MEMORANDUM FOR THE RECORD

Event: Phone call with George O'Connell, Attorney General of Connecticut

Type of Event: Phone call

Date of Event: Monday, April 26, 2010

Team Leader: Brad Bondi

Location: 1717 Pennsylvania Avenue, NW, Suite 800, Washington, DC, 20036

Participants - Non-Commission:

- George O'Connell, Attorney General of Connecticut
- Lauran Martell, office of the Connecticut Attorney General

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MFR Prepared by: Sarah Zuckerman

Date of MFR: April 30, 2010

Summary of the Interview or Submission:

This is a paraphrasing of the interview dialogue and is not a transcript and should not be quoted as such.

O'CONNELL: We watched the Senate hearings on Friday.

BONDI: We have the emails that they released publicly on a disk-for the press. We will get it to you. It may not be OCR'd.

We are a ways behind CT on what you are doing on rating agencies. Can you tell us where you are in your case?

O'CONNELL: We filed lawsuits against Moody's and S&P on March 10. They recently moved the case to federal court. We are briefing remand and filed remand soon. We filed lawsuits against them in 2008 on a separate issue and they moved them to federal court and they were remanded then so we expect the same result. Do you want me to speak about the cases?

BONDI: Yes it would be helpful as background. What are the theories, and what other theories might you be adding.

O'CONNELL: It is under the Connecticut Unfair Trading Act. Both Moody's and S&P make representations about being fair and unbiased in various places. On their website, etc, they say that they are independent and objective and that their analysis is not based on a desire to do business with anyone.

Based on our investigation, that was not true. They were very influenced by their desire to do business with large companies and increase their market share. It effects how they rate securities and set standards for their ratings. The case is that they were not objective—even though they said they were—because they wanted to increase revenue and market share. We started off pursuing a traditional antitrust angle, but we decided now to go with the unfair trade angle because their conduct is so divergent from how they present themselves.

BONDI: Was there any evidence of collusion between the two?

O'CONNELL: No, not in the traditional sense. They did not speak to each other. They could both tell what the other was doing—*i.e.*, ratings shopping. Someone would say, "S&P can do the following. Can you do that for us?"

A lot of information is available about competitors from an analytic standpoint, so they didn't have to get in a room together to make decisions. They decided to compete on who could quickly and efficiently modify their ratings to please issuers. Competition was based in a large part on who weakened their models most to please clients.

BONDI: In terms of Moody's models, there are three: binomial expansion, correlated binary expansion, and CDO ram model. There is talk about the correlated model coming into existence in 2004, invented by Gary Witt, who intended it for CDOs, but it wasn't used for CDOs. Do you know why it wasn't used in 2004 for CDOs?

O'CONNELL: We spoke to Gary Witt and he gave us materials. In the summer of 2004, Moody's was using binomial expansion for rating CDOs, and there was much more diversity of asset classes in CDOs at that time. They were using the binomial model, which emphasizes a diverse asset base, so there are higher ratings on diverse assets.

In September of 2004, they introduced the correlated model. At the time, it was for a very small group of CDOs. Moody's was slow to make methodology changes and wanted to test out the model and they wanted to test out how issuers reacted to it. They had some pushback to the correlated model. It was initially designed as more conservative, so it was harder to get a high rating, and they received pushback from large investment clients.

They were starting to get market intelligence on S&P that they were involved in a similar review of their CDO ratings process. They heard that S&P was having success rating the non-diverse CDOs at a level that was very high and what the client wanted. Moody's became increasingly concerned in fall 2004 and early 2005 about the correlated binary model. They couldn't keep it the way it was designed because it was not in line with the way S&P was working. They decided to go forward with the correlated model, but they changed the correlation to get results that would be more in line with competitors like S&P.

In June 2005, they introduced a new report with new correlation assumptions, and by September of 2005 they applied those assumptions to the correlated model and started to use it on deals that were heavily concentrated in asset-backed securities. Market share was carefully monitored in 2004 and 2005. Witt was aware that if anything he did hurt market share, he would have to explain it to the marketplace and his superiors.

BONDI: Was there any indication that Moody's was dragging their feet in terms of implementing their models because they were concerned about market share?

