State of Connecticut

RICHARD BLUMENTHAL
ATTORNEY GENERAL

Hartford

May 6, 2009

Honorable Timothy F. Geithner
Secretary of the Treasury
Department of the Treasury
1500 Pennsylvania Ave, NW
Washington, DC 20220

Dear Secretary Geithner:

I write to express my continued concern about the ratings eligibility criteria for the Federal Reserve's $1 trillion lending initiative, the Term Asset-Backed Securities Loan Facility (TALF). As I am sure you are aware, the Federal Reserve currently mandates that TALF-eligible collateral must be rated by two or more "major nationally recognized statistical rating organizations (NRSROs)." Under the Federal Reserve's definition, the only NRSROs -- more commonly referred to as credit rating agencies -- that qualify are Standard & Poor's, Moody's Investors Service, and Fitch Ratings.

This senseless restriction rewards the same rating agencies who are at the center of our current financial crisis and whose shortcomings made creation of the TALF necessary in the first place. The Federal Reserve's policy is also very short sighted because it virtually guarantees a concentrated, non-competitive market in structured security credit ratings for the foreseeable future by shutting out other qualified NRSROs that stand ready at the very least to compete for TALF work. Overdependence on the Big Three credit raters is exactly what led to the current financial debacle. I strongly urge you to contact the Federal Reserve and request that it reverse this wrong-headed policy.

I am directing my concern to your office as part of my ongoing antitrust investigation into the practices of the credit rating agencies, after unsuccessfully seeking action from Dr. Ben S. Bernanke, Chairman of the Federal Reserve Board of Governors. In particular, responding to my letter of April 6, 2009, Chairman Bernanke indicated that the Federal Reserve supports the Credit Rating Agency Reform Act of 2006's Congressional objective of promoting competition in the credit ratings market, but that other important goals, including protecting the Treasury and the U.S. taxpayer, have led the Federal Reserve to limit ratings under the TALF to just S&P, Moody's and Fitch. In light of your similar mandate to protect taxpayer money at risk in the TALF, I ask that you be involved.

First, I disagree strongly with Chairman Bernanke that allowing "non-major" NRSRO's to rate TALF collateral is somehow at odds with the goal of protecting the U.S. taxpayer. As Chairman Bernanke states in his response to me, "the rating methods employed by major NRSROs for asset backed securities have exhibited significant shortcomings." I think more accurately, Neil M. Barofsky, the head of Treasury's Office of the Special Inspector General for the TARP, stated in his most recent quarterly report to Congress that:

> Credit ratings, cited as one of the primary credit protections in TALF as currently configured, have been proven to be of questionable value in the general market for MBS, and for legacy RMBS, they have proven to be unreliable and largely irrelevant to the actual value and performance of the security. Arguably, the wholesale failure of the credit rating agencies to rate adequately such securities is at the heart of the securitization market collapse, if not the primary cause of the current credit crisis. *See* Quarterly Report to Congress, April 21, 2009, at 141.

While Chairman Bernanke may be correct that an SEC license to issue credit ratings does not guarantee the accuracy of rating models used by "non-major" NRSROs, the same is obviously true for the "major" credit rating agencies. Indeed, as Mr. Barofsky notes, the major NRSROs have not demonstrated any particular skill or unique competency in rating asset-backed securities, or structured finance transactions. Indeed, their track record has glaringly demonstrated just the opposite. Thus, the Federal Reserve's stated reason for favoring those NRSRO's it has "customarily employed" appears to perpetuate the Old Boy's Club mentality that has been condoned for too long. The policy seems hardly likely to instill the sort of confidence in the due diligence undertaken by the Federal Reserve that U.S. taxpayers deserve and the markets need.

In my view, just as the Federal Reserve must perform its own due diligence on this issue, the Treasury Department should require the Federal Reserve to publicly explain what due diligence was undertaken and why, as a result of this due diligence, only the three major credit rating agencies should be entrusted with rating the securities issued as part of the TALF. Otherwise taxpayers and investors remain unable to accurately assess the credit risk of asset-backed securities.

Moreover, the stated purpose of the Credit Rating Agency Reform Act of 2006 is "to improve ratings quality for the protection of investors . . . by fostering accountability, transparency, and competition in the credit rating industry." Congress specifically stated that accomplishing these important goals was necessary because of "the failure by the large credit rating agencies to warn investors in a timely manner about the impending bankruptcies of Enron, WorldCom, and others." How many more financial crises are needed before decisive action is taken to fix such problems aided and abetted by the major NRSROs?

