefully tell it like it is." A crucial part of that process, he added, "requires us to render an opinion when we believe that investors are being misled."

There were, of course, two sides to this issue; for issuers had good reason to limit the availability of lower ratings on their debt. Not only do lower ratings tend to translate into higher borrowing costs, they may also limit access to wider pools of capital. Typically, two ratings were required to meet regulatory guidelines for new issues. With four nationally recognized agencies to choose from in the early 1990s (Moody's, S&P, Fitch, and Duff & Phelps), issuers were free to request—i.e., shop for—ratings from any two agencies whose opinions would meet those guidelines, while attempting to keep other opinions out of the marketplace.

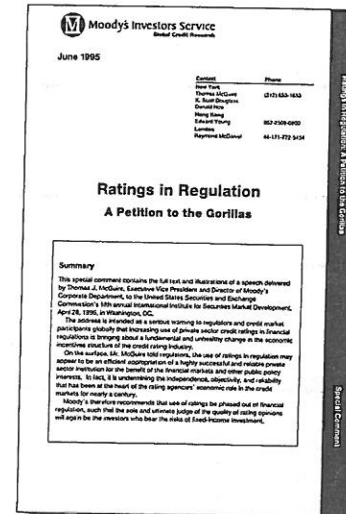
Indeed, a study published in the fourth quarter of 1994 by the Federal Reserve Board of New York suggested that the increased number of rating agencies was posing problems for existing ratings-based regulations. "For junk bonds," the Fed researchers noted, "the availability of third opinions enables many borrowers to climb out of the speculative grades to investment grade territory" (thereby meeting many regulatory guidelines). Likewise, in the mortgage-backed securities markets, the researchers found that "intensifying competition among the four agencies has been associated with downward revisions of required enhancement standards."

Many at Moody's concluded that the central problem did not lie with any agency's efforts to keep investors informed of risks, but rather with the use of private sector ratings in government regulations. In an April 28, 1995 speech before a conference in Washington, DC, organized by the Securities and Exchange Commission, Tom McGuire issued what *Institutional Investor* would call "a double-barreled blast" against ratings-based regulations.

In his address, "Ratings in Regulation: A Petition to the Gorillas," McGuire argued that such regulations provide dangerous incentives for all rating agencies. By using ratings as tools of regulation, governments fundamentally change the nature of the product rating agencies offer, said McGuire. As a result, he explained, "issuers pay rating fees to purchase, not credibility with the investor community, but a license from a government. The rating agencies are thus no longer bound to maintain their credibility with investors." This, he said, is "undermining the independence, objectivity, and reliability that have been at the heart of the rating agencies' economic role in the credit markets for nearly a century."

Private ratings, he told regulators, should therefore be systematically phased out of financial regulation, such that "the sole and ultimate judge of the quality of rating opinions will again be the investors who bear the risks." McGuire concluded his address with this warning:

> The rating system looks very solid from afar, but I assure you that it is more fragile than it seems. The idea of having rating agencies share with you the burden of regulation may seem very attractive, but the weight of government regulators on private institutions can be enormous. Eight hundred pound gorillas should be careful where they sit.



In April 1995, Tom McGuire told attendees at a conference sponsored by the US Securities and Exchange Commission that the use of ratings in regulation was undermining the independence, objectivity, and reliability of rating agencies, arguing that private-sector ratings should be phased out of financial regulations. McGuire's remarks were later published as a *Moody's Special Comment*.

Although many regulators saw the wisdom of these arguments, they had little effect on a regulatory regime that had been increasingly embedded in the capital markets since the 1930s. Moody's practice of assigning unsolicited ratings would continue to be a public and market relations problem for the firm.

MOODY'S FIRST-EVER ACQUISITIONS

In the mid 1990s, many at Moody's were also busy with efforts designed to expand the business beyond its traditional emphasis on bond rating. In a series of talks with associates in 1995, Moody's president John Bohn announced that "A new Moody's is emerging. We are reconceptualizing Moody's from a financial information and bond rating company to an opinion company which provides reliable, high-quality opinion, analysis, research and information to its customers."

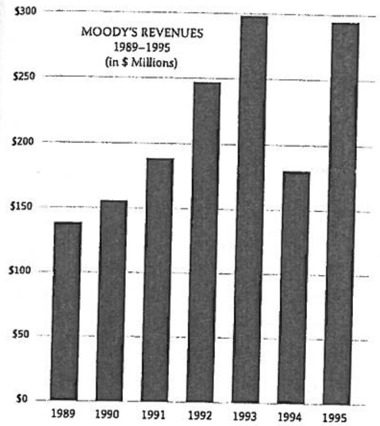
In part, this attempt at diversification was precipitated by a sharp fall-off in new issuance in both the corporate and municipal bond markets. The bond refinancing boom that had been powered by falling interest rates earlier in the decade had come to an end. As the Federal Reserve began to raise interest rates, rating revenues declined. Moody's overall revenues fell by six percent to $280 million in 1994, the agency's first down year since 1948.

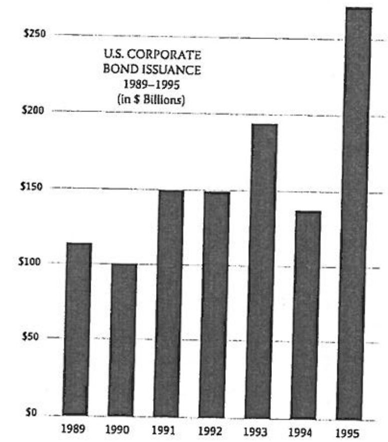
Looking to develop lines of business that would be less sensitive to trends in interest rates and bond volumes, Bohn oversaw two acquisitions in 1995. They were the first in Moody's long history—though they would not be the last.

In January the agency acquired Docutronics Information Services, a provider of on-line information and document retrieval services for the business, financial, and legal communities. The new venture, spearheaded by Moody's Danny Zotolli, was designed to complement the Financial Information Services Department's entry into the SEC source document and research market, while also building a base for expanded research, consulting, and document delivery services to the U.S. and international securities markets.

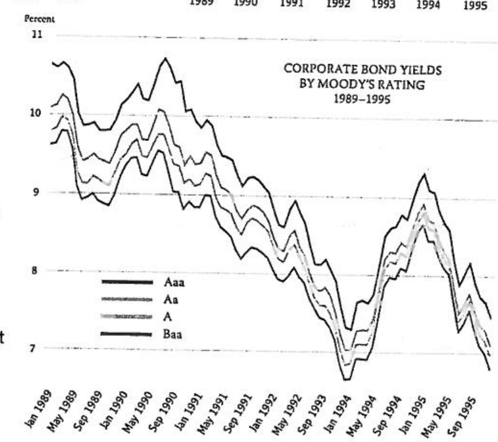
In October, Moody's acquired Financial Proformas, Inc. (FPI), a commercial-lending software and credit training company located in Walnut Creek, California. The company had nine regional offices in the United States, Australia, Canada, the United Kingdom, and Denmark. Its FAST automated credit analysis and risk rating product was then in use by more than half of the largest 100 banks in the United States. And its overall client-base included some 2,000 lending institutions around the world.

n effort to and Moody's iness beyond d rating, the ncy acquired fornia-based ncial Proformas, (FPI). The l was signed in ber 1995 by dy's president Bohn (left) and president and der Rex Beach.





Moody's revenues rose steadily during most years during president John Bohn's seven-year tenure. Despite a fall-off in new issue volumes in 1990, revenues were supported by rating activity overseas and in structured finance, then by a surge in new issue volumes when interest rates began moving lower around 1991. But as the U.S. Federal Reserve began to raise rates in late 1993, bond issuance dwindled. Moody's overall revenues fell by six percent to $280 million in 1994, its first down year since 1948.



When the deal was signed on October 2, Bohn commented that it would "enable us to bring credit training to emerging markets where we believe that assisting financial institutions in making better credit decisions is an appropriate entry strategy." The new unit—renamed FPI, a Moody's Company—would also complement the extension of Moody's statistically-based ratings and research services into the commercial lending market. Two years later, the subsidiary would be merged into the agency's default research operations to form Moody's Risk Management Services.

Around the same time, Ed Roberts was heading another project designed to extend Moody's business beyond credit rating: Moody's Emerging Markets Service. The goal of this joint venture with the International Finance Corporation was to offer the most comprehensive intelligence available on the emerging markets of Asia, Africa, Eastern Europe, and Latin America. Legally distinct from Moody's Investors Service, it did not aim to provide ratings on debt securities. Rather, development work was underway in 1995 to provide on-line information on stock indices and economic data covering 27 emerging markets, financials on 1,600 companies, as well as ongoing news summaries and commentary.

During 1995, Moody's entered into a joint venture with International Financing Corporation to develop Moody's Emerging Markets Service (MEMS). The service aimed to provide comprehensive, on-line intelligence on all major emerging markets around the world. MEMS was set to launch in early 1996, but was ultimately discontinued.

The service was set to launch in early 1996. But due to poor financial performance, the project was discontinued in April of that year.

CHAPTER ELEVEN

FROM "WHOOPS" TO ORANGE COUNTY

Moody's Municipal Ratings Franchise (1979-1996)

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WHEN FREDA STERN ACKERMAN was named director of Moody's Municipal Bond Department in 1979, she took over the agency's largest and in many ways most sophisticated rating franchise. Issuance of new municipal bonds in the U.S. markets would rise to an all-time high of $46 billion in 1980, well ahead of the $35 billion of new corporate bonds issued that year, and the municipal department's rating coverage of new issues was near 100 percent.

At the time, Moody's corporate franchise was publishing its rating commentary almost exclusively through the agency's *Bond Survey* weekly. Since the mid 1970s, by contrast, the municipal department had been distributing its research to clients daily through its *Municipal Credit Report* service. And at the turn of the decade, while corporate managers were only beginning to reach out to market participants on the taxable side of the capital markets, the municipal department had long maintained strong relationships with government officials and key municipal market bankers and financial advisors—particularly through its active memberships in the Municipal Analysts Society and the Municipal Bond Forum of New York.

Ackerman had taken over as director of Moody's municipal ratings franchise a few weeks after the sudden death of Jackson Phillips in late February of 1979. She was well prepared for the position, having worked under Phillips since joining Dun & Bradstreet's municipal rating unit in 1968, right out of college. After the D&B unit merged into Moody's municipal department in 1971, she worked her way up to become the first woman to be named a vice president of Moody's and she served for several years as the agency's lead analyst for New York City during the city's deepening financial crisis.

da Ackerman, then in her early 30s, :ame director of Moody's Municipal Bond partment in March 1979. She would ınage the agency's municipal rating nchise throughout the 1980s. When she : the firm in 1990, the *New York Times* led her "one of the most prominent men executives on Wall Street."

As in earlier decades, the municipal department continued to have the highest public profile of any area within Moody's, a distinction that was sometimes a positive, sometimes a negative for the agency's public image. In January 1980, for instance, Ackerman was called to Washington to testify before a Congressional committee on the health of New York City's finances and to explain why, after many years of adjustment, the city continued to warrant speculative-grade status. Moody's attracted further critical attention in March of 1981, when Standard & Poor's raised its rating on the city's bonds to investment grade but Moody's maintained its B rating on the same bonds.

A few years later, that perceived negative would turn into a

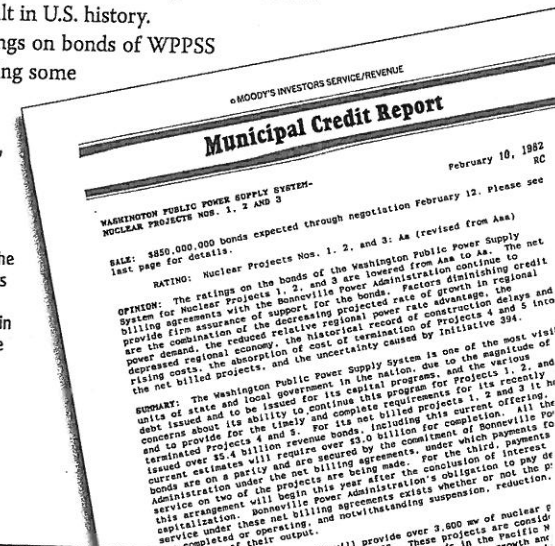
positive. In November 1983, when Moody's raised New York City's rating to investment-grade Baa, the *New York Times* would report that Mayor Ed Koch "seemed barely able to contain his delight." The mayor held a press conference to make what he termed "probably the most important announcement I've made in years." "Our single largest mission to date was to achieve all the things that were necessary in order to get an investment-grade rating," Koch explained, adding that the Baa rating from Moody's "ends the last major impediment to once again being perceived as totally fiscally sound." Thereafter, Koch often took to wearing the Moody's tie that he had earlier received from Ms. Ackerman. The tie was decorated with Moody's investment grade rating symbols, Aaa through Baa.