O'CONNELL: In email we have evidence of them tracking market share. There is overlap in the emails that we have with those from the Senate hearings.

For example, a request goes out that "I noticed market share went down from 98 to 95%. What's going on? Did we lose market share?" These emails to the managing directors coincided with what Gary and others told us about influence of market share on development. There were not emails saying that they needed to slow down or change a model for market share. People told us that and then documents supported that.

BONDI: In paragraph 135 is that what you were talking about? Is that what was referenced in your complaint?

O'CONNELL: Yes. The managing director was Yuri Yoshizawa. She was beaten around by Senator Levin in the hearing. At first she said that she didn't take staff off of deals, and then she said she might have, and then she said she did, but she said that it was because her staff was getting beaten around by issuers and she didn't want that.

BONDI: She is the one behind the Abacus deal?

O'CONNELL: Yes, we didn't put that together until last week, but Eric who also testified said that they were involved in rating that deal, so it was definitely her group.

BONDI: We are struggling with whether we have found everything there is to find with the Connecticut case, the Ohio case, the Permanent Subcommittee on Investigations hearing, and the House Oversight Committee hearing. Is there something more to this story that everyone has missed?

O'CONNELL: My impression is that there are probably a lot more examples that have not yet come to life. In our lawsuit we are attacking their misaligned incentives that have been in place since early 2001. As CDO issuances skyrocketed in 2004, some of these problems became more noticeable. There are many more examples out there about these issues. From my standpoint, the main problems from the incentive sides and the broad types of misconduct have been explained, but all the examples of them have not yet been revealed.

BONDI: We are trying to look at the connection to management, particularly Clarkson. What have you found about him?

O'CONNELL: We haven't spoken to him yet but everyone tells the same story. He was in structured finance and was very well regarded—he was flying through the ranks. He was very focused on market share issues and revenue enhancement. He had a lot of power in the company. He was very explicit in talking to people: if issuers complained to him or senior people at Moody's about certain analysts or vice presidents, Clarkson would sit them down and say, "Unless we can add value, there is no reason to be on this deal. We should not pushing back the issuer too hard but instead giving them what they wanted."

He led the cultural change to make it more revenue-centric. It was an environment focused on pleasing the issuer as their client, not the investor. It was a customer satisfaction model where the issuer is the customer who wants you to rate their product as highly as possible.

BONDI: Can you, under Connecticut laws, charge individuals and did you consider doing so?

O'CONNELL: We can charge individuals and we thought about it briefly but not seriously. Not because there weren't individuals at fault, but we had trouble verifying key information on individuals before filing suit. We didn't have documents that tied it up enough to charge anyone individually.

BONDI: In paragraph 162, you refer to a conversation between Clarkson and McClesky. It looks like we are overlapping but we are behind in terms of interviews. Can you give us any sense of who to talk to or not talk to in terms of who would be helpful?

O'CONNELL: Are you focusing on Moody's? Is that who you are singling out? Gary Witt was very helpful. He has done a nice job of explaining the 2004-2005 time period.

BONDI: We have spoken to Witt and Scott McCleskey, we are planning to speak to Eric Kolchinsky. He was the big whistleblower. We haven't gotten much farther. We have made contact with a few others—a few former employees to see if they know anything, like Arturo Cifuentes. In terms of folks we thought were useful, we haven't received much information. We also spoke to Jerome Fons. We are looking to RMBS and CDO side of ratings but also at the monolines. We are looking at MBIA and AMBAC.

O'CONNELL: Mark Froeba is a good person. He was useful confirming what Gary Witt said. He spoke a lot about how analysts and mid-level managers were compensated in terms of receiving stock options which aligned their needs with issuers and not investors.

Moody's conducted an annual survey of business performance between 2006-2007 where managers had to assess their success in terms of market share. It was called the BES survey. Some of those documents were released on Friday. It was helpful to get personnel files on people involved—there would be discussion on market share and revenue and giving people negative reviews if they didn't meet those goals. Eric Kolchinsky has a lot of great stuff to say.

We spoke to Jerry Fons also, He was very helpful getting us linked up with other people like Eric and Mark. 36CFR1256.56: Privacy [redacted] He was on the credit policy and symbols committees so he would have been very involved in methodology changes. We will go back and ask him more about changes because he didn't leave the company until 2007. The credit policy committee would have to approve the transition to the correlated model so we will go back on that one.