Limiting participation in the TALF to the Big Three raters solidifies their dominant position in the credit ratings market for the foreseeable future. As Chairman Bernanke stated in his response to me, there have been virtually no asset-backed securities issued in the fourth quarter of 2008 and the early months of 2009. Thus, the securities issued under the TALF effectively are the market for structured security ratings. Blocking access to that market for "non-major" credit raters in favor of the Big Three raters assures that those raters will dominate the structured security ratings market for a long time to come. In my view, the Federal Reserve has ignored Congress' legislative directive to enhance competition in the credit rating industry just at the time when it is needed most and when the taxpayer has the most reason to expect assurances that the mistakes of the past will not be repeated.

Finally, if our financial system is going to continue to look to credit ratings for guidance in the world of structured finance, investors and the public in general need to have reason to believe that the credit rating agencies can accurately assess credit risk for these securities. The way to instill this belief is not by further entrenching the comfortable oligopoly of the past that generated such questionable work product.

I ask you, as the public official tasked with administering the taxpayer money that now is at risk, to encourage Chairman Bernanke to open the eligibility criteria requirements under the TALF to the other NRSROs licensed by the SEC as soon as possible. This action is the first step to correcting poor past practices and to adhering trust by financial markets in ratings.

Thank you for your attention to this matter.

Sincerely yours,

Richard Blumenthal

Richard Blumenthal
Attorney General of Connecticut

RB/pas
Enclosure

c: Dr. Ben S. Bernanke, Chairman Federal Reserve Board of Governors
Mary L. Schapiro, Chairperson, U.S. Securities and Exchange Commission
Christine A. Varney, Assistant Attorney General for Antitrust
Neil M. Barofsky, Special Inspector General, TARP
Elizabeth Warren, Chairperson, Congressional Oversight Committee, TARP
Rep. Henry A. Waxman, Chairman, Committee on Oversight and Government Reform
Rep. Barney Frank, Chairman, House Committee on Financial Services
Sen. Christopher J. Dodd, Chairman, Senate Committee on Banking, Housing & Urban Affairs

State of Connecticut

RICHARD BLUMENTHAL
ATTORNEY GENERAL

Hartford

April 6, 2009

Dr. Ben S. Bernanke
Chairman
Federal Reserve Board of Governors
20th Street and Constitution Avenue, NW
Washington, DC 20551

Dear Chairman Bernanke:

I write to express my deep concern about the ratings eligibility criteria for the Federal Reserve's anticipated $1 trillion lending initiative, the Term Asset-Backed Securities Loan Facility (TALF). Specifically, current Federal Reserve policy mandates that TALF-eligible securities must be rated by two or more "major nationally recognized statistical rating organizations (NRSROs)." Under the Federal Reserve's definition, the only NRSROs – more commonly referred to as credit rating agencies – considered "major" are Standard & Poor's, Moody's Investors Service, and Fitch Ratings.

As I am sure you are aware, one of Congress' primary goals in enacting the Credit Rating Agency Reform Act of 2006 was to *increase* competition in the credit ratings market. To accommodate that purpose, Congress provided authority to the Securities and Exchange Commission (SEC) to oversee a regulatory process to register NRSROs and oversee aspects of their business. Currently there are upwards of nine NRSROs deemed eligible by the SEC to provide credit ratings for the types of securities contemplated by the TALF.

Despite the number of NRSROs the SEC considers fully capable of rating asset-backed securities of the type eligible for the TALF, the Federal Reserve's policy of preferring just Standard & Poor's, Moody's Investors Service, and Fitch Ratings, has the effect of unfairly blocking the other NRSROs from the TALF program which, according to many experts, is likely to be the entire securitization market in the United States for the foreseeable future.

Further, limiting the number of acceptable credit ratings agencies under the TALF program solely to the three major credit rating agencies contradicts and undermines Congress' intent to enhance competition; solidifying the major credit rating agencies' market dominance to the detriment of the other qualified NRSROs. Even more inexplicably, it rewards the very incompetence by Standard & Poor's, Moody's Investors Service, and Fitch Ratings, that helped cause our current financial crisis. In effect, the policy handsomely rewards failure. Indeed, it enables those specific credit rating agencies to profit from their own self-enriching malfeasance.