"WHOOPS"

Questions surrounding Moody's ratings on Washington Public Power Supply System (WPPSS), then the largest issuer of municipal bonds, would, however, be a lingering sore point. In early November 1981, the *Wall Street Journal* ran a page-one story titled "Moody's Dominance in Municipals Market is Slowly Eroding," pointing to the agency's Aaa ratings on many WPPSS bonds as a key reason for the decline.

Earlier that year, the *Journal* article noted, Moody's had lowered its ratings on bonds issued to fund two of the five nuclear plants in the system (plants Nos. 4 and 5) to Baa1 from A1. The agency cited repeated cost overruns and poor management; but many market participants felt Moody's did not go far enough, noting that institutional interest in the bonds had "all but dried up." In early January 1982, as it turned out, WPPSS defaulted on more than $2.2 billion of the plant Nos. 4 and 5 bonds, making it the largest municipal default in U.S. history.

The next month, Moody's lowered its ratings on bonds of WPPSS plants Nos. 1, 2, and 3 to Aa from Aaa, affecting some $4.6 billion of outstanding debt. Many observers continued to argue that both Moody's and S&P were behind the curve on all "Whoops"


MOODY'S INVESTORS SERVICE/REVENUE

Municipal Credit Report

February 10, 1982
RC

WASHINGTON PUBLIC POWER SUPPLY SYSTEM-
NUCLEAR PROJECTS NOS. 1, 2 AND 3

SALE: $850,000,000 bonds expected through negotiation February 12. Please see last page for details.

RATING: Nuclear Projects Nos. 1, 2, and 3: Aa (revised from Aaa)

OPINION: The ratings on the bonds of the Washington Public Power Supply System for Nuclear Projects 1, 2, and 3 are lowered from Aaa to Aa. The net billing agreements with the Bonneville Power Administration continue to provide firm assurance of support for the bonds. Factors diminishing credit are the combination of the decreasing projected rate of growth in regional power demand, the reduced relative regional power rate advantage, the depressed regional economy, the historical record of construction delays and rising costs, the absorption of cost of termination of Projects 4 and 5 into the net billed projects, and the uncertainty caused by Initiative 394.

SUMMARY: The Washington Public Power Supply System is one of the most visi[ble] units of state and local government in the nation, due to the magnitude of debt issued and to be issued for its capital programs, and the various concerns about its ability to continue this program for Projects 1, 2, and and to provide for the timely and complete requirements for its recently terminated Projects 4 and 5. For its net billed projects 1, 2 and 3 it ha[s] issued over $5.4 billion revenue bonds, including this current offering. current estimates will require over $3.0 billion for completion. All the bonds are on a parity and are secured by the commitment of Bonneville Po[wer] Administration under the net billing agreements, under which payments fo[r] service on two of the projects are being made. For the third, payments this arrangement will begin this year after the conclusion of interest capitalization. Bonneville Power Administration's obligation to pay de[bt] service under these net billing agreements exists whether or not the p[rojects are] completed or operating, and notwithstanding suspension, reduction, of their output.

...will provide over 3,600 mw of nuclear ... These projects are consid... needs in the Pacific N... energy growth and ... year upd...

Moody's downgraded its ratings on two of the five nuclear power plants under construction by Washington Public Power Supply System in June of 1981, six months before the units defaulted on $2.25 billion of debt. Market participants continued to be skeptical as Moody's downgraded the remaining bonds by only one rating level (to Aa from Aaa) in February 1982; but the bonds did not default and would be upgraded to Aaa in 1996.

The Rating Game

Moody's Dominance In Municipals Market Is Slowly Being Eroded

S&P Gains, and Wall Street Beefs Up Its Own System; Dissension Rises in Ranks

Skepticism in 'Whoops' Case

By VICTOR F. ZONANA And DANIEL HERTZBERG
Staff Reporters of THE WALL STREET JOURNAL

NEW YORK—Ever since John Moody issued his first municipal-bond rating in 1919, Moody's Investors Service Inc. has been a key player in the nation's municipal-financing system.

Mayors and governors troop through its offices here, seeking the nod that can determine whether—and at what cost—schools, hospitals and other public facilities get built. The ratings propounded by the unit of Dun & Bradstreet Corp. can add or subtract millions of dollars in borrowing costs for state

In a front page article November 2, 1981, the *Wall Street Journal* reported that Moody's was losing its dominance in the municipal rating business, citing high staff turnover, stogy management, and criticism of Moody's ratings on bonds issued to fund nuclear power plant construction by Washington Public Power Supply System (WPPSS—dubbed "Whoops" by many market observers).

bonds, as they had come to be known. But Ackerman and Craig Atwater, Moody's lead analyst on WPPSS, argued that holders of the plants Nos. 1, 2, and 3 bonds were "insulated from the supply system's problems" by a complex "take-or-pay" contract. Under the contract, the federal Bonneville Power Administration had agreed to raise its own electric rates to cover debt service even if the remaining three plants were never completed. In fact, the remaining bonds did not default; and in 1996 the WPPSS project would be upgraded to Aaa.

"PRESSURE COOKER ATMOSPHERE"

Among other issues at Moody's in the early 1980s, the *Journal's* 1981 article pointed to a high level of staff turnover in the agency's municipal ratings department, among what it termed "faceless workhorses who churn out 3,000 credit reports a year." The article cited "stodgy unimaginative management" and "a pressure cooker atmosphere where work quality is sacrificed for high production."

Under President Bill Dwyer, Ackerman and her associates worked successfully over the next few years to improve internal morale. In part, this came through the increased use of computer technology to better manage the huge volumes of data involved in municipal research. Externally, the department upgraded its Municipal Credit Report service, hosted regional seminars for municipal officers and financial advisors, and began to issue press releases on key rating actions.

In 1983, the decision was made to shift Moody's sovereign research from the municipal to the corporate department, but the municipal department continued to rate Canadian provinces and other sub-sovereign issuers in Canada. In 1984, the department began rating the credit quality of municipal bond insurance, assigning Aaa ratings to bonds insured by Municipal Bond Insurance Association (MBIA),

Financial Guaranty Insurance Company (FGIC), and Bond Insurance Group (BIG). Over the next few years, bonds insured by Municipal Bond Investors Assurance Corporation (MBIA Corp.) and American Municipal Bond Assurance Corporation (AMBAC) also received Aaa status.

THE WALL STREET JOURNAL.

Moody's Will Award Top Ratings to Issues Insured by Association

3 July 1984

NEW YORK -- Moody's Investors Service Inc. said it will award its highest ratings to all municipal securities guaranteed by the Municipal Bond Insurance Association.

All long-term obligations insured by MBIA now will be rated triple-A by Moody's, and all short-term securities will be rated MIG-1. The ratings apply to about $17.2 billion of issues insured by MBIA to date, as well as to all future issues.

Moody's municipal department began rating the quality of bonds insured by the Municipal Bond Insurance Association (MBIA) in early July 1984. MBIA's insured bonds received Aaa ratings, as would those of all major municipal bond insurers over the next few years.

New issue volumes in the U.S. municipals market doubled to more than $200 billion in 1985. That, however, was a mixed blessing: the increase was due mainly to a flurry of issues by municipalities aiming to borrow before passage of the 1986 Tax Reform Act. The Act reduced the tax advantage of municipal bond investments, while other rulings around the same time placed funding caps on municipal issuance. After the new law and regulations went into effect the following year, new issue volumes and bond rating revenues declined in both 1986 and 1987. But Moody's found new ways to serve the municipal marketplace.

In 1986, the agency's VMIG (Variable Moody's Investment Grade) short-term rating system was introduced to distinguish the credit characteristics of variable rate demand obligations, which had become increasingly prevalent in the municipal markets. The next year, Moody's Municipal Rating Monitor, a daily summary of municipal ratings and research activity, was launched on Munifacts, a wire service operated by American Banker-Bond Buyer, Inc. And in 1989, Moody's Western Regional Office opened in San Francisco, the agency's first municipal office outside New York.

Ackerman left Moody's in January 1990 to pursue other interests in the municipal markets. In a story announcing the departure, the *New York Times* described her as "one of the most prominent woman executives on Wall Street."

Moody's Municipal Credit Report

San Antonio, Texas — April 8, 1985

New Issue — Revenue

sale: — Electric and Gas Systems Revenue Improvement Bonds, New Series 1985-A

date: — Tue Feb. April 11

Moody's rating: Aa
Electric and Gas Revenue, Second Lien

opinion:

key facts: Type System: Electric generation, transmission, distribution, gas distribution.
Service Area:
Fiscal Year Ended 1/31/85:
Operating Ratio:
Median:
Operating Revenues:
Electric:
Gas:

Largest Expense Components:
Electric Production:
Gas Purchases:
Payments & Services to City as % of Gross Revenues:
Debt Service as % of Gross Revenues, All Bonds:
Peak Debt Coverage by Net Revenues:
Debt Ratio:
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update:

Moody's upgraded its Municipal Credit Report service in 1985, giving it a new look supported by improved production and distribution.

FOCUS ON INVESTORS

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Daniel Heimowitz took over as director of Moody's Public Finance Department in April, 1990, reporting to President John Bohn. Shortly thereafter, Moody's began to shift its business strategy in the municipal markets, in part because of the 1989 recapitalization of Fitch Investors Service under H. Russell Fraser. Fraser had made it clear that Fitch aimed to grow its share of rating activity in the municipal sector.

Heimowitz had joined the firm in 1972. After being named associate director in 1982, he had been responsible for developing and managing the department's structured finance and insured bond ratings. During his first year as director, he established an investor services group to build research relationships with institutional bond buyers. The department continued to maintain close relationships with the sell side of the markets; but now, for the first time, Moody's municipal analysts and investor services representatives began to make "house calls" on key institutional investors around the country. At the same time, the department initiated a new series of investor seminars, along with a program of unsolicited rating assignments parallel to that underway on the corporate side of the business.

The Public Finance Department's credit reports, rating recaps, special comments, and press releases were made available to Bloomberg subscribers world wide in the early 1990s.

Under Heimowitz, the department also began publishing sector-specific reports on a wide range of topics, including airports, regional school districts, municipal structured financings, and Canadian provinces. A Higher Education Group was formed to rate bonds of universities and colleges across the U.S. And the department began to deliver its credit reports and rating news to clients by fax and through the Moody's Public Finance pages on Bloomberg.

During the recession years of the early 1990s, municipal ratings again entered the public spotlight in a big way. That was the case, for example, when Standard & Poor's lowered its rating on the State of California to AA from triple-A in December 1991 and a year earlier, when Moody's had again reviewed its rating on New York City for possible downgrade. The controversy took on nationwide proportions in July 1992, when Moody's lowered its rating on the general obliga-

tion bonds of Detroit, Michigan to speculative-grade Ba1 from Baa. The same day, Detroit Mayor Coleman Young issued a press release challenging Moody's decision and implying that it reflected "quality of life" issues, including an assessment of the racial makeup of the city. "It is a fact," said a spokesperson, pointing more specifically to a charge of discrimination in Moody's municipal ratings area, "that in that section of Moody's there aren't any minorities."

Overall, as *Newsweek* magazine put it, these and a flurry of other municipal downgrades during the period, were enough to "get government leaders fighting mad."

Over time, though, that dissatisfaction subsided with U.S. economic recovery and as municipal interest rates declined to 13-year lows beginning in 1992. Although the unsettling charges of discrimination proved unfounded, they did prompt Moody's to initiate a broad program designed to foster minority inclusion across the firm.

In May of 1993, Moody's became the first agency to open an office in Texas and staffing in the agency's San Francisco office was expanded. Later the same year, Moody's rated a record 13,500 municipal bonds, as new issue volumes rose to $290 billion.

THE BOND BUYER

Mayor of Detroit Protests Moody's Ba1 Downgrade, Citing Unfairness

Karen Pierog
20 July 1992

Detroit officials are charging that Moody's Investors Service used new and inconsistent criteria in rating the city's general obligation debt when it downgraded the city to the non-investment grade rating of Ba1 from Baa on Thursday.