A group of people we spoke to who were somewhat helpful were Sylvain Raines and Ann Rutledge.

BONDI: We have spoken to him and Ann.

O'CONNELL: We spoke to Sylvain, Ann and Josh Rosner. Their focus was emphasizing that rating committees were reconvened to make changes to ratings that had resulted in complaints from issuers. So that was a common thing at Moody's—if a rating goes out and Countrywide responds that there are some problems, the committee was reconvened.

BONDI: Have you found any evidence of that?

O'CONNELL: We haven't. We sent some subpoenas out to some deals that Sylvain and Josh said might involve that kind of conduct. Moody's started to fight compliance with the subpoena. So we decided to sue instead of fighting compliance.

For a while we were focused on specific deals and 36CFR1256.56: Privacy [redacted] mentioned that the best way to influence those was on the methodology side. An analyst would need to differ from procedure, so methodology changes would be a more efficient way to affect deals because they applied across all deals. So after that we focused more on the methodologies.

We intend to speak to Richard Michalek. He was at Moody's from 1999-2007. He testified on Friday, and he has a lot of great documents. He recounted sitting down with Clarkson and Clarkson saying that his job on the line because issuers were complaining about him, and there was a group of issuers that he was not allowed to work with any more. He echoes a lot about methodologies being influenced by market share.

There are some other Moody's people who we have not talked to yet but will reach out to. 36CFR125 [redacted] They found an error in the model and instead of fixing it, they ran with it and it resulted in some higher ratings than are justified. He is located in NYC.

BONDI: Are you constrained on subpoenaing now because of the status of the litigation?

O'CONNELL: We have pre-complaint discovery under antitrust and antitrade, but once we filed the lawsuit we can't use that. We can keep talking to former employees. We can't compel anyone to talk with us at the moment because we have to go through discovery process. We are doing a motion to remand. On first set of cases when they tried to start discovery before remand the judge didn't like that

Here is his [redacted] That is his home address. If he does call back let me know.

BONDI: We are definitely going to talk to him, and our approach is that if they won't talk voluntarily and are important enough, we will subpoena them.

O'CONNELL: He had been identified as someone who is very imported to us by Gary Witt, Jerry Fons, and Mark Froeba. Several people have identified him as someone who knows a lot.

BONDI: We also interviewed Jay Eisbruck. He is a former Moody's guy. [redacted] He did give us names and said he did ABS CDOs, but he said he did not do mortgage CDOs. [redacted]

O'CONNELL: Kanef is a current employee. When we initially started investigating the company, they gave a presentation about how they rate things. It was not new but it was helpful to understand basic process. Michael Kanef was part of that. We dealt with him in the context of litigation. He is a group managing director and has been identified as someone who would be in the thick of it. He testified before Congress. He knows quite a bit.

BONDI: What about Andy Kimball?

O'CONNELL: He is a current employee. He wrote that memo about "We drank the KoolAid" to Ray McDaniel. At first through we thought Ray wrote it, but turns out Andy wrote it for Ray. He would be useful for a number of reasons—most importantly because he wrote the presentation about acknowledging market influence and drinking the KoolAid. Eric Kolchinsky reached out to him when he was unhappy about how things were going and complained about how Yuri Yoshizawa was doing things and allowing downgrades to take place. He would have a recollection about that whole sequence.

BONDI: Anyone else?

O'CONNELL: Another person is Jim Brennan. He is currently at Stone Capital Partners, and his number is [redacted]. We were told he would have some knowledge of the transition from binomial expansion to the correlated model. When the model first came out, Moody's used it for a very narrow group of assets, and he was involved in those assets, so he would know how the model was received by those issuers. He is on some of the Senate documents.

BONDI: What about Jerry Gluck?

O'CONNELL: We haven't talked to him, but Gary Witt mentioned him to us. Do you know where he is?

BONDI: We haven't found him yet.

O'CONNELL: There are two other names: Charles "Chuck" Windernett who was the head of internal auditing. He was criticized for documenting his concerns too much and was eventually forced out. We heard that Clarkson and Goggins were very adamant about not documenting concerns. Clarkson was very careful not to put things in writing or email, and when he had concerns he would relay them in person. Scott McCleskey told us and others that Clarkson and the general counsel were very aware of document creation.

