Securities Litigation & Regulation

Andrews Litigation Reporter

VOLUME 15 ★ ISSUE 4 ★ JUNE 30, 2009

Expert Analysis

Credit Rating Agencies: Out of Control and in Need of Reform

By Blair A. Nicholas, Esq., and Ian D. Berg, Esq.

The Pervasive Reach of Credit Rating Agencies

In 1975 the U.S. Securities and Exchange Commission adopted the term "nationally recognized statistical rating organization, or NRSRO, when amending a broker-dealer regulation under the Securities Act of 1934, 15 U.S.C. § 78j(b). That change marked the first time that compliance with a government regulation was contingent upon a credit rating from a nongovernmental, independent agency. Since then, the term NRSRO — and the notion of a quality threshold based upon a requisite rating — has been incorporated into a wide range of federal regulations and legislation. In turn, credit rating mandates, whether governmental or private, have become an integral part of the financial markets and of critical importance to securities market participants and creditors.[1]

Many large public institutions and pension funds use credit rating thresholds to prescribe the quality of securities that may be owned or held. Similarly, creditors such as (commercial and investment) banks use ratings to manage risk and to govern transactional agreements; incorporating "trigger" provisions in credit facilities for additional collateral should the borrower's credit rating be lowered.

Fitch, Moody's and S&P enjoy a quasi-governmental power.

Typically, at any given time, only a select few credit rating agencies qualify as approved NRSROs whose ratings can be used to fulfill regulatory requirements.[2] In particular, three rating agencies have historically dominated the field: Fitch, Moody's and Standard & Poor's, a division of McGraw-Hill. Collectively, Fitch, Moody's and S&P are responsible for 98 percent of all outstanding ratings issued by NRSROs.[3] In fact, in 2005 Moody's provided ratings for roughly 745,000 securities.[4] Because only NRSRO ratings can be used to fulfill most regulatory requirements, Fitch, Moody's and S&P enjoy quasi-governmental power and a perpetually steady market share of all outstanding ratings, thus

WEST®

generating significant revenues in what is now a $5 billion-per-year credit rating industry.[5]

Rating agency revenues and profit margins reached new heights in the early 2000s, during the housing market run-up and the rapid proliferation of mortgage-backed securities and other similar asset-backed securities. From 2000 to 2007 more than $5 trillion was spent purchasing MBS and other collateralized debt obligations that repackaged pooled mortgage loans.[6] Because ratings were vital to the success of those offerings, issuers paid lucrative fees to the rating agencies, reaching up to $120,000 for every $100 million of structured finance securities rated and supporting operating margins that topped 50 percent.[7]

Indeed, for five consecutive years during that time, profit margins at Moody's were higher than that of any other company in the S&P 500. At its peak, the rating agency's market capitalization was nearly $20 billion. In 2007 its revenues from structured finance alone topped $775 million, representing nearly half its total revenues for the year.[8] That same year, Fitch profited $240 million based on $1.1 billion in revenue.[9]

Profit margins at Moody's were higher than at any other company in the S&P 500.

With revenues pouring in, the rating agencies were incentivized to provide the high ratings necessary to ensure the success of the offerings, even at the expense of objectivity. As recounted by the former head of residential MBS ratings at S&P, Frank Raiter, during his time with the company: "Profits were primary. Analytics were secondary. Profits were running the show. … [B]usiness managers that were in charge just wanted to get as much of the revenue into their coffers."[10] Furthermore, an ex-employee of Moody's has alleged in a wrongful-termination lawsuit that he was fired after reporting a manager for downgrading a company that "didn't pay them."[11]

During a hearing of the House of Representatives' Committee on Oversight and Government Reform held Oct. 22, 2008, Chairman Henry Waxman, D-Calif., offered more proof regarding the culture at Moody's when he revealed an October 2007 presentation by Moody's Chairman and CEO Ray McDaniel. The firm's top executive acknowledged that bankers, investors and creditors continually "pitched" the credit rating agencies to get certain ratings, and he admitted in a confidential address to the board of directors that sometimes Moody's "drank the Kool-Aid."[12] Notably, during the six-year period including 2002 to 2007, the heads of S&P, Moody's and Fitch earned more than $80 million in compensation.[13]

Abandoning Objectivity for Profit

The agencies issue credit ratings for a wide variety of investment offerings, from traditional commercial paper and debt securities of public companies, sovereign governments and municipalities to various forms of structured products deriving from asset-backed and mortgage-backed securities. Market investors understand generally that a credit rating is intended to serve as an independent verification of an issuer's creditworthiness, and the resulting value of those financial instruments, by assessing the likelihood of payment on a particular issue versus the risk of default by the issuer. Thus the ultimate success of an offering, particularly an offering for a structured product aimed at institutional investors, is dependent on the assigned rating.

At the height of the housing market, from late 2005 to 2006, more than $546 billion in mortgage-backed securities were issued to the market, with about 75 percent of them issued at the highest, triple-A investment-grade rating.[14] These MBS offerings, which were directed mostly toward institutional investors with investment restrictions, could not have gone forward without investment-grade ratings for at least the most senior tranches. Tranche, which is French for "slice," refers to a specific level of risk that distinguishes one security from a related one backed by the same underlying bundle of assets.