In a press release issued late Thursday afternoon, Mayor Coleman Young charged that the criteria used by Moody's in its rating decision "is substantially different from the criteria Moody's has used to rate any other large American city."

California, New York City, and may other high-profile municipal bond issuers saw their ratings fall amid the recession of the early 1990s. When the Detroit, Michigan was lowered below investment grade in 1992, Mayor Coleman Young protested that the action was unfairly based on "quality of life" issues.

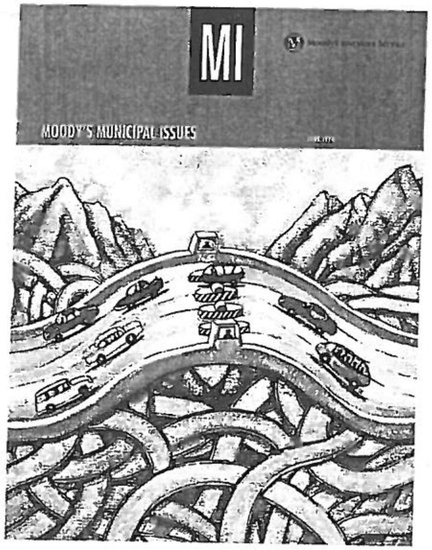
STEEP DECLINE IN NEW ISSUES

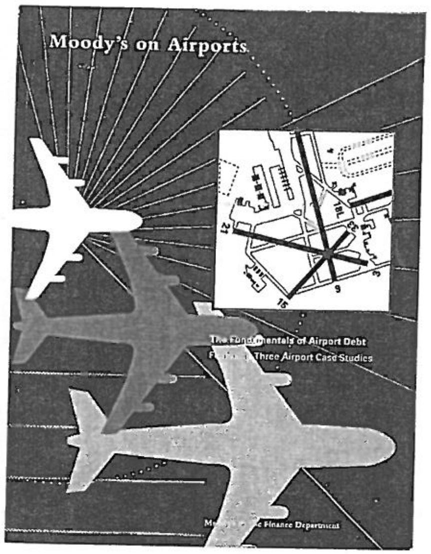
Things changed abruptly in 1994. Interest rates took a sharp upward turn beginning in January, and the dollar volume of new issues was cut nearly in half to $165 billion for the year. As a consequence, many major Wall Street firms decided to stop underwriting municipal debt altogether. The fall-off in new issuance trimmed Moody's municipal rating revenues and contributed to the first annual decline in the agency's overall revenues in more than four decades. Declining issuance in the primary markets would also prompt increased trading activity in the secondary bond markets, along with heightened investor demand for timely research on outstanding municipal debt.

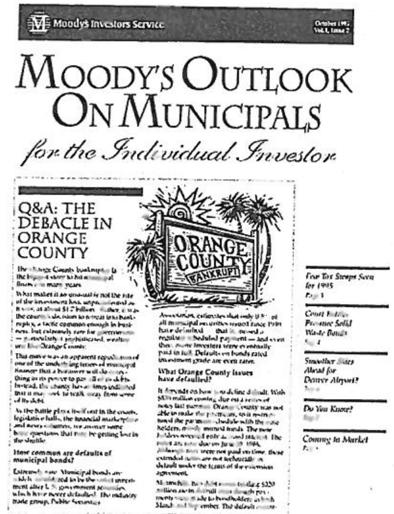
Accordingly, the U.S. Securities and Exchange Commission recommended that municipalities be required to disclose any information relevant to secondary market trading through what it termed Nationally Recognized Municipal Securities Information Repositories (NRMSIRs). The recommendation went into effect as

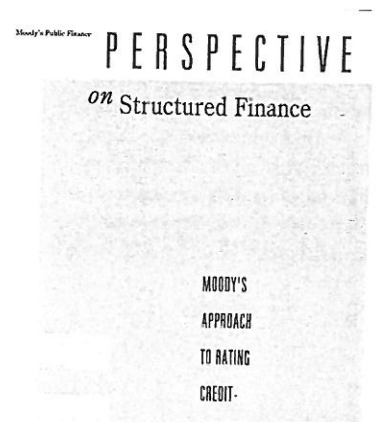
MOODY'S MUNICIPAL PUBLICATIONS IN THE EARLY 1990s

Beginning in the early 1990s, Moody's placed increasing emphasis on attractively designed publications for key segments of the municipal marketplace. Booklets such as *Moody's on Airports,* along with the Public Finance Department's *Perspective* series were targeted at institutional bond buyers. *Moody's Municipal Issues,* a quarterly featuring articles on municipal credit trends, was prepared specifically for municipal managers and financial advisors. And *Moody's Outlook on Municipals,* introduced in early 1995, aimed to educate the growing numbers of high net worth individuals active in the municipal bond markets.









SEC Rule 15c2-12 in July 1994. Moody's became a NRMSIR the following January, a move that helped the Public Finance Department to supply better current information on municipal issuers as it broadened surveillance of ratings on outstanding bonds.

The steep decline in new issue volumes was not the only problem facing Moody's municipal franchise in 1994. In March, Richmond Unified School District in California complained through its financial advisor that it had been "blindsided" by Moody's unsolicited rating on one of the district's refunding bonds. In a related development the same month, an Orange County (California) agency said that it would not ask Moody's to rate an upcoming $1.5 billion toll road revenue bond, thereby adding fuel to ongoing controversy over unsolicited ratings in both the municipal and corporate bond markets.

ORANGE COUNTY GOES BANKRUPT

The atmosphere at Moody's became particularly tense on December 6, 1994, the day Orange County filed for bankruptcy because of losses stemming from the use of interest rate-sensitive derivative products in its $7.4 billion pooled investment fund. The same day, Moody's suspended its Aa1 rating on Orange County bonds pending further information, then downgraded the bonds to Caa on January 6, when it was disclosed that the county had suffered a $172 million shortfall in its general fund budget. Testifying before a U.S. Congressional committee in July, Heimowitz said that Moody's had been "shocked" at the unprecedented magnitude of the county's investment losses, adding that he was worried that its rejection of a proposed sales tax increase to cover losses was actively opposed by a number of city councils. "We believe that these events are beginning to fray the edges of public trust," said Heimowitz.

Many market observers nevertheless faulted the rating agencies for not identifying the problem earlier, saying that the agencies had "dropped the ball" on Orange County. The harshness of their criticism moderated somewhat in January 1996, when the Securities and Exchange Commission acknowledged that both Moody's and S&P were lied to by the county's treasurer. The official, said the SEC, had grossly understated the amount of volatile derivatives that eventually sank the county's investment pool.

Meanwhile, in March of 1995, partly in response to the Orange Country default,

THE BOND BUYER

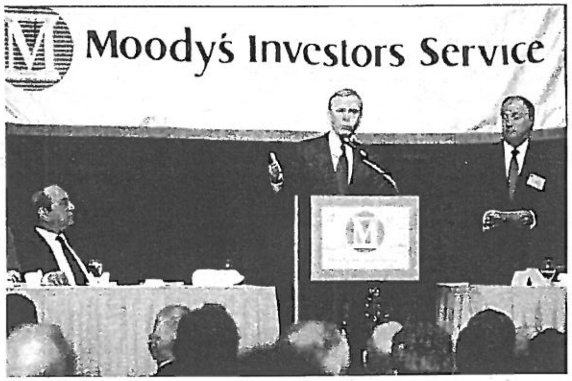
Orange County Sees Moody's Downgrade Following Shortfall In General Budget

Michael Utley
9 January 1995

Moody's Investors Service on Friday downgraded Orange County's long-term debt rating from Aa1 to Caa, following last week's disclosure of a $172 million shortfall in the bankrupt county's general fund budget.

A Moody's representative said the rating action was based on the revised shortfall amount and clear indications that the county will not be able to repay its debt without some sort of a refinancing.

Moody's downgraded its rating on debt of Orange County, California to Caa in early January 1995 when it became known that the bankrupt county had suffered large losses on its pooled investment fund. A year later, the U.S. Securities and Exchange Commission confirmed that both Moody's and S&P had been lied to concerning the amount of volatile derivatives in the pool.



In early March 1995, three months after the Orange County debacle, Moody's held a seminar in San Francisco, "California at a Crossroad." State governor Pete Wilson (left-hand photo, at the podium) was a featured speaker. Moody's Dan Heimowitz chaired a panel on the subject "Is California Governable." He is shown in the photo on the right with panelist Willie Brown, then Speaker of the California Assembly.

Moody's held a seminar in San Francisco titled "California at a Crossroad: A State in Transition." The event featured California Governor Pete Wilson, along with Moody's president John Bohn and other notables, including California state legislator Willie Brown. At the seminar, some 230 attendees heard panel discussions on topics ranging from "Can California Compete?" to "Is California governable?"

The same month, Fitch Investors Service upped the competitive ante in the municipals sector when it announced that it would begin charging fees for assigning ratings to bonds insured by two major bond insurers, AMBAC and FGIC. The agency had already been rating insured bonds at no charge beyond its fee for rating the credit of the bond insurers themselves. Now it would charge for ratings on each insured bond—but at about half the rates then charged by Moody's and S&P. "We believe profit margins associated with rating insured bonds are sufficiently high to invite competition," said Fitch vice chairman Neil Baron.

THE BOND BUYER

Fitch Challenges Moody's and S&P With Price Policy

Peter J. Wamsteker
8 May 1995

Fitch Investors Service today will unveil a new pricing policy on municipal bond deals insured by AMBAC Indemnity Corp and Financial Guarantee Insurance Co.

Under the policy, Fitch will assign a rating on bonds insured by AMBAC and FGIC only at the request of the issuer, but for a fee that is half of what is typically charged by other rating agencies.

In taking this approach, Fitch is aiming to provide a low-cost rating alternative in a market dominated by Standard & Poor's Corp. and Moody's Investor Services.

"We believe profit margins associated with rating insured bonds are sufficiently high to invite competition," said Neil D. Baron, Fitch's vice chairman and general counsel. "We believe we can charge lower fees and enjoy reasonable profit margins."

The policy reverses Fitch's long-standing practice of assigning ratings to deals insured by AMBAC and FGIC at no cost to the is-

/estors announced 1995 that begin a fee for on municipal insured by or bond The fees e about half arged by and S&P.

COST CUTTING AND REORGANIZATION

In May 1995, the Public Finance Department began a series of cost-cutting moves designed to streamline management and to be more responsive to investors. "The goal," said Heimowitz in a public announcement a few months later, "is to be closer to the client and to get more analysts out in the field." With a trimmed down management, he explained, the department sought to meet investor needs for increased secondary market information, freer access to municipal analysts, and publication of the results of rating surveillance activity that had previously been for internal use only. Instead of seven regional rating groups, the department would now have 13 regional groups, while the number of associate directors managing the groups was reduced from seven to four.

At the same time, the department reinforced its emphasis on high-quality publications targeted at specific segments of the municipal marketplace. A new quarterly, *Moody's Outlook on Municipals,* launched in the spring of 1995, was promoted as an educational vehicle for high-net-worth individual investors. Its second number featured a concise Q&A overview of the "Debacle in Orange County."