BONDI: What about Jay Siegel?

O'CONNELL: Who is he?

BONDI: He is former managing director of structured finance in 2006. We are looking for contact information.

O'CONNELL: We have been looking for Pramila Gupta. She was involved on the CDO side and in models. She retired and has been off of the radar.

BONDI: I haven't heard of her.

O'CONNELL: Jerry Gluck was the predecessor to Dr Witt. Witt replaced Gluck. We have also heard the name Gus Harris?

BONDI: I think he is still there. 36CFR1256.56: Privacy [redacted] I think he was managing director of one of analysts' groups and was under a lot of pressure to get the deals rated.

Moody's is represented by Akin Gump and Steve Ross. We have not had any interviews yet. I am supposed to talk to Steve Ross about scheduling interviews today, and he has offered to do same presentation that Moody's did for you at the beginning. We will ask about current employees—like Gus Harris and Michael Kanef. Are there any other current employees we should talk to?

O'CONNELL: Yuri Yoshizawa. She has a lot of interesting things to say. She supervised Eric Kolchinsky. According to him, she said we can't do what you want to do because it would affect our revenue and market share. She acknowledged that they pulled people off deals after investment banks complained, and she was on the Abacus deal.

BONDI: We will probably want Andy Kimball.

O'CONNELL: We referenced this in our complaint, paragraphs 138 and 139. This is the discussion where Eric Kolchinsky is asked by the Moody's policy team to evaluate CDOs and this is where he gives comments about how they can't continue to do it the way they are doing it. The people who are on that email—Nicholas Weill and Richard Cantor—they seem like interesting people to talk to. Cantor was chief credit officer and Nick Weill was a very senior managing director in structured finance. There are a number of people on that email.

Another way to go would be to ask for the credit policy team in place on 0ct 30, 2008.

O'CONNELL: David Teicher was head of CDOs and got McClesky's job. It was the start of structured finance taking over compliance, and it started as a slow bleed with replacing people. Then McCleskey lost his job to someone without any compliance background. There is also David Teischer at S&P who worked with David Gugliada—he would be good to talk to.

BONDI: Do you have a sense of who has been fired because they didn't get in line? We have heard stories about employees being told to pack their bags and then sign a nondisclosure agreement.

O'CONNELL: 36CFR1256.56: Privac is one of those people, and he knows a lot of other people who are like him. We asked him and he never got back to us. We made a strategic decision not to pursue that but to pursue the lawsuit.

BONDI: How did you get emails?

O'CONNELL: Pretrial discovery and some from former employees who kept emails.

BONDI: Do you have anything the Senate doesn't have?

O'CONNELL: I will have to check. Some was in not in Senate materials. Eric Kolchinsky had a number of documents. He provided some pretty scathing comments about what Moody's was doing. Another guy is 36CFR1256.56: He was in derivatives and worked for Yuri and with Eric Kolchinsky. He was very much aware of all the stuff going on as well.

BONDI: Are there any documents we should be aiming for in our request? We asked for ratings memos. We understand Moody's has been fighting to prevent disclosure. Do you anticipate getting them?

O'CONNELL: We haven't gotten them comprehensively. One of the things we asked for are minutes of ratings committees and some ratings memos, but we haven't gotten anything we found to be extremely incriminating. I would ask for credit policy minutes to the extent that they have those. We have been told that there is some record kept of what happened in those meetings. I don't know if they are called minutes. We'll also pick 15-20 people and ask to see their personnel files during discovery. We have been told that that is something they are fighting not to give us.

BONDI: Are you getting that they were compensating for market share?

O'CONNELL: They were given negative performance reviews if issuers found them troublesome to work with or if they asked too many questions. [redacted] talked about how Cantor came into his office and said his job was on the line and he had to justify what he was doing. That sort of feedback would filter into performance reviews, and if people were viewed as favorable they would get higher bonuses.

They would fight this, but it would be interesting to see the emails about the development of the correlated model and the transition from September 2004 though September 2005. We have been told that that transition would have gone through credit policy and Noel Kiernan would have been involved. There would have been emails drafted.

