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March 30, 2007

By Electronic Mail

Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Proposed Rules Regarding Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations (Release No. 34-55231; File No. S7-04-07)

Dear Ms. Morris:

I would like to correct an apparent misconception that some market participants have expressed about the rating practices of Moody's Investors Service (Moody's) with regard to collateralized debt obligations (CDOs). Contrary to assertions made by some market participants,[1] when rating securities issued by a CDO, Moody's does **not** require that the underlying collateral carry Moody's credit ratings.

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[1] See, for example, in a letter dated March 12, 2007, from Charles Brown of FitchRatings to Nancy Morris of the SEC, where Charles Brown asserts,

> "Moody's Investor Services, [sic] …, as a condition of rating securities or money market instruments issued by an asset pool (such as a money market mutual fund or a pooled investment vehicle), or as part of any asset-backed or mortgage-backed securities transaction (such as a collateralized debt obligation or structured investment vehicle) (collectively, a "Portfolio Product"), *insist[s] on rating most, if not all, of the assets underlying the portfolio*…." (Emphasis added).

Moody's commonly rates CDOs in which some – and, in some cases, all – of the underlying collateral assets do not carry a published credit rating from Moody's.[2] Of course, in such situations, Moody's still forms its own opinions about collateral securities included in CDOs, and does not automatically accept third party opinions, whether from transaction sponsors, other rating agencies or even other Moody's affiliates as if they were our own.

A sponsor of a securitization can choose from among three methods by which Moody's can form an opinion about the risk profile of non-Moody's-rated collateral debt obligations:

1. Moody's can undertake a fundamental review or a quantitative analysis[3] of the collateral to arrive at credit estimates;
2. Moody's can review the sponsor's internal credit scoring system and "map" Moody's ratings to the sponsor's credit scores;[4] and
3. Moody's can incorporate the opinions of other rating agencies about the collateral, including adjusting ("notching") where appropriate, to reflect where Moody's credit opinions diverge from those of other agencies.

Moody's provides the third option at the request of some collateral managers who prefer the speed of execution and certainty of results it provides in comparison to credit estimates. This last option, however, is available only when Moody's has sufficient data to derive a mapping between another agency's ratings and the ratings Moody's has derived internally or determines it would have assigned for a similar type of collateral based on existing ratings comparison analysis.

For a number of important asset classes, Moody's has sufficient data to devise appropriate mapping and notching rules for Fitch's and S&P's ratings.[5] These rules and the data analysis that supports them are publicly available.[6] As documented in these

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[2] For example, see "Moody's Approach to Rating U.S. Bank Trust Preferred Security CDOs" (4/14/04), "Moody's Approach to Rating U.S. Middle Market CLOs: Part I" (3/16/04), "Moody's Rating Methodology: An Alternative Approach to Evaluating Market Value CDOs" (12/5/02).

[3] For example, see "Moody's Rating Approach to U.S. SME CLOs: Using Credit Tools to Expand Manager Flexibility" (2/1/05) and "Moody's Approach to Rating U.S. REIT CDOs" (4/4/06).

[4] To provide a reliable mapping, Moody's would generally expect full access to the sponsor's credit management system and its performance, and we would re-map the sponsor's credit scores to Moody's ratings periodically. For a mapping to be reliable, however, Moody's needs to be confident the sponsor will not "adverse select" debt obligations for inclusion in CDOs that are riskier than those suggested by the mapping. For this reason, mapping is most commonly used for bank balance sheet collateralized loan obligations, in which the very large size or a random selection process guards against the risk of adverse selection.

[5] Due to limited coverage and publication of ratings by other rating agencies, however, our ability to offer the third alternative may not be available for all current and potential future Nationally Recognized Statistical Rating Organizations (NRSROs).

[6] See the following Moody's *Special Reports*: "Moody's Views on "Notching" CMBS Ratings in CDOs" (June 22, 2001), "Moody's Study of Ratings of Non-Moody's-Rated RMBS" (April 18, 2002), "Moody's Studies Ratings of Non -Moody's-Rated CDOs and Confirms Rating Estimate Approach" (March 22, 2002).

reports, Moody's rating opinions and the opinions of other agencies often diverge substantially in situations when Moody's is not asked to rate a particular security. Given the complex nature of many of these instruments, differences in opinion are not surprising. Moreover, the differences tend to be larger than those observed when comparing only published ratings on jointly-rated securities.[7] "Rating shopping" explains why these differences in credit opinions are likely to be larger. Moody's is often not asked to rate a particular security because a transaction's sponsor determines that Moody's rating would be lower than the ratings assigned by other agencies because of differences in methodology or more favorable views on the quality of the underlying collateral assets by such other rating agencies. Similarly, another agency may not be asked to rate a security because the sponsor believes its rating would be lower than that assigned by Moody's.

I hope this communication clarifies Moody's practices with respect to assessing the credit quality of collateral contributed into collateralized debt obligations. Moody's would be pleased to address any further questions the Commission may have.

Sincerely,

Cc: Chairman Christopher Cox
Commissioner Paul S. Atkins
Commissioner Roel C. Campos
Commissioner Annette L. Nazareth
Commissioner Kathleen L. Casey
Erik R. Sirri
Michael A. Macchiaroli

[7] Surprisingly, even for jointly-rated instruments the difference in the non-Aaa rating levels can be large. Please see the following Moody's *Special Reports*: "Comparing Ratings on Jointly-Rated U.S. Structured Finance Securities" (5/25/06) and the 2007 Update (3/30/07).