In October, the department introduced *Moody's Municipal Credit Perspectives,* a newsweekly designed to provide municipal bond buyers with timely rating analysis and commentary on developing credit trends. The department also placed increased emphasis on its attractive quarterly, *Moody's Municipal Issues.* The

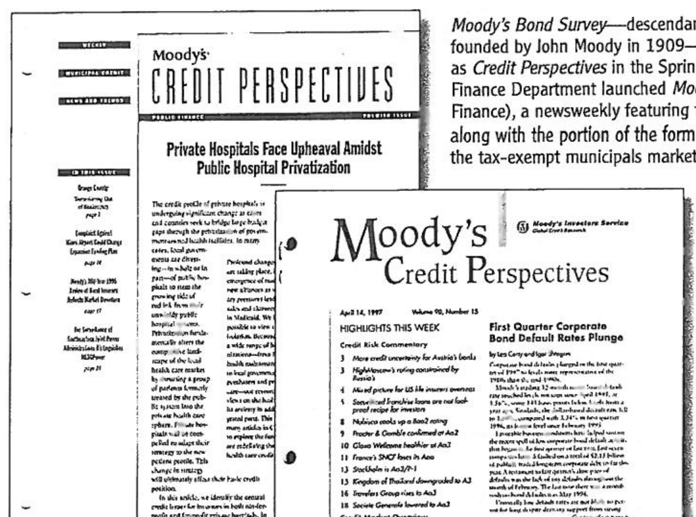
Newsday

Moody's Trimming Staff In Muni Bond Department

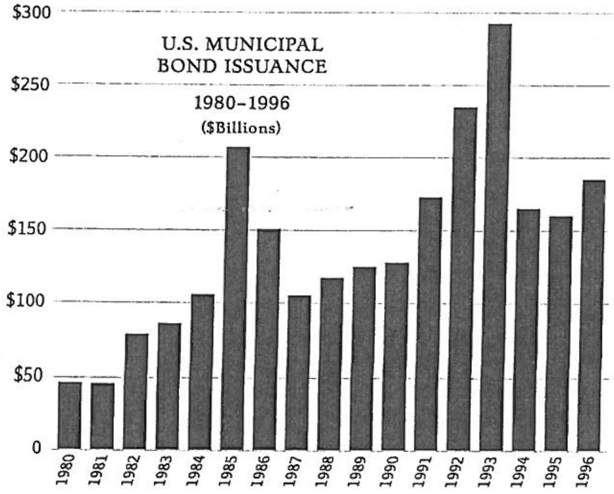
By Charles Gasparino and David M. Halbfinger.
17 May 1995

Moody's Investors Service, one of the major bond-rating agencies, yesterday began laying off employees from its public finance department, officials there confirmed.

Moody's Public Finance Department initiated cost-cutting and restructuring measures in the spring of 1995, amid declining rating revenues and issues stemming from its unsolicited rating assignments and Orange County's sudden default. "The goal," said director Dan Heimowitz, was to "be closer to the client and get more analysts into the field."



Moody's Bond Survey—descendant of *Moody's Weekly Letters,* founded by John Moody in 1909—was redesigned and rebranded as *Credit Perspectives* in the Spring of 1995. In October, The Public Finance Department launched *Moody's Credit Perspectives* (Public Finance), a newsweekly featuring timely articles on credit trends, along with the portion of the former Bond Survey that covered the tax-exempt municipals markets. Thereafter the Corporate Department published a separate edition of *Credit Perspectives,* including weekly bond market data and commentary and summaries of the department's special comments and industry studies covering the taxable portion of the capital markets globally.



After spiking to record levels, issuance of new municipal bonds in the U.S. markets fell sharply beginning in 1986 and again in 1994. The second decline would lead to cost-cutting in the Public Finance Department in 1995 and would be a factor in the reorganization of Moody's the following year.

publication had been introduced as a newsletter in the 1980s, then reintroduced in magazine format during 1994, with the aim of providing municipal issuers and their bankers with insights into the rating process and Moody's thinking on emerging issues.

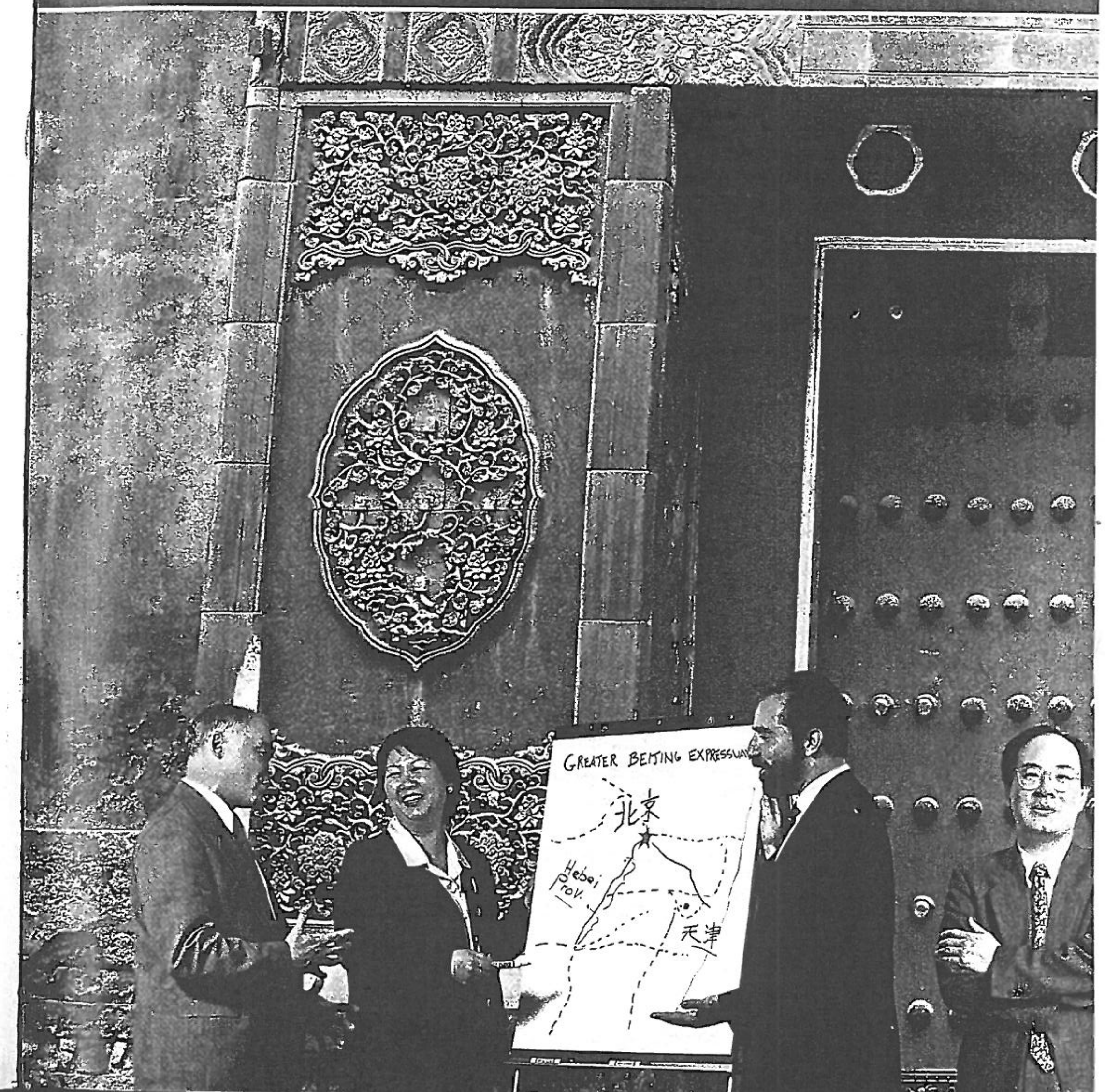
Although demand for ratings and analysis on new bond issues had declined, the department made few changes to its Municipal Credit Report service. The daily service continued to include detailed background information on each newly rated issue, making it costly to prepare and to publish. The fact that Moody's public finance and corporate departments continued to maintain separate publishing operations (as well as separate technology and sales functions) only added to that cost burden.

In May 1996, with the reorganization of Moody's, the Public Finance Department would become one of seven rating groups in Moody's Credit Rating and Analysis division. The above-mentioned publications were either discontinued or merged into Moody's Global Credit Research service, and all other support functions were likewise merged into the new division.

CHAPTER TWELVE

SHAKEUP

Moody's Regroups for Record Performance (1996-1999)



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THE FIRSTS MONTHS of 1996 were particularly unsettling at Moody's. Several significant events occurred in rapid succession.

In January, Harold Goldberg, long-time chairman of Moody's Corporate Rating Committee, died of cancer at age 68. Earlier the same month, Dun & Bradstreet had announced that it would split itself into three separate companies, leaving uncertainties as to how Moody's would fare as a larger portion of a new, smaller D&B.

In March, the United States Department of Justice (DOJ) began an investigation of rating agencies for anti-competitive practices; Moody's was the focus of its attention. The same month, Moody's president John Bohn retired suddenly. Two weeks later, Bill Dwyer came out of retirement to head Moody's again.

At the end of May, Dwyer announced the first major restructuring of Moody's operations in 25 years. That shakeup would be followed by many more changes at Moody's, at Dun & Bradstreet, and in the rating industry, as Dwyer, then John Rutherfurd, reorganized the firm for record-setting performance through the end of the century.

Harold Goldberg (Hal) worked for 23 years at Moody's, most of that time as chairman of Moody's Corporate Rating Committee. Known by many on Wall Street as the "Doyen of Credit Rating," he was a father figure at Moody's during the early period of its global expansion, one who took special interest in teaching the nuances of credit analysis. The photo above shows him meeting with Moody's analysts covering the industrials sector in the late 1980s. Goldberg died of cancer in January 1996.

GOLDBERG'S PASSING

The death of Harold H. Goldberg would have nothing to do with the impending reorganization, though his absence heralded a changing of the guard.

Known to many capital market participants as the "Doyen of Credit Rating," he held a place at Moody's and on Wall Street similar to that of Al Esokait in the early 1970s. After earning a law degree from Brooklyn University, Goldberg got a job in 1952 as a Dun & Bradstreet credit reporter, then came to Moody's in 1973, where he served as head of the Corporate Bond Department in the late 1970s and chairman of Moody's Corporate Rating Committee from 1981 on.

Whereas Esokait was generally feared on Wall Street, Goldberg was loved and respected during those years. He had an infectious sense of humor and a winning way with issuers. Even

outside Moody's, few called him Mr. Goldberg: he was known as Hal. Like Esokait, though, he had a sixth sense for financial analysis.

Pam Stubing, a senior credit analyst who worked with Goldberg for 20 years, called him a father figure who took special interest in teaching the nuances of credit analysis. "He taught me, and others, that bond raters should have very forceful opinions," said Stubing, as quoted in Goldberg's *New York Times* obituary, January 31, 1996. "He taught you to say what you think and to remember that your opinion could change because a bond rating was an opinion."

Martin S. Fridson, then chief of high-yield securities at Merrill Lynch, praised Goldberg for his "unusual insight." Quoted in the same obituary, Fridson recalled that Goldberg had gleaned from the footnotes in financial statements of natural gas pipeline companies that many of them would eventually get into financial trouble. He had noted that the companies were obligated by contract to pay well owners for natural gas whether or not they had buyers for the gas. "Hal felt strongly that these contracts were significant burdens for pipeline companies," added Jack Malvey, an executive at Lehman Brothers who had been a Moody's junior analyst at the time. "Unfortunately," Malvey explained, "some of Hal's colleagues, including me, persuaded others that this difficulty was manageable and was not something that we needed to be overly concerned about." As it turned out, said Malvey, "the contracts were a major problem for the gas companies, notably Columbia Gas System, and Hal identified the problem years before anyone else."

After Goldberg's death, an issuer meeting room on the eleventh floor at Moody's 99 Church Street headquarters was dedicated to his memory.

THE NEW DUN & BRADSTREET

Dun & Bradstreet announced its strategic de-merger on January 9, 1996, by calling it "Our most exciting news in 155 years." Its aim was not to cut costs. Rather, said CEO Robert Weissman, it was "designed to increase value by unlocking D&B's substantial underlying franchise strengths."

The restructuring, completed in November, involved spinning off A.C. Nielson, D&B's market research unit, and the formation and spin-off of a new company called Cognizant, consisting of IMS Health and Nielson Media Research. Moody's remained as part of the new D&B, along with D&B Information Services and Reuben H. Donnelly, provider of Yellow Pages marketing and publishing. Volney Taylor, who had begun his career with D&B's Funk &

Calling it "our most exciting news in 155 years, Dun and Bradstreet announced in January 1996 that it would split into three separate companies. The new D&B, under CEO Volney Taylor, would include D&B Credit Information Services, R.H. Donnelley, and Moody's. Taylor promised that D&B would now have "increased nimbleness in the marketplace.

AP Associated Press

Dun & Bradstreet To Split into Three Companies

FARRELL KRAMER
9 January 1996

NEW YORK (AP) - Financial information provider Dun & Bradstreet Corp. announced Tuesday it will split into three companies, divesting itself of the compiler of Nielsen television ratings and some other operations.

Dun & Bradstreet will continue to exist and provide the business information for which it has been known for 155 years. A second company, Cognizant Corp., will offer advice and information to the health-care and technology industries. It will include Nielsen Media Research.

A third, called A.C. Nielsen, will be created to provide marketing data to companies that produce consumer packaged goods.
Dun & Bradstreet's move follows the decisions of several large companies last year to spin off operations and become more nimble and competitive. They include AT&T Corp. and ITT

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Wagnalls unit in 1972, was named chairman and chief executive officer of the new company.

