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September 10, 2007

Honorable Christopher J. Dodd, Chairman
U.S. Senate Committee on Banking, Housing, and Urban Affairs
448 Russell Building
Washington, D.C. 20510

Re: **Wrongful Actions of the Credit Rating Agencies**:

1. SEC Enforcement Failure; Distortion of True Credit Risk; and Propagation of Credit Market Contagion:

   a) Actions Evidencing the Application of a Reckless Standard of Care;
   b) Intentional Violations of Published Metrics and Criteria;
   c) Intentional Violations of the Investment Advisers Act; and
   d) Intentional Violations of SEC Published NRSRO Standards.

2. Need for Senate Concurrent Legislation.

Dear Chairman Dodd:

We respectfully write to your attention in regard to a very serious matter directly pertinent to your position as both Committee Chairman of the Senate Banking Committee and as Senior Member of the Senate Committee on Health, Education, Labor and Pensions. We refer to the catastrophic consequences resulting from the egregious abandonment of an appropriate standard of care by the three most prominent nationally recognized statistical rating organizations ("NRSROs") in pursuit of ever greater issuer-compensated ratings revenue. The failure to regulate the wrongful practices engaged in by Standard & Poor's, Moody's Investors Service and Fitch Ratings is directly responsible for causing unprecedented and potentially irreparable damage to the integrity of the U.S. capital markets. The SEC has proven itself complicit in actively encouraging such practices through its adoption of a "zero accountability" policy, implicitly endorsing the continuation of the fraudulent practices engaged in by the three primary NRSROs. In this regard, it is noteworthy that in mid-2005 the SEC refused to investigate such wrongful practices despite a request by the Hon. Jim Saxton, then-Chairman of the Joint Economic Committee of the U.S. Congress (please refer to tab 10 of the companion reference binder).

§1.0 Recurrent Theme: Inflated Ratings Profit the Agencies and Injure Investors

Although the SEC defines the term "NRSRO" as an entity that "uses systematic procedures designed to ensure credible and reliable ratings", the ratings assigned by the three most prominent NRSROs are neither credible nor reliable as evidenced by the numerous "after the fact" credit events which have occurred over the past few decades (please see Exhibit 1.0 for a summary of several of the major such incidents). Invariably, in the immediate aftermath of a serious credit implosion and resultant market contagion, the credit rating agencies claim that they were deceived by management or that they are just publishing editorial opinions that either should not be relied upon or are protected by the "free speech" provisions afforded by the first amendment. The agencies and, thus far at least, various regulators, conveniently ignore the fact that the credit ratings assigned by the largest NRSROs are empowered with the force of law due to the duopoly franchise enjoyed by Standard and Poor's and Moody's Investors Service in conjunction with extensive regulatory and prudential codification of their rating classifications by both the public and private sectors (see, e.g., private pension plan administrative standards, municipal retirement systems policies, and federal banking regulations governing permissible activities of insured depository institutions including investment portfolio allocation criteria). In any event, such arguments fail abjectly in the instance involving the false and artificial sovereign credit rating assigned to the government of China, which has been the subject of explicit notice provided to the NRSROs on numerous occasions throughout the past several years. In regard to the "free speech" claim, we note that the first amendment does not protect actions which are intentional, injurious, and in the instance of China, knowingly false. The wrongful actions of the three primary NRSROs are best explained by their revenue model, which creates an endemic conflict of interest as the credit rating agencies seek to maximize issuer fees. This conflicted model is described at length in the excellent investigative series published as a three-part serial installment by the Washington Post (please refer to tab 24 of the companion reference binder). The NRSROs' thirst for ever increasing profits is unmasked in China's instance by the assignment of a phony sovereign credit rating designed to establish an artificial "investment grade" sovereign benchmark which conceals the Chinese government's defaulted sovereign debt, thereby opening the door to large-scale international debt financing by the many thousands of Chinese corporations and providing the NRSROs with a commensurate windfall in ratings revenue. This motivation is revealed as the proximate driver for the assignment of a false sovereign credit rating which conceals the defaulted sovereign debt of the government of China, and which debt is the repayment obligation of the communist Chinese government which refuses repayment in violation of international law and is able to do so in reliance upon its artificial credit rating.