BONDI: Have you been told that Moody's had a 90 day email retention policy before 2007.

O'CONNELL: Moody's told us that before 2007 they were on a 90 day purge and people had to opt out to keep things. People may have kept things.

BONDI: Even with centralized deleting, .pst files can show up on a hard drive. It would be interesting to image the hard drive of key people like Clarkson or Kanef or Cantor or some of the other centralized people.

O'CONNELL: We haven't gone down this road with them or explored with them what sort of disaster recovery they had in place. For the Abacus deal itself we were going to ask who was the lead analyst on the transaction and ask to get the lead analyst's files on that deal, which would include emails. Anything about Abacus AC1 would be useful to see. If the pool is as bad as people say it was, I find it hard to believe that the analyst would be able to rate it AAA without expressing some dissonance to superiors or others. So if 90% were going to blow up in 3 months that is something that would attract notice.

BONDI: We have heard rumblings that there are other deals like Abacus out there. Have you heard of any?

O'CONNELL: We don't have any others but it would make sense. The hearing tomorrow which focuses on Goldman Sachs might have some more documents coming out.

BONDI: Have you focused at all on monolines and the rating of MBIA and AMBAC?

O'CONNELL: We spent a lot of time on that in our first lawsuit. Municipalities that issue bonds to get a AAA have to buy insurance even thought the bonds never default. Our basic claim was that Moody's knowingly underrated the publicly-issued bonds compared to corporate bonds even though they have a much lower rate of default. Public issuers couldn't get AAA even though they were closer to a sure bet, so they had to buy insurance. Monolines were AAA but they were much riskier.

We looked at it in the context that it was the dual rating for public insurance, but we never found specific collusions between the ratings agencies in terms of monolines. We found that the interests of the rating agencies and the monolines were aligned, but there was no evidence of an actual agreement in place. It seemed like it was mutually beneficial to keep things rated AAA because it helped monolines because it gave dual ratings scale for public finance. It wasn't illegal or Section 1 antitrust, but you are right to be looking at them.

BONDI: We really appreciate this. We will get you that disk from the Senate. If there are any emails that you have that are not on that disk, we would love anything you are willing to share. We anticipate this culminating in a hearing probably over the summer, so we are on a tight time frame. We don't want an identical hearing to PSI, so we are looking at difference angles that have not been covered—getting behind models and getting into analytical stuff. We are marching forward on a very quick time frame, so anything you come across we would appreciate and anything we find will likely come out in hearing. When will the judge find the motion to remand?

O'CONNELL: We will file in next couple weeks and then they will have to remand. Last time it took many months to play out. Hopefully it won't take as long, but I wouldn't expect a decision until over the summer. To what extent can you share information with us during the process of interviews and investigation?

BONDI: I will have to run it up the chain—commission decisions about what we can share before the hearing go to the Chair and Vice Chair. We would probably do something very similar to PSI in terms of making things available to the public and that won't be too far away. So there might not be much difference between then and now. We don't know much and we are meeting with a lot of other regulators and Ohio.

O'CONNELL: Are you talking to Doreen Johnson?

BONDI: Yes.

O'CONNELL: They sued on a different theory—it's a state securities lawsuit on behalf of a pension fund in Ohio saying that it lost value because ratings agencies mis-rated. I don't know if she worked on the investigation that resulted in that lawsuit, but she is knowledgeable about the basic issues. Is there a possibility for us to get access to complete records perhaps after the hearing? Similar to the SEC process?

BONDI: We don't have precedent. That has to be decided by the Chair and Vice Chair or a vote of the commission. We haven't had any other request from agencies, so I don't know how they would handle it. My guess is that we might be in a position to do so, so I will raise this up the chain. We do have referral power to refer other agencies to violation of the law. But you want confidential sharing of information, so I will find it out and let you know. We will not share with private litigants but states are in a difference category.

O'CONNELL: If you talk to people that you think are helpful, if you could just refer us to them that would be great.

BONDI: We can at least share impressions if not actual documents.

O'CONNELL: AG Blumenthal submitted a written statement providing a summary and he might be interested in helping the committee.

BONDI: That would be very useful and we will check on that.