The mood among managers at Moody's was apparently upbeat. Those quoted in *Aaa*, the firm's employee newsletter, expressed excitement. "First of all," said Danny Zottoli, head of Moody's Financial Information Services, "it's a much smaller organization to understand and relate to than the present configuration, and it's an organization in which Moody's is a big fish in a smaller pond." Since the new D&B will be smaller, he added, "decisions will be made quicker, and they'll be better decisions." Along the same lines, Volney Taylor promised that the new D&B would have "increased nimbleness in the marketplace."

Indeed, the new company was about half the size of the old one. In 1996 that meant that Moody's would represent about 16 percent of revenues (up from 3 percent a decade earlier) and almost a quarter of D&B's pre-tax profits. It remained to be seen, however, what synergies Moody's would have with the two companies that still accounted for most of the parent's revenues.

To the astute credit analysts at Moody's, it was obvious that D&B would remain a patchwork of marginally related entities. D&B Information Services was a descendant of the Dun and Bradstreet companies that had introduced the first credit ratings in the mid-19th century. The modern company, however, had become a vast marketing and commercial credit information service; little of the information it offered had much relevance to the capital market institutions that made up Moody's core customer base. Rueben H. Donnelly would contribute strong cash flow to the new D&B; but as a publisher of phone books, the firm was in an entirely different business from Moody's.

BILL DWYER RETURNS

On March 22, D&B issued a press release announcing that John A. Bohn Jr. would resign as president of Moody's effective April 1. Bohn cited the impending split up of D&B as the reason for the move, adding that he had been "entertaining thoughts of pursing some career and personal interests for some time." In its story on the "surprise move," *The New York Times* noted that during his tenure Bohn had "gained the reputation as a manager who maintained a strong global interest while morale in some of Moody's domestic operations, especially the public finance section, was failing."

In early March, Moody's had received a notice of civil investigative demand (an order to obtain information and documents) from the U.S. Department of Justice's Antitrust Division. But the notice did not become public knowledge until

the end of the month. On March 28, both *The Wall Street Journal* and *The New York Times* reported that the focus of the investigation was on anti-competitive practices by Moody's—particularly in asset-backed securities, mortgage-backed securities, municipal instruments, and the question of unsolicited ratings. They noted, too, that other agencies, including S&P, Fitch, and Duff & Phelps, had been asked to provide information in the case.

On April 8, Moody's announced that former president William O. Dwyer would come out of retirement to serve again as president, reporting to Volney Taylor. "Dwyer's knowledge of Moody's and the bond-rating industry will allow him to have an immediate impact on the business," said Taylor. Dwyer commented that he would not have altered his retirement plans "for any other company except Moody's."

After leaving the firm in 1989, Dwyer had served for a year as president of D&B's Financial Information Services Group. In 1990, he was named president of Dun & Bradstreet Corporation Japan and moved to Tokyo, where he ran the company until his first retirement in 1993.

On returning to Moody's, Dwyer was briefed on the progress of a study of the firm's internal organization, begun the preceding October by consulting firm McKinsey & Company. And he was briefed on a recent business effectiveness survey designed to assess employee attitudes and issues relating to Moody's internal and external operations. After reading a report on the latter survey, Dwyer said he was "appalled at the results." It suggested, he explained, "that we don't like each other—we don't want to talk with one another. There is a huge lack of communication. No one can work in an atmosphere like that. I don't choose to, and I wouldn't ask anyone else to. That atmosphere has got to change."

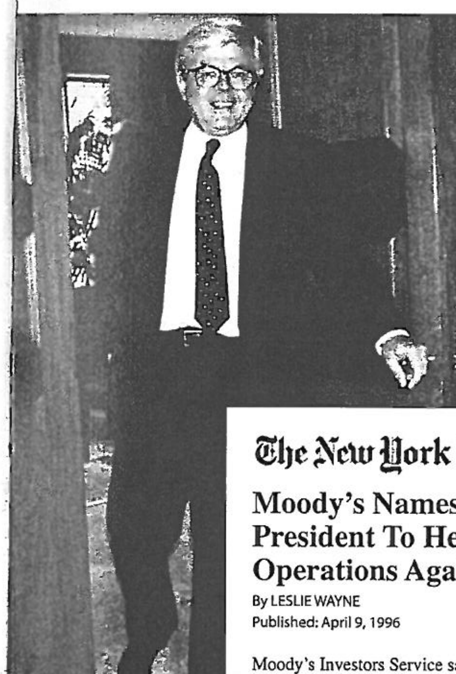
The New York Times

Federal Antitrust Inquiry Has Begun Against Moody's

By KENNETH N. GILPIN
Published: March 28, 1996

The Justice Department has begun an investigation into the workings of the credit-rating industry that focuses on what some contend are anti-competitive practices by Moody's Investors Services Inc. in its ratings of some types of debt securities, people in the industry confirmed yesterday.

In early March 1996, Moody's received notice from the U.S. Department of Justice that it was under investigation concerning potentially anti-competitive rating practices. Moody's president John Bohn resigned on March 22.



The New York Times

Moody's Names Ex-President To Head Its Operations Again

By LESLIE WAYNE
Published: April 9, 1996

Moody's Investors Service said yester-

On April 8, 1996, D&B announced that Bill Dwyer would come out of retirement to serve again as Moody's president.

"BAD GUY" OR WATCHDOG?

Dwyer was also briefed on the status of the DOJ inquiry. The investigation would go on for three years, until February 1999, when the department decided to take no action. Nor would it have a noticeable impact on Moody's overall performance. Revenues had declined in 1994, owing mainly to downturns in the issuance of municipal bonds and competition in mortgage-backed securities (which had been among the reasons for conducting the internal study of Moody's operations). But Moody's revenues rose steadily thereafter, from $300 million in 1995 to $564 million in 1999.

At the time, though, the DOJ investigation did generate a flood of criticism in news stories highlighting grievances of issuers, investment bankers, and competing rating agencies; and it precipitated serious reflection within the firm.

Charles Gasparino, a reporter at *The Wall Street Journal,* was first off the mark. In an article published March 28, he cited analysts and credit rating executives who were saying that the antitrust probe of Moody's "could lead to heightened regulation of the credit-rating business." A month later, SEC Chairman Arthur Levitt Jr. would state that the SEC had no such plans.

But in an article published April 4 titled "Rivals Hope to Gain from Moody's Inquiry," Gasparino accurately captured the sentiments of many rating industry participants and observers. With Moody's being investigated for allegedly pressuring bond issuers to use its ratings, he wrote, "executives at Fitch Investors Service and Duff & Phelps Credit Rating Co. believe they have a unique chance to grab market share from Moody's." Both agencies, according to Gasparino, reported that they had "received dozens of inquiries from major bond issuers and investment bankers who say they feel less pressure to use Moody's ratings and now may turn to one of the lesser-known companies in the bond-rating business." Fitch executives said they had won some additional business in recent days.

In an article published May 2, Gasparino reported more charges that Moody's unsolicited ratings were upsetting bond issuers and their bankers and could cause

THE WALL STREET JOURNAL.

Triple-A Dispute: Unsolicited Ratings From Moody's Upset Some Bond Issuers

They Say It Demands Money For Unnecessary Work; It Says It Helps Investors --- An Industry Vastly Changed

By Charles Gasparino
Staff Reporter of The Wall Street Journal
2 May 1996

NEW YORK -- In burnishing its reputation as a bond-rating company, Moody's Investors Service Inc. contends it protects the capital markets by putting the interests of investors first. Its analysts scour the markets for deals to size up; they don't wait for rating assignments from issuers.
But the zeal that is widely praised by investors has also thrust Moody's into a ruckus that is dividing the rating business -- and drawing regulators' attention. At issue: unsolicited ratings, a practice that unnerves the very bond issuers that pay Moody's bills. Some gripe that the Dun & Bradstreet Corp. unit tries to bully them into buying its ratings.

When Chippewa County, Mich., was planning the financing of a new medical facility last summer, its investment advisers told Moody's, which wanted to rate the pending bond issue, that it had hired two other rating companies at far lower prices. But Moody's wouldn't take no for an answer.

Shortly after the Justice Department inquiry became public knowledge, financial media began highlighting complaints about Moody's unsolicited rating practices.

Moody's some headaches. "If I'm an issuer, they're the real bad guy of the bond markets," said Douglas Nelson, an analyst at Kirkpatrick Pettis, an investment banking firm in Omaha, Nebraska. "Bond raters are supposed to be green-eyeshade types," said Michael Shamosh, a municipal-market strategist at Corby North Bridge Securities in Irvine, New York. "If they're viewed as shakedown artists or using ratings as a hammer to win business, that will shake the underpinnings of the credit markets."

"We fundamentally believe that we are doing what is in the best interest of the markets."

For its part, Moody's continued to defend its rating practices, and Tom McGuire's response to the accusations was: "We fundamentally believe that we are doing what is in the best interest of the markets."

FIRST AMENDMENT PROTECTION

In the same May 2 article, Gasparino pointed to an ongoing dispute in Colorado that seemed to crystallize the complaints against Moody's. In 1993, the agency had published an unsolicited credit report on a bond issue by Jefferson County School District. The district later sued Moody's in Federal court, charging that its report cost taxpayers about $800,000 in additional interest. In its write-up, Moody's had termed the outlook for the district's general obligation bonds as "negative." Eventually, Moody's did rate the bond Baa1, compared with requested ratings in the double-A range issued by S&P and Fitch. The school district contended that Moody's was retaliating for not having been hired to rate the security and that its rating practices amounted to "civil extortion."

An article in the *Economist* focused on the "mud now flying between the agencies," concluding that if the industry itself is not to be downgraded, "they might all have to learn to be more polite.

On May 9, 1996, however, the lawsuit was dismissed. The presiding Federal judge agreed with Moody's assertion that ratings are a matter of free speech, protected by the First Amendment. "We are pleased with the court's ruling, as our livelihood depends on such protection," said Bill Dwyer in a press release.

Like many others, Joe Mysak, editor of *Grant's Municipal Bond Observer,* commented that the ruling "is really good news for Moody's." At the same time, pointing to the DOJ's continuing investigation, he was right to note that "Moody's is still in the soup, so to speak."

Meanwhile, a series of articles in *The Economist* had aptly described the "soup" in which the agency was still swimming. The series—particularly an article published April 6 titled "Aaargh! Credit Rating Agencies"—had enflamed passions at

The Economist

AARGH! CREDIT-RATING AGENCIES.

6 April 1996

WERE he alive today, John Moody, a railway-bond enthusiast and the founder of Moody's Investors Service, a big American rating agency, would be horrified. Last week it emerged that America's justice department is investigating possible breaches of antitrust rules in the rating-agency business. By Moody's own admission, the firm appears to be the chief focus of the investigation.

Like all credit-rating agencies, which publish their opinions on the creditworthiness of the companies and governments that borrow in the world's bond markets, Moody's depends for its livelihood on its reputation among investors for objectivity and accuracy. Over time, its judgments and those of other big agencies, such as Standard & Poor's (S&P), have proved remarkably accurate.

Why all the fuss, then? The justice department, says Moody's, is worried about the agency's practice of issuing "unsolicited", or "hostile", ratings. These involve it judging the creditworthiness of

Moody's. But writers at the publication did try to tell both sides of the story.

On the one hand, *The Economist* noted that Fitch was believed to have had a tough time the previous year and that the agency was then earning 65 percent of its revenues from the three markets in which rating practices were being examined. *The Economist* noted further (based on "information supplied by a rival agency") that Moody's had on occasion sent invoices for rating fees to issuers whether or not they had requested the ratings. The letters purportedly asked the issuer's management to "reflect on the propriety of failing to pay for the substantial benefits that the issuer reaps from our efforts." The implication, once again, was that Moody's may have issued "hostile" ratings to pressure issuers for the purpose of edging Fitch out of the market.

On the other hand, *The Economist* argued that the right of any agency to express its opinion on debt issues "is about as basic as that of free speech." The publication added that, from the viewpoint of the bigger agencies, the "industry's minnows . . . are hardly saints themselves." As evidence the article cited research by the Federal Reserve Bank of New York on the topic of rating shopping. For example, said *The Economist*, the Fed study noted that "borrowers rated by the two big agencies on the borderline of investment grade (a category that means that big investors can buy their bonds) often try the services of a third, smaller agency. And more often than not, the borrower was awarded an investment grade rating."