Exhibit 1.0
Recurrent Theme: Credit Raters' Pattern of Deception [1]

2007	Misstated the risk and misled investors re: **U.S. sub-prime mortgage meltdown**
2002	Misstated the risk and misled investors re: **Worldcom collapse**
2001	Misstated the risk and misled investors re: **Enron collapse**
1997	Misstated the risk and misled investors re: **Asian debt crisis, including the governments of Thailand and Korea**
1994	Misstated the risk and misled investors re: **Orange County debt crisis**
1992-present	Continue to misstate the risk and mislead investors re: true sovereign credit risk of the **Chinese government and its state-owned enterprises by concealing the action of selective default (e.g., the prevailing false rating classifications ignore the "willingness" metric as applied to the Chinese government's evasion of its repayment obligation of its defaulted sovereign debt and its practice of making preferential and discriminatory payments to selected creditors)**
1983	Misstated the risk and misled investors re: **Washington State Public Power Supply System default**
1975	Misstated the risk and misled investors re: **New York City financial crisis**
1970	Misstated the risk and misled investors re: **Penn Central debt default**

Despite their published claim that they rate a government's *willingness* to pay its sovereign obligations, the three primary NRSROs continue to maintain an artificial "investment grade" credit rating classification for China and have actually upgraded China's rating six times since disclosure of the Chinese government's refusal to honor repayment of its defaulted sovereign debt was communicated to each of the primary rating agencies in 2002 and previous to that, extensive publication in June 2001 concerning the formation of the American Bondholders Foundation (the "ABF") to represent defaulted U.S. creditors (please refer to tab 25 of the companion reference binder). In fact, we observe that S&P affirmed China's "investment grade" credit rating

[1] Primary source: Article entitled, "Unchecked Power", *Washington Post* (November 22, 2004); article entitled, "Shaping the Wealth of Nations", *Washington Post* (November 23, 2004); article entitled, "Flexing Business Muscle", *Washington Post* (November 24, 2004). Reprints of each of these articles are included as tab 24 of the companion reference binder.

the very next day (October 22, 2003) following the Congressional hearing on the ABF, in order to improve the prospects for the sale of China's sovereign bonds and notes registered in the U.S. the same month (October 2003). It is revealing to note that China reportedly denied seeking a credit rating in 1988, after which it bought and paid for a rating from S&P which concealed China's defaulted sovereign debt (please refer to tab 9 of the companion reference binder). Beyond actively assisting a government in default on its national debt in evading repayment, the wrongful actions of the NRSROs including the deliberate assignment, maintenance, and periodic upgrading of false, artificial and disingenuous sovereign credit ratings of a government in default (and which ratings do not conform to their published definitions) have acted to distort the credit risk endemic to investment in Chinese government securities by U.S. pension funds and project yet another concealed risk upon the investing public.

§2.0 Dangerous Focus on Creating Marketable Products for Investor Consumption

As evidenced by the facts, the root cause of ratings inflation and the recurring cyclical credit contagions is the predilection of the agencies for creating marketable investment products which are highly saleable by the prime brokerage community and targeting institutional and retail investor consumption to the enormous profitable benefit of the rating agencies. Such penchant is evocative of the often articulated industry maxim, "brokers are selling machines when backed by agency ratings". In this regard, see also the recent Wall Street Journal article entitled, "Credit and Blame: How Rating Firms' Calls Fueled Subprime Mess --- Benign View of Loans Helped Create Bonds, Led to More Lending" (August 15, 2007) which truthfully states "Underwriters don't just assemble a security out of home loans and ship it off to the credit raters to see what grade it gets. Instead, they work with rating companies while designing a mortgage bond or other security, *making sure it gets high-enough ratings to be marketable*. The result of the rating firms' collaboration and generally benign ratings of securities based on subprime mortgages was that more got marketed." The article further states, "The subprime market has been lucrative for the credit-rating firms. Moreover, through their collaboration with underwriters, the rating companies can actually influence how many such securities get created." According to this same article, Moody's Investors Service admitted to taking in "around $3 billion" over a four year period just from rating securities built from loans and other debt pools. This amount accounted for less than half of the revenue Moody's earned during this period from rating debt securities. A former Moody's managing director is quoted as stating that, "It was always about shopping around" for higher ratings, although Wall Street and mortgage firms "called the process by other names, like 'best execution' or 'maximizing value'". Ohio Attorney General Marc Dann contends that the rating firms had much to gain by issuing investment-grade ratings, and is quoted as stating the opinion that the rating agencies have a "symbiotic relationship" with issuers of securities. Mr. Dann's office is presently investigating the agencies' practices. The propensity of the rating agencies for adjusting ratings as a marketing consideration is also described, enumerating several specific incidents, in our letter to Mr. David Walker, Comptroller General of the United States, Government Accountability Office (please refer to tab 11 of the companion reference binder). It is unfortunate for participants in the credit markets that the propagation of such unrestrained business practices, coupled with and empowered by the NRSROs' duopoly franchise and the enforcement failure by the SEC, virtually ensures (in the absence of remedial legislation) the continuation of market debacles on a scale of magnitude similar to the instances comprising Exhibit 1.0.