On October 23, 2008, your predecessor, Dr. Alan Greenspan, testified before the House Committee on Oversight and Government Reform that "unrealistically positive rating designations by the credit agencies was, in my judgment, the core of the problem," referring to the current credit crisis. I am sure you are aware that Dr. Greenspan's assessment of the *major* credit rating agencies' poor performance is widely shared. Indeed, the explicit purpose of the Credit Rating Agency Reform Act is "to improve ratings quality for the protection of investors ... by fostering accountability, transparency, and competition in the credit rating industry." Congress specifically stated that accomplishing these important goals was necessary because of the "failures by the large credit rating agencies to warn investors in a timely manner about the impending bankruptcies of Enron, Worldcom, and others." The major rating agencies' role in the current credit crisis underscores the urgency and significance of these goals, especially since, as the primary lender for the TALF, the Federal Reserve Bank of New York -- and ultimately U.S. taxpayers in the event of default -- will be secured by the collateral rated by the major credit rating agencies.

I strongly urge the Federal Reserve to reassess and revamp its current policy and to adopt a policy that gives all properly registered NRSROs the same chance to compete for work rating securities for the Federal Reserve liquidity enhancement facilities, such as the TALF. The Federal Reserve should not be favoring large market participants, whose mistakes helped precipitate the current crisis, over smaller ones seeking to break into the market.

I look forward to your response.

Very truly yours,

RICHARD BLUMENTHAL

RB/pas

c: Federal Reserve Board of Governors
Mary L. Schapiro, Chairperson, U.S. Securities and Exchange Commission

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

April 13, 2009

The Honorable Richard Blumenthal
Attorney General
State of Connecticut
55 Elm Street
Hartford, Connecticut 06106

Dear Mr. Attorney General:

I am responding to your letter of April 6, 2009, regarding nationally recognized statistical rating organizations (NRSROs) and Federal Reserve lending programs. You expressed concern that the Federal Reserve currently permits the ratings of only three NRSROs to be accepted for purposes of the Term Asset Backed Securities Loan Facility (TALF).

The Federal Reserve supports the objective of Congress in enacting the Credit Rating Agency Reform Act of 2006 of promoting meaningful competition in the credit ratings market. However, in carrying out its lending programs the Federal Reserve must give due weight to other important goals.

One key objective is to protect the Federal Reserve and the Treasury, and thus the U.S. taxpayer, from credit losses. To this end, the Federal Reserve has set out several conditions for collateral eligibility in its lending programs. These conditions include requirements for ratings by major NRSROs. As you point out, the ratings methods employed by major NRSROs for asset backed securities have exhibited significant shortcomings. However, the agencies have been working to remedy these shortcomings. The Federal Reserve believes that the ratings of the three major NRSROs provide useful information in its credit screening process.

In assessing the usefulness of the information provided by an NRSRO, it is important to note that in designating a credit rating agency as an NRSRO, the Securities and Exchange Commission does not certify the quality of the agencies' rating. Thus, it is incumbent on the Federal Reserve to perform its own due diligence regarding the rating agencies. We believe that a blanket acceptance of ratings provided by any NRSRO would not provide the appropriate level of credit protection to the Federal Reserve and to the taxpayer.

Another key objective of the Federal Reserve in establishing the TALF has been to make it available as quickly as possible. As you are well aware, U.S. financial markets and institutions are undergoing a period of extreme stress. For example, during the fourth quarter of 2008 and in the early months of 2009, the issuance of asset-backed securities was nil. These developments have resulted in a sharp cutback in the availability of credit to households and firms, which in turn are having a pronounced adverse effect on U.S. economic activity. In these circumstances, the Federal Reserve has put a high priority on making the TALF available expeditiously while ensuring appropriate protection against credit risk for the taxpayer. Timely initiation of the facility has required that the Federal Reserve proceed with the set of NRSROs whose ratings it has customarily employed.

Although ratings provided by only the three major agencies are currently eligible for the TALF, the Federal Reserve is in the process of analyzing the potential for expansion to include other agencies. For example, the Federal Reserve is in the process of reviewing the full set of NRSROs that rate commercial mortgage-backed securities (CMBS) in connection with the Federal Reserve's consideration of expanding TALF to include CMBS. We have requested information from the NRSROs to assist us in this analysis, and Federal Reserve staff will be meeting with some of the NRSROs later in April.

Moreover, the number of NRSROs is expanding, and partly for that reason we are conducting a broader review of our approach to using rating agencies. That review encompasses the ratings of securities of all types accepted as collateral at all our recently established credit facilities as well as collateral accepted to secure regular discount window loans. However, as we conduct this analysis, the Federal Reserve will need to keep two key considerations in mind: first, as noted above, the NRSRO designation is not a reflection of the quality of an entity's ratings; and second, as agreed by organizations such as the Group of 30, best practices dictate that lenders and investors have the independent capacity to evaluate their exposure to risk without sole reliance on rating agencies.

I hope these comments are helpful. Please let me know if I can be of further assistance.

Sincerely,