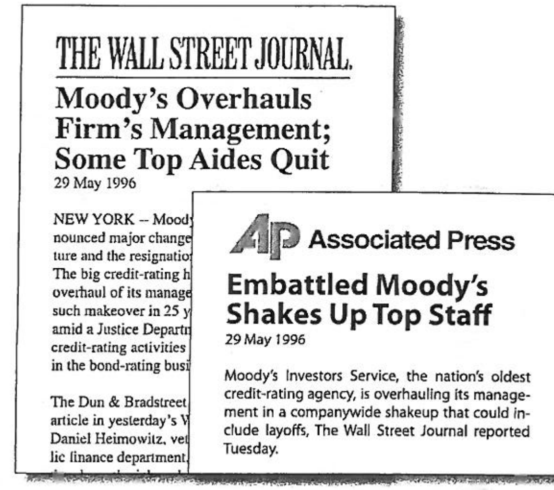
Moody's managers began to recognize that such sniping in the court of public opinion was not good for business, no matter how strong the case on either side.

But *The Economist's* overall opinion on the rating agency brouhaha turned out to be the most telling commentary of all. "Inevitably," the publication concluded:

> . . . much of the mud now flying between agencies is also being hurled for commercial reasons. Since all of them trade on their reputations, the best way for competitors to hurt them is to besmirch these. The smaller agencies, which have less to lose than the behemoths, have sharper tongues. If the industry is not, in the agencies' own jargon, to be downgraded, they might all have to learn to be more polite.

Moody's managers began to recognize that such sniping in the court of public opinion was not good for business, no matter how strong the case on either side. Equally damaging was the acrimonious internal competition that had hampered relations between the Corporate and Public Finance Departments for years, the intensity of which had only been exacerbated by recent events.

THE NEW MOODY'S


THE WALL STREET JOURNAL.

Moody's Overhauls Firm's Management; Some Top Aides Quit

29 May 1996

NEW YORK – Mood
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Daniel Heimowitz, ve
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Associated Press

Embattled Moody's Shakes Up Top Staff

29 May 1996

Moody's Investors Service, the nation's oldest credit-rating agency, is overhauling its management in a companywide shakeup that could include layoffs, The Wall Street Journal reported Tuesday.

On May 28, 1996, Bill Dwyer announced in an internal memo that McKinsey & Company's eight-month-long study of Moody's internal organization was complete and that the agency was launching a broad overhaul of its management structure. He cited a need to become more efficient in the face of more aggressive competitors and the maturing of some of the company's key markets (notably municipal finance). The new structure, said Dwyer, was designed to facilitate long-term strategy and resource allocation decisions and to develop the next generation of leaders for the enterprise. "In the new Moody's," he added, "the success of each organizational unit will depend on the performance of its sister units. Cross-unit interdependencies will exist in every corner of the new organization."

The new structure, said Dwyer, was designed to facilitate long-term strategy and resource allocation decisions and to develop the next generation of leaders for the enterprise.

Accordingly, the biggest change implemented by Dwyer was to consolidate Moody's corporate and municipal bond rating operations into a single Credit Ratings and Analysis unit (CR&A). Ken Pinkes and Don Noe were named co-heads of the new unit, reporting to Dwyer. CR&A included six rating groups. Doug Watson became managing director of the Public Finance group, while the former Corporate Department was reconfigured into seven new groups, each also reporting to Pinkes and Noe: Finance, Insurance and Securities; Banking and Sovereign; Derivatives and Funds; Asset-Backed Finance; Mortgage Finance; Industrials; and Energy, Communications and Speculative Grade.

Among Dwyer's other new direct reports was Ray McDaniel. Having served in London since 1993 as Moody's managing director for Europe, McDaniel would now return to New York to head Moody's international operations. Chester Murray would move to London to serve as managing director for Europe, Africa, and the Middle East, and Ted Young would remain in Hong Kong as managing director of Moody's Asia-Pacific operations. Scott Douglass, whom John Bohn had tapped

MOODY'S NEW MANAGEMENT, MAY 28, 1996


Danny A. Zottoli, Jr.
EVP & publisher,
ancial Information Services


Paul Rumley
vice president & managing director,
Human Resources


Raymond W. McDaniel
managing director,
International


Chester Murray
managing director
Europe


Scott Douglass
managing director,
Marketing


WILLIAM O. DWYER
President


Matthew Molé
vice preident &
general legal counsel


Edward (Ted) Young
managing director,
Asia-Pacific


John Rutherfurd, Jr.
managing director,
New Business Initiatives


Gail Lieberman
vice president, managing
director, chief financial officer


Donald H. Noe
managing director,
Credit Ratings & Analysis


Kenneth J.H. Pinkes
chief credit officer,
Credit Ratings & Analysis

Chief administrative officer
(not yet named)*

*John Rutherford would soon take on additional responsibility as Moody's chief administrative officer.


Ruth Morley
vice president,
managing director,
Technology

to coordinate the McKinsey study, became managing director of marketing, a new group encompassing Moody's research sales and communications functions. And John Rutherfurd was named managing director of another new group, New Business Initiatives.

Rutherfurd had joined Moody's in 1994 as president of Interactive Data Corporation (IDC) when the company became a Moody's business through a D&B restructuring. When IDC was sold in 1995, he remained at Moody's to develop new business. As managing director of Moody's holdings, he also played an important part in the planning behind the reorganization.

In a memo distributed at Moody's May 28, 1996, president Bill Dwyer announced the completion of a study of the firm's internal organization and an overhaul of Moody's management. The new structure wrapped all rating operations into a single Credit Ratings & Analysis (CR&A) unit. Among key changes, Don Noe and Ken Pinkes were named co-heads of CR&A; Ray McDaniel was named managing director, International; and Scott Douglass was tapped to head a new marketing department. Tom McGuire and Dan Heimowitz, heads respectively of the former Corporate and Public Finance Departments, resigned from the firm.

Five of Moody's senior managers continued on in their existing positions: Danny Zottoli, head of Financial Information Services; Paul Rumely, head of human resources; Matthew Molé, general counsel; Gail Lieberman, chief financial officer; and Ruth Morely, head of Moody's technology department. Tom McGuire and Dan Heimowitz, heads respectively of the former Corporate Finance and Public Finance departments, resigned from the company. McGuire took early retirement to begin work on a doctorate degree in American history. Heimowitz had been asked to stay on as head of the Public Finance group under Pinkes and Noe, but declined and moved to Lehman Brothers.

As part of the reorganization, Dwyer also set up several "performance improvement" initiatives to implement the new order, including the formation of task forces in five areas: non-wage expense management, support group redesign, revenue growth, management information systems, and organizational performance.

OPENING THE "BLACK BOX"

High on the list of issues to be addressed in the new Moody's was the growing perception of the agency's arrogance, particularly on the issuer side of its client base. "'Arrogance' can mean many things, and all of them are intolerable here," said Ken Pinkes, in an interview with *Aaa,* Moody's company newsletter, soon after the reorganization. "Comparatively speaking, this is a relatively small company, one that is far more conspicuous than its size would suggest. People pay attention to what we do," he explained. "That's why it's critical that we remain utterly professional, vigi-

on Noe (left) and Ken Pinkes, co-heads, Credit Ratings Analysis, met with rating staff shortly after Moody's 996 reorganization to lay out plans for the new group. rrogance. . .will not be tolerated in the New Moody's," id Pinkes. "If there is one thing that will make us rmidable with respect to our competitors," added Noe, t is a deeply felt sense of shared purpose."

lant, and conscious of market perceptions."

With that in mind, Moody's began to ease up on its unsolicited rating practices and to look instead for other ways to address the competitive pressures of rating shopping. "If we produce good research, high quality and timely ratings, we'll have dealt with the competition," said Don Noe in the same interview. "If there is one thing that will make us formidable with respect to our competitors, it is a deeply felt sense of shared purpose."

Soon thereafter, Pinkes and Noe introduced Moody's Credit Policy Standing Committee process as a way of coordinating that shared purpose. The Standing Committees were formed to address analytic and credit practices issues in several areas, including securitization, indentures and support mechanisms, rating symbols and definitions, and the rating committee process. Each committee solicited questions and commentary on emerging issues and met to arrive at consistent approaches. "Instead of spending time recreating the wheel," commented Noe, "Moody's analysts have begun turning to these committees for guidance on particular questions."

Initially, the process was intended to foster greater analytic transparency within Moody's. But it soon became a vehicle for extending that transparency to key constituencies outside the firm, particularly as committee members sought feedback and commentary from investors, intermediaries, and issuers, as well as from regulators. Committee members also began making presentations at conferences held by intermediaries and treasurer societies. A central aim of the Standing Committee process, said Pinkes, "is to develop collaborative relations with all the constituencies we serve, effectively to make them part of the process by which we establish standards and develop our analytic concepts and practices."

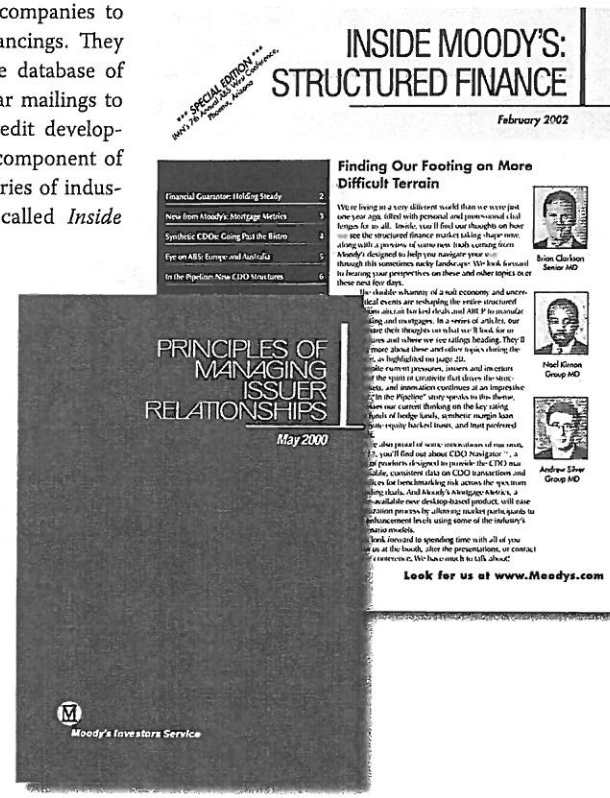
The Standing Committee project also became an important means for opening what market participants had long referred to as the rating agencies' "black box." And it did much to erase perceptions of Moody's as an arrogant, "ivory tower" institution. In 1998, the agency went a step further when it formally introduced a new concept across the firm: issuer marketing.

A year earlier, the agency had commissioned a survey of issuer clients similar to the polls that it had long conducted among investors. The survey corroborated the results of earlier studies by the likes of *Treasury & Risk Management* maga-

zine—namely, that issuers then regarded Standard & Poor's as the "leader in the field," with Moody's a distant second and Fitch and Duff & Phelps still further behind. At the same time, Moody's came in last on nearly every key attribute of agency performance important to issuers, including timely and candid response to inquiries, quality of analytic staff, accuracy of ratings, and clarity of guidelines for ratings and rating changes.

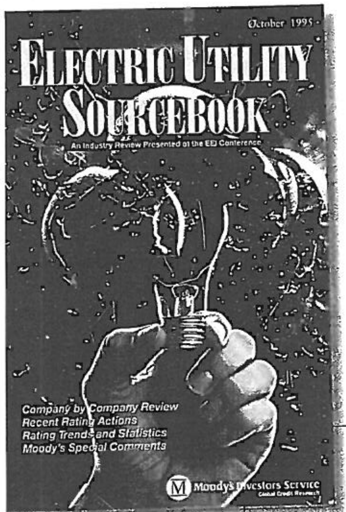
Bill Dwyer, again, was appalled at the results. He mandated that an issuer relations program be set up immediately to address the agency's reputation problem, tapping Michael Foley, managing director of the Energy, Communications, and Speculative Grade group, to head the effort. Foley and his team met with key issuers and their bankers to determine the best approach, then initiated a world-wide training program to enhance analysts' professional relationship-management skills.