§3.0 As Registrants Under the Advisers Act (Registered Investment Advisers), the Three Primary NRSROs are Prohibited from Engaging in Fraudulent, Deceptive or Manipulative Business Practices Yet Continue to do so with Impunity

The Advisers Act, under which the three primary NRSROs are registered, prohibits registrants from engaging in unethical business practices including engaging in any act, practice, or course of business which is fraudulent, deceptive or manipulative.[2] Accordingly, the three primary NRSROs are restrained from applying a reckless standard of care in developing their rating classifications. The rating definitions, as published by the NRSROs themselves, state that such ratings are an evaluation of the rated entity's <u>willingness</u> and ability to pay financial obligations (please refer to tab 22 of the companion reference binder). As evidenced by an examination of the factual record in the instance of China, the prevailing rating classifications assigned to the Chinese government by the three primary NRSROs do not conform to their published definitions and so do not meet the required standard and, in the face of constructive notice, evidence foreknowledge of falsity and the application of a reckless standard of care by the NRSROs. The Advisers Act explicitly requires the SEC to investigate allegations of wrongdoing and impose penalties upon registrants whose wrongful actions "directly or indirectly result in substantial losses or create a significant risk of substantial losses to other persons" (Section 209 "Enforcement of Title"). We have prepared a concise summary of the wrongful actions of the three primary credit rating agencies, up to and including the specification of fraud (please refer to tab 9 of the companion reference binder). Because their ratings are imbued with the force of law as a function of their NRSRO designation, and the fact that the three primary rating agencies are each Registered Investment Advisers and are therefore subject to the provisions of the

[2] Investment Advisers Act of 1940, as amended. See specifically Section 206 and Section 209.

Advisers Act, and in consideration of the extensive prudential and regulatory codification of investment policies referencing the rating classifications assigned by the three largest NRSROs and the pervasive influence of their rating classifications, we are concerned regarding the lax enforcement posture adopted by the SEC and particularly the failure of the SEC to enforce the provisions of the Advisers Act as such provisions pertain to the wrongful actions and conflicted business practices engaged in by the three primary NRSROs.

§4.0 Example: Primary NRSROs Continue to Assign China an Artificial Sovereign Benchmark Rating Even as the Chinese Government Continues to Engage in *both* Selective Default *and* Discriminatory Settlement of Defaulted Sovereign Debt

The three largest NRSROs continue to assign artificial sovereign credit ratings to China despite the Chinese government's continuing practices of both selective default and discriminatory settlement (please refer to tab 9 of the companion reference binder). Exhibit 4.0 presents a comparison of the prevailing artificial sovereign credit rating classifications assigned to China with the appropriate rating classifications as determined by the published definitions contrasted with the factual evidence (i.e., the actions of the Communist Chinese government with respect to evasion of repayment of its defaulted sovereign debt, e.g., the Chinese government's 1960 bond which remains unpaid and in a state of default, and which bond certificates explicitly state that the obligations are intended to be binding upon the government of China and any successor government). The full complement of actions by the Chinese government which are concealed by the prevailing ratings include repudiation of the debt; selective default; rejection of the successor government doctrine of settled international law; discriminatory settlement with Great Britain; and the practice of preferential, exclusionary and discriminatory payments to selected general obligation creditors of the government of China. Standard & Poor's presently maintains an "A" rating for China. Note the definition of this rating classification as published by S&P: "An obligor rated 'A' has STRONG capacity to meet its financial commitments but is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligors in higher-rated categories." Compare this definition to S&P's published definition of the "Selective Default" rating classification, which is the classification S&P claims to assign to nations with defaulted sovereign debt: "An obligor rated "SD" (Selective Default) has failed to pay one or more of its financial obligations (rated or unrated) when it came due. An "SD" rating is assigned when Standard & Poor's believes that the obligor has selectively defaulted on a specific issue or class of obligations but it will continue to meet its payment obligations on other issues or classes of obligations in a timely manner." A nation rated "Selective Default" is virtually unable to issue international sovereign bonds until it repays its defaulted sovereign debt (please refer to tab 9 of the companion reference binder).

Exhibit 4.0
Published Definitions: International Sovereign Credit Rating Classifications

4.1 Prevailing Artificial Sovereign Credit Rating Classifications:

Long-Term Foreign Currency Debt of the Chinese Government

Agency	Rating	Definition
Standard & Poor's	A	An obligor rated 'A' has STRONG capacity to meet its financial commitments but is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligors in higher-rated categories.
Moody's	A1	Bonds which are rated "A" possess many favorable investment attributes and are to be considered as upper medium-grade obligations. Factors giving security to principal and interest are considered adequate, but elements may be present which suggest a susceptibility to impairment some time in the future. The modifier "1" indicates that the obligation ranks in the higher end of its generic rating category.
Fitch	A	High credit quality. 'A' ratings denote expectations of low credit risk. The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to changes in circumstances or in economic conditions than is the case for higher ratings.