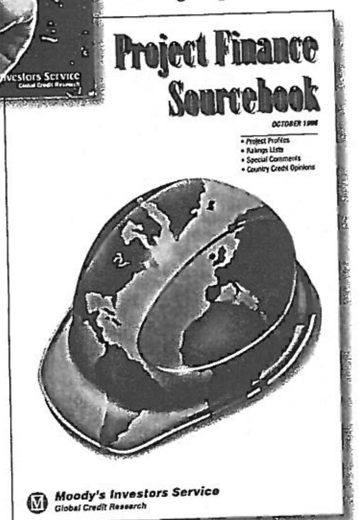
The issuer relations team coordinated production of a new series of Rating Methodology reports written specifically for issuers in key market segments, from electric utilities and industrial companies to specific types of structured financings. They also developed a comprehensive database of issuer contacts and began regular mailings to issuers on topics relevant to credit developments in their industries—one component of this outreach would be a new series of industry-specific issuer newsletters called *Inside Moody's.*



Beginning in 1997, Ken Pinkes and Don Noe introduced a series of Standing Committees as a way of fostering the consistency of Moody's rating process throughout the firm. That work was then communicated to market participants through a variety of channels, including rating methodology handbooks and regular mailings to issuers and intermediaries. A guide for Moody's analysts on the principles of issuer relationship management was introduced in 1998. The first issue of *Inside Moody's* newsletter was mailed to issuers in the real estate finance sector in 2000. Later editions of those publications are shown here.

Moody's also began to hold issuer briefings and teleconferences covering key industries and market segments around the world. Additionally, an improved system for scheduling and coordinating issuer meetings was instituted, and issuers were invited to provide feedback on their experience with Moody's.





Even before Moody's reorganization, efforts to make the agency's rating process more transparent to market participants were evident in its annual *Electric Utility Sourcebook*, first published in 1995. A similar series of sourcebooks focusing on the project finance sector began in 1996.

RATING COOPERATIVELY

Over the next year and a half under Bill Dwyer's leadership, Moody's reputation among issuers would improve dramatically; and revenues would climb to record levels in both 1996 and 1997, as the agency's new organization helped to foster a fruitful spirit of cooperation. Sharing rating expertise and support services between rating groups, said Dwyer, was leading to cost savings, more rapid response to new types of debt, and greater flexibility to allocate resources to new opportunities.

During this period, the Public Finance group introduced a concise, opinion-oriented research product in a format parallel to that of *Moody's Global Credit Research* service. The group also drew on the expertise of structured finance analysts from across the formerly walled-off corporate and municipals sides of the business to rate new instruments, such as securities backed by municipal tax liens. And many municipals analysts, whose work had once been limited to tax-exempt issuers in the U.S. and Canada, were tapped to rate municipalities overseas. In 1997, Moody's rating coverage of Eurobonds issued by such sub-sovereign entities grew 60 percent, including ratings of regional and city governments in Italy, Czech Republic, and Russia.

Among many other activities during the period, the agency's

Electric Utility group partnered with analysts from the municipals and structured finance areas on investor briefings and special commentary. They also joined forces to rate securities backed by utilities' "stranded assets," an outgrowth of ongoing utility deregulation in the U.S. Similarly, Moody's Project Finance team drew on firm-wide analytic expertise to promote the team's services around the world and to publish Moody's first *Project Finance Sourcebook.* The publication included contributions from the agency's sovereign, financial guarantor, power, energy, and public finance rating areas.

Moody's Mortgage Finance group increased rating coverage by some 50 percent during 1997 in both the commercial and residential mortgage sectors.

Moody's Mortgage Finance group increased rating coverage by some 50 percent during 1997 in both the commercial and residential mortgage sectors. The Asset-Backed Finance group began rating several new asset classes the same year, including the structured market's first intellectual-property transaction, and the so-called Bowie Bond (backed by cash flow from the back catalogue of performer/musician David Bowie). In 1997, the group assigned ratings to more than $100 billion worth of asset-backed securities, with the result that Moody's ABS rating revenues came close to surpassing all of the agency's corporate bond revenues. This was a harbinger of the phenomenal growth to come in the structured finance portion of the rating business.

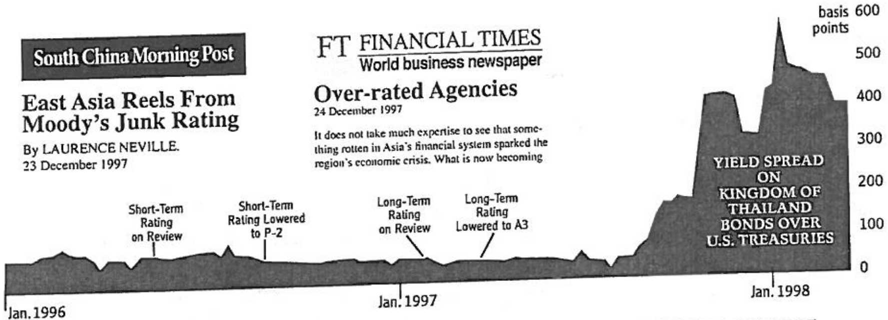
As rating activities all across Moody's were humming along smartly in 1997, the Banking & Sovereign group successfully implemented a three-fold expansion of its global research services. The same year, Moody's Credit Risk Management Service was introduced to provide clients with direct access to the agency's growing database of bond defaults and rating transitions.

Outside the U.S., Moody's registered strong growth across the board in both the fundamental and structured finance rating areas, and in cross-border as well as local debt markets. For the first time, international operations accounted for one-fifth of Moody's total revenues in the corporate sector.

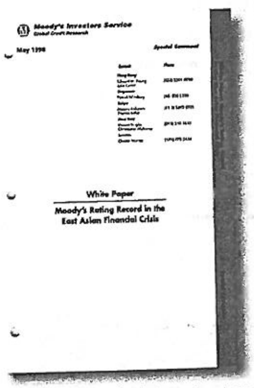
CRISIS IN EAST ASIA

Not all international developments were positive for Moody's, however. Beginning mid-year 1997 with the onset of the Asian financial crisis, the agency's Banking and Sovereign group was in full crisis mode to keep up with day-to-day monitoring, reviewing, and downgrading of ratings for Thailand, Korea, Malaysia, Hong Kong, Indonesia and other East Asian nations that had come to be known collectively as the "Asian Miracle."

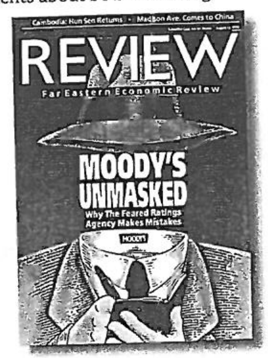
The crisis broke first in Thailand, notably in July 1997, when the Thai baht, which had been pegged to the U.S. dollar, was devalued and allowed to float. The



INSIDE STORY: RATINGS AND THE ASIAN FINANCIAL CRISIS



WHEN THE MAJOR international agencies lowered ratings on Thailand, South Korea, and Indonesia below investment grade in December 1997, many market participants complained that the downgrades were too late and the agencies' sovereign analytics were insufficient to the task. That was an abrupt shift in market sentiments about both the rating agencies and the so-called Asian miracle.



A year earlier, as recounted in Moody's May 1998 "white paper" on the crisis, very few observers had heeded the warnings in Moody's publications of a build-up of short-dated capital and the possibly of a sharp reversal capital flows to East Asian nations. In February of 1997, Moody's reviewed Thailand's A2 rating for possible downgrade, seven months before the crisis first broke with the sharp rise in interest rates on Thai government bonds (see chart). When Moody's lowered Thailand's sovereign rating in April of that year, *Euroweek* magazine reported that the downgrade had "angered many banks and debt specialists." It was widely believed that the decision was "not warranted by economic fundamentals."

In retrospect, nevertheless, the general consensus (as expressed in an August 1998 feature story in the *Far Eastern Economic Review*) was that agencies had "missed the crisis." From Moody's viewpoint, such critiques failed to recognize what credit rating methodology can and cannot do. As the agency put it in its white paper, "ratings are not intended to predict the precise timing and severity of default by a given borrower nor of the precise timing of financial crises which borrowers may face. These events are essentially unpredictable by rating agencies or anyone else."

That said, Moody's, like so many others, searched for lessons learned in the wake of the crisis. Beginning in early 1998, the agency redoubled efforts to enhance its on-the-ground staffing across the emerging markets. And in all of its sovereign rating research Moody's placed increased analytic emphasis on assessing each nation's sensitivity to sudden capital outflows.

Vincent Truglia, co-head of Moody's Sovereign Risk Unit (left), was responsible for East Asian ratings throughout the Asian crisis. David Levey, the unit's other co-head during the period, was responsible for sovereign ratings in regions later affected as the crisis spread, notably to Eastern Europe and Latin America.

same international investors who had fueled excessive investment in East Asia over the previous decade then began to reassess the situation, particularly the massive buildup of short-dated capital coupled with a lack of adequate foreign currency reserves. By September, interest rates on Thai government bonds began to skyrocket and the Asian Miracle turned into a rout that soon raised concerns in Japan and across the emerging markets. The major rating agencies responded to these developments with rating reviews and downgrades that were viewed as causing the crisis to snowball. Although Moody's had issued repeated warnings on the risk of capital outflows across the region and had adjusted several ratings and outlooks downward well in advance, the general consensus was that all agencies had "missed the crisis" (see opposite page).

JOHN RUTHERFURD SETS A NEW TONE

In January 1998, D&B announced that John Rutherfurd, then Moody's chief administrative officer, would succeed Bill Dwyer as president. Dwyer would stay on as chairman until March.

On January 7, 1998, D&B chairman and CEO Volney Taylor announced that John Rutherfurd would succeed Bill Dwyer as president of Moody's. Dwyer stayed on as chairman until his second retirement at the end of March.

Dwyer, said Taylor, had succeeded in achieving all of the objectives he laid out on returning to Moody's, "including the establishment of a new company culture and improvement of the financial results." Moody's, he added, "is now on the right course to remain the leading global authority on credit risk." "Rutherfurd," said Taylor, "is an outstanding businessman." As president of Interactive Data Corporation under D&B he had increased the firm's market value from $60 million to more than $200 million. Over the past year and one-half as Moody's chief administrative officer, Taylor added, Rutherfurd "has become very familiar with Moody's strategy, people, and economics, and has developed a real confidence in Moody's."

John Rutherford did not fit the mold of previous Moody's presidents. Although he held a law degree from Harvard, he was also trained as a physicist at Princeton. And his knowledge of theoretical finance—a hobby of his—could be intimidating to Moody's managers and analysts. He had an understated, yet intensely detailed-oriented style, and a keen understanding of the financial information services business.

As president of Moody's, Rutherfurd got to work immediately setting a new direction for the firm. In early April, he promoted Andrew Kimball to a newly created position as chief information officer, citing the critical importance of the firm's technology infrastructure to future growth. Rutherfurd then initiated what would be by far the most active series of acquisitions, joint ventures, and other tie-ups and divestitures ever undertaken by the firm.

The biggest change, implemented in 1998, was the landmark divesture of Moody's Financial Information Services (FIS) division. Since its formation in the early 1980s, FIS had continued the century-long tradition of publishing Moody's manuals, and had recently introduced Moody's Company Database, which offered electronic access to information on 10,000 companies, including SEC documents. FIS had become a relatively small division, however, with low to moderate growth prospects. The decision to sell, said Rutherfurd, "is based on our desire to concentrate on our core credit rating and analysis operations."

In July 1998, FIS was acquired for $26.5 million by Financial Communications Company, Inc. (FCC), headquartered in Chicago. The company had been formed in 1997 by Berwick Capital, a private equity fund created by Robert S. Andrialis, and by M/C Partners of Boston. Andrialis, a former Standard & Poor's executive, was chairman and chief executive of FCC when it bought *Futures* magazine and other publications serving the derivatives and financial services industry. He now expected that the acquisition of Moody's FIS would double FCC's annual sales to around $70 million.

A year later, the former Moody's division would be rebranded as Mergent FIS. Moody's Manuals were then relabeled Mergent Manuals, and a Mergent Online service was introduced. In June of 2004, Mergent would be acquired by Xinhua Finance, China's premier financial services and media company.

In June 1998, Moody's acquired Syndicated Underwriting Research, Ltd. (SURL), a UK-based research company specializing in the Lloyd's of London insurance market. SURL managing director Mark Hewlett (right) then became head of Moody's non-life European insurance group. Hewlett (right) was featured at the first Moody's-SURL conference later that year, along with Chester Murray, managing director for Europe, and Debra Perry, managing director, Finance, Insurance, and Securities.

TWO NEW ACQUISITIONS

Rutherfurd also oversaw two acquisitions during his first years as president. On June 9, 1998, Moody's acquired Syndicated Underwriting Research Ltd. (SURL), a UK-based research unit specializing in the Lloyd's of London insurance market. The acquisition proved to be a timely addition to Moody's growing coverage of the Lloyd's market, as well as insurance markets across Europe. SURL managing director Mark Hewlett joined Moody's as managing director of the agency's European Property, Casualty, and Reinsurance team. Two weeks later, Moody's published the *Moody's-SURL Lloyd's Syndicate Ratings Guide.* The guide warned, correctly, that fierce competition in the global insurance markets would leave many Lloyd's syndicates reporting losses in 1998 and 1999.

Moody's second acquisition under Rutherfurd was concluded on January 28, 2000, when the agency acquired the Software Products Group of Crowe, Chizek and Company. Crowe Chizek was then the eighth largest accounting and consulting firm in the United States, with domestic offices in the Midwest and international offices in Ireland and the United Kingdom. Its software products unit had a client base of 4,000 financial institutions in 50 states and 46 countries, and its financial statement analysis and credit risk assessment software were industry standards.

The Crowe Chizek acquisition was meant to help Moody's Risk Management Services become a one-stop provider of financial statement analysis and credit scoring software to banks and financial institutions. "When the combined company is in place," said Rutherfurd, "Moody's will offer a complete array of cost-effective credit-assessment and risk-management capabilities to serve the needs of the smallest and largest credit institutions."

Moody's president John Rutherfurd (second from right) shakes hands with Song Tae-june, president of Korea Investors Service (KIS), after signing an agreement to set up a joint-venture rating company, as Ray McDaniel, managing director, International, looks on. The Moody's-KIS alliance was announced in June of 1999. [Photo from the *Korean Herald,* August 11, 1998.]

TEAMING UP WITH LOCAL RATING AGENCIES

For years, Moody's had shied away from joint ventures with local rating agencies. The fear was that any merger of local ratings into Moody's system would compromise the rating consistency that was at the core of the agency's competitive edge in the global marketplace. The problem with that approach was that Moody's was missing important opportunities to enter local markets. Also, the agency was receiving a constant stream of offers from local agencies, and turning them down only added to Moody's reputation for arrogance, still strong in some quarters.

Rutherfurd found a way around these difficulties by seeking alliances that did not involve Moody's ratings. Instead, they featured various forms of technical assistance, notably analyst training and joint research projects and products.

The first such alliance, a joint venture with Korea Investors Service Inc. (KIS), was announced in June 1998. KIS had been established in 1985 by some 70 financial institutions in Korea. By the late 1990s, the firm was issuing ratings on domestic-market bonds and commercial paper, and was publishing stock information. Under a formal agreement signed in August 1998, Moody's took a minority stake in a new rating firm established under the KIS name. While KIS management remained separate from Moody's, the agency would be represented on the KIS board of directors and Moody's agreed to participate in activities including an exchange of credit rating reports, a joint research publication, joint external seminars, and credit training for KIS analysts.

The joint venture also held indirect benefits for Moody's rating franchise. Korea had been among the countries most affected by the Asian financial crisis; and the major rating agencies, Moody's included, had been sharply criticized for not having an adequate presence in the region. "One of the main reasons why we are affiliating with Korea Investors Service, Rutherfurd told KIS management at the opening ceremony, "is to provide members of our staff with the opportunity to learn more about the conditions in Korea, so that they can provide more informed opinions to our clients about the very significant Korean economy."

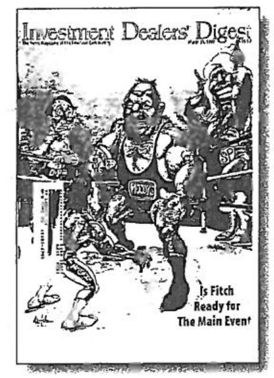
In December 1998, Moody's entered into a partnership agreement with ICRA Ltd., one of India's leading rating agencies. Shown signing the agreement in Mumbai are ICRA chairman D.N. Gohsh (left) and Moody's president John Rutherfurd.

Over the next year, Moody's entered into two more alliances with local agencies in Asia. In December 1998, the agency signed an agreement with ICRA Ltd., headquartered in New Delhi, India. Incorporated in 1991, ICRA was one of the country's two leading credit agencies, with some 100 analysts in eight Indian cities. Under the new partnership agreement, Moody's took

Moody's and China's leading rating agency, Dagong Global Rating Company, inaugurated a cooperative relationship in July 1999. Three Moody's representatives present for the signing ceremony in Beijing are shown (from left): Julia Turner, Ray McDaniel, and John Rutherfurd.

an 11 percent stake in ICRA, making it the second largest shareholder after Life Insurance Corporation of India (which had a 30 percent stake). In July 1999, Moody's reinforced its presence in the People's Republic of China by entering into a cooperative relationship with Dagong Global Credit Rating Company to provide technical assistance in credit analysis and training for Dagong analysts. The agency was a newly formed offshoot of Dagong International Credit Assessment Company, one of China's oldest credit rating firms.

Around the same time, Moody's was actively extending its presence in Latin America. In March 1999, the agency agreed to acquire a partnership interest in Chile's Clasificadora de Riesgo Humphreys Ltda., a provider of business risk ratings. In September, Moody's entered into a deal with Buenos Aires-based Ratto-Humphreys Calificadora de Riesgo and Value Calificadora de Riesgo to provide credit risk ratings in Argentina. Moody's took an equity stake in Ratto-Humphreys, which then combined with Value to create Humphreys-Argentina. The partner agencies would help to extend Moody's on-the-ground presence in Latin America. That expansion had begun with the opening of Moody's America Latina in São Paulo, Brazil in 1997. In early 2000, Moody's would open its second wholly owned Latin American subsidiary: Moody's de Mexico S.A. de C.V., in Mexico City.



The lead story in *Investment Dealers' Digest* magazine's March 31, 1997 issue questioned whether Fitch Investors Service was ready to take on Moody's and S&P for a top-tier position in the rating industry. Author Michael Bender concluded that the agency's small size "may well keep Fitch a niche player—at least for the present."

RATING INDUSTRY CONSOLIDATION

Meanwhile, the competitive landscape in the rating industry had begun to shift again. Just a year after the U.S. Department of Justice investigation of anti-competitive practices began, *Investment Dealers' Digest* ran an article by Michael Bender titled "Is Fitch Ready for the Main Event?" Fitch executives, he reported, "smell blood at Moody's, and are ready to grapple with it for a top-tier position." Bender concluded, however, that lack of size "may well keep Fitch a niche player—at least for the present." Without critical mass in rating coverage of corporate and municipal securities, he wrote, "Fitch stands little chance of ever being considered a top rating agency, sources agree."

In 1997, for the fourth straight year, Moody's topped listings for rating agencies in *Institutional Investor* magazine's All-America Fixed-Income Research Team. Six of the seven Moody's analysts named to the team that year received special honors from chairman Bill Dwyer. Shown here from the left: John Nelson, Tom Calibeo, Greg Bauer, Dwyer, Tassos Philippakos, Ryan O'Connell, and Sean Jones. Missing is Naomi Richman. Separately, *Institutional Investor* named Moody's the industry's "leading rating agency" for five years running, 1996 through 2000.

Moody's emphasis on building constructive relationships with all of its customers may have had something to do with that—including its ban on aggressive unsolicited ratings, imposed by Rutherfurd in 1998. An uptick in U.S. and international bond volumes in 1997 and 1998 certainly helped, as did the awards Moody's analysts were receiving from key financial media. For the fourth year running in 1997, for instance, Moody's analysts topped *Institutional Investor*'s All-American Fixed-Income Research Team listing for rating agencies. For whatever reason, the strengthening of both Moody's and S&P would lead to a period of consolidation among the rating industry's second-tier players.

In October 1997, Fitch was acquired by the French conglomerate Fimalac and was at the same time merged with London-based IBCA to create Fitch IBCA, Inc. Fimalac, created in 1991 by Marc Ladreit de Lacharriere, had diverse worldwide interests in industry, communications, and real estate and was traded on the Paris Stock Exchange. Having worked for several years as an executive at L'Oreal, the French cosmetics giant, De Lacharriere was a firm believer in the opportunities presented by globalization, and the rating business fit naturally with that worldview. Through its association with Centenaire Blanzy, Fimalac had gained a controlling interest in IBCA in 1992. After Fimalac acquired Fitch for $175 million in cash from Van Kampen Group, De Lacharriere

In mid-March 1999 it became public knowledge that the U.S. Department of Justice had ended its investigation of anti-competitive practices in the rating industry.

The New York Times

Justice Dept. Inquiry on Moody's Is Over, With No Charges Filed

By KENNETH N. GILPIN
13 March 1999

The Justice Department has ended an investigation without finding anti-competitive practices at Moody's Investors Services Inc., the credit rating agency that is a subsidiary of the Dun & Bradstreet Corporation.

The Government's investigation of Moody's, part of a wide-ranging investigation into charges of anti-competitive practices in the bond-rating services industry, began early in 1996. It was conducted by the Justice Department's antitrust division.

FITCH BECOMES A FORMIDABLE COMPETITOR

When French conglomerate Fimalac purchased Fitch Investors Service and merged the firm with its UK-based IBCA unit in October 1997, many believed that the combination would be a threat to Moody's and S&P. The new agency, Fitch-IBCA, became a still stronger competitor when Fimalac acquired Duff & Phelps in March 2000, followed in October of the same year by Fimalac's acquisition of Thomson BankWatch from Canada's Thomson Corporation. The combined entity would soon be renamed Fitch Ratings.

REUTERS

Fitch-IBCA provides new ratings alternatives

16 October 1997

PARIS, Oct 16 (Reuters) - The merger of U.S. ratings agency Fitch and Britain's IBCA will create an alternative to the major U.S. agencies in the rapidly growing industry, said the chairman of IBCA parent FIMALAC.

Marc Ladreit de Lacharriere said the companies would build on their strengths in the securities, structured financing, bank and sovereign debt sectors.

AFP

French Fimalac Group Buys Ratings Business of Canada's Thomson

19 October 2000

PARIS, Oct 19 (AFP) - French group Fimalac, which controls the Fitch ratings agency, said Thursday it would buy the ratings business of Canada's Thomson Corp for an undisclosed sum.

The deal would result in Thomson owning a 3.4 percent share in Fitch, the company said in a statement.

Los Angeles Times

Duff & Phelps, Fitch Say They Plan to Merge Credit:

Move would pit new firm against Moody's, S&P, refueling competition in the ratings business.

From Reuters, 8 March 2000

NEW YORK – Fitch IBCA and Duff & Phelps Credit Rating Co. on Tuesday announced plans to merge, refueling competition in the credit rating business by pitting the new company against heavyweight foes Moody's Investors Service and Standard & Poor's.

THE WALL STREET JOURNAL.

French-Run Firm Hopes to Take On Moody's and S&P

By Douglas Lavin
Staff Reporter of The Wall Street Journal
26 September 1997

PARIS -- Marc Ladreit de Lacharriere, a French entrepreneur who is trying to buy New York-based credit-rating firm Fitch Investors Service L.P., may not seem like much of a threat to ratings giants Standard & Poor's Ratings Group and Moody's Investors Service Inc.

Then again, look at what he has done in China. After buying a controlling stake in a French

became chairman of Fitch IBCA. Former IBCA chairman Robin Monro-Davies became vice chairman and chief executive officer. And Fitch's president, Stephen W. Joynt, became president and chief operations officer. The combined company, said Joynt, "will benefit from IBCA's international coverage and Fitch's strong market recognition in the U.S. and a leading position in securitization markets."

A year or so later, the firm's prospects may have looked a bit less bright when it became widely known that the DOJ had closed its investigation into Moody's anti-competitive practices without taking any action. "This puts any lingering doubts as to Moody's credibility behind them," said Michael Shamosh, a fixed-income strategist at Tucker Anthony Inc., in a *Wall Street Journal* report of March 12, 1999.

In early March 2000, the rating industry entered its next phase of consolidation when Fitch IBCA agreed to acquire Duff & Phelps Credit Rating Company for $528 million in cash. Quoted in the *American Banker*, Robin Monro-Davies commented that the combined entity, with about $260 million of annual revenues, would be in a better position to compete with Moody's and S&P. "Obviously, we won't overtake