Compare the above artificial sovereign credit rating classifications assigned to China with the published definitions maintained by the same agencies appearing below, which definitions truthfully describe the genuine rating classifications in light of the factual evidence (i.e., the actions of the Communist Chinese government with respect to evasion of repayment of its defaulted sovereign debt, including the actions of repudiation; selective default; rejection of the successor government doctrine of settled international law; discriminatory settlement with Great Britain; and the practice of preferential, exclusionary and discriminatory payments to selected general obligation creditors of the government of China).

4.2 Truthful Sovereign Credit Rating Classifications

Long-Term Foreign Currency Debt of the Chinese Government As Determined by Conformance of Agencies' Published Criteria and Definitions to Facts Comprising the Actions of the Communist Chinese Government, Including: [1] **Repudiation**; [2] **Selective Default**; [3] **Rejection of Successor Government Doctrine of International Law**; [4] **Discriminatory Settlement with Great Britain**; [5] **Preferential and Discriminatory Payments to Selected General Obligation Creditors**

Agency	Rating	Definition
Standard & Poor's	SD (Selective Default)	An obligor rated "SD" (Selective Default) has failed to pay one or more of its financial obligations (rated or unrated) when it came due. An "SD" rating is assigned when Standard & Poor's believes that the obligor has selectively defaulted on a specific issue or class of obligations but it will continue to meet its payment obligations on other issues or classes of obligations in a timely manner
Moody's	Ba (high) Caa (low)	Bonds which are rated "Ba" are judged to have speculative elements; their future cannot be considered as well-assured. Often the protection of interest and principal payments may be very moderate, and thereby not well safeguarded during both good and bad times over the future. Uncertainty of position characterizes bonds in this class. Bonds which are rated "Caa" are of poor standing. Such issues may be in default or there may be present elements of danger with respect to principal or interest.
Fitch	DDD RD	Default. Entities rated in this category have defaulted on some or all of their obligations. Entities rated "DDD" have the highest prospect for resumption of performance or continued operation with or without a formal reorganization process. Note that the newly introduced rating of "RD" (Restrictive Default) is described as the classification Fitch will assign to an issuer (including sovereigns) in cases in which the issuer has defaulted on one or more of its financial commitments, although it continues to meet other obligations.

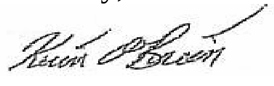
§5.0 China's Fraudulent Sovereign Credit Rating Conceals Defaulted Debt, Injures Defaulted Creditors, and Misstates Actual Risk

As the enclosed materials reveal in detail, the wrongful actions of the credit rating agencies distort the true credit risk endemic to certain rated obligations, including sovereign obligations of the government of China, and thereby pose a hidden danger to U.S. institutions and individual investors (e.g., in the instance of Chinese securities, as noted previously, the Chinese government denied seeking a sovereign credit rating even as it was reportedly pursuing a rating which it subsequently obtained, and which rating concealed, and continues to conceal the existence of the Chinese government's defaulted sovereign debt and its continuing practice of making discriminatory payments to selected creditors, and which artificial rating enabled China to resume international debt financing and establish a sovereign benchmark providing Chinese corporations with the ability to access the international financial markets while the central government continues to evade repayment of its defaulted sovereign debt).

§6.0 Unchecked Power of the NRSROs, Enforcement Failure by the SEC, and Pervasive Credit Contagion Requires Immediate Corrective Action by the Legislative Branch

In addition to domestic concerns, we are credibly informed that significant international concern exists that American regulators are not properly monitoring the disclosure of risk endemic to financial products sold abroad. Financial products continue to be marketed to domestic and international investors which were "not as advertised" (or, in the words of one financial commentator, "The subprime mess is only the latest example of liar's paper pawned off on unsuspecting European banks as triple-A rated 'investment quality' bonds"). Risky investments, masquerading under the guise of quality securities with top ratings, were sold to unsuspecting investors. Continuation of the wrongful practices by the rating agencies, which directly contribute to misstatement of risks and resultant investor losses, is antithetical and inimical to the interests of the U.S. public at large. Senate concurrent legislation (please refer to tab 1 of the companion reference binder) is warranted in order to remedy the continuation of the abusive practices described herein, provide relief to defaulted creditors from the injurious actions of the credit rating agencies, and preserve the integrity and transparency of the U.S. capital markets.

Sincerely,



Kevin J. O'Brien, President
KJO: jwc

Enclosure: Bound reference materials to be transmitted separately.

cc: Hon. Richard Shelby, Ranking Member, Senate Committee on Banking
Hon. Jeff Sessions, U.S. Senator
Hon. Charles Schumer, U.S. Senator
Hon. Roger W. Robinson, Jr., Former Chairman, U.S.-China Commission
Ms. Jonna Z. Bianco, President, American Bondholders Foundation
Mr. John Petty, President, U.S. Foreign Bondholders Protective Council
Consumer Federation of America
International News Media (via newswire release)

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