Thus, to ensure the success of the offerings, the issuers commissioned one or more rating agencies to provide predetermined ratings and to participate directly in the structuring of the securitization transactions and the selection of the assets underlying each tranche in order to maximize those offerings with the highest possible ratings.

Ordinarily, a rating agency would assign a rating to a particular MBS after assessing the borrowers' ability to repay the principal and interest on the loans and the adequacy of the collateral underlying the securitized loan pool. However, by participating in the structuring of the offerings — and receiving lucrative

fees for their participation — the rating agencies were faced with an inherent conflict of interest because they were incentivized to provide presupposed investment-grade ratings regardless of their assessment.

Investors may have suspected that the financial engineers of MBS and collateralized debt obligations, from the local banks and mortgage brokers to the highest-level Wall Street investment bankers, paid little attention to the quality of the mortgages and assets being pooled because they profited from the mere proliferation of the instruments. However, those investors were unaware that the credit rating agencies had abandoned their duty to provide an independent, unbiased assessment of risk and purchased MBS, in their various structures and packages, by relying on the triple-A and investment-grade ratings.

By the end of 2007 home prices were on a steep decline, loan delinquencies and defaults were rising steadily, and several of the largest and most prolific subprime lenders were out of business, including New Century Mortgage Corp. and Accredited Home Lenders. It soon became clear to investors and market watchers that most of the investment-grade ratings given to CDO instruments were never warranted, as evidenced by their rapid downgrades so soon after issuance.

In fact, in 2008 roughly 30,000 structured finance securities had their ratings downgraded by credit rating agencies — about 3,000 of them had originally been rated at the highest triple-A rating.[15] These downgrades led to significant investor losses, even on the supposedly "safest" investments. For example, losses on $340 million worth of collateralized debt securities issued by Credit Suisse Group were $125 million, or more than 36 percent of the original value, despite being rated at the highest triple-A rating by S&P, Fitch and Moody's.[16]

In June 2008 the SEC confirmed that the rating agencies failed to adequately manage conflicts of interests when rating mortgage-backed securities. After a 10-month investigation of the three dominant rating agencies (S&P, Moody's and Fitch), the SEC released a report describing serious deficiencies in their rating processes.[17] The report concluded, among other things, that the rating agencies failed to adequately manage conflicts of interest in that analysts charged with rating bonds and MBS were often aware that a high rating would improve the financial success of the firm.

The SEC supported its conclusion with a sampling of e-mails uncovered during its investigation. In one e-mail, an analyst complained that her agency's methodology did not capture "half" the risk of a particular security, later adding that the deal "could be structured by cows" and the company would still rate it. A manager at the same rating agency wrote in an e-mail that, compared to the MBS market, his employer was "creating an even bigger monster, the CDO market," remarking, "Let's hope we are all retired and wealthy before this house of cards falters."[18]

The rating agencies were faced with an inherent conflict of interest.

The SEC also concluded that the rating agencies failed to maintain adequate resources to properly assess and track the issues they rated. An e-mail by a senior analytical manager at one of the major ratings agencies said, "We do not have the resources to support what we are doing now."[19] These flaws in the rating process — the incentive to issue investment-grade ratings and a lack of resources to properly assess and track issued ratings — led the President's Working Group on Financial Markets to sharply criticize the rating agencies for their assessment of complex products, calling them a "principal underlying cause" of the financial crisis.

Ratings Have Proven to Be Unreliable And Reactionary

Where are we now? In the wake of the financial crisis, rating agencies have been criticized for not only their artificially high initial ratings, but also their failure to timely downgrade issues despite concrete evidence of an increased risk of default. As the crisis grew, the value of some MBS fell up to 50 percent, yet the ratings on those bonds remained relatively unchanged.[20]

Many believe this is the result of the rating agencies' issuer-pay business models. In the first instance, initial ratings are too heavily influenced by the conflict of interest between revenue and objectivity. In the second instance, rating agencies lack incentive to process subsequent data and circumstances that might cause them to lower already established ratings. The result is simply that ratings have become unreliable and reactionary.

Unfortunately, because ratings have become so intertwined in regulations and other aspects of business, lowering a credit rating could create a vicious cycle leading to a complete loss of value in a downgraded issue or even the demise of a downgraded company. The very structure of bundled securities, including MBS and CDOs, is inherently problematic. When hundreds of thousands of similar securities are bundled, the risk is concentrated such that even a slight change to the assessed chance of default — the rating — could have an enormous effect on the price of the bundled security.[21]

As explained by renowned market commentator Henry C.K. Liu, this means that even though a rating agency could be correct in its opinion that the chance of default of a structured product is very low, even a slight change in the market's perception of the risk of that product can have a disproportionate effect on the product's market price. That is, an ostensibly triple-A security that is reduced even to double-A or single-A rating can collapse in price even without there being any default.

This possibility raises significant regulatory issues because it contradicts the traditional assumption that high ratings (such as the double-A or single-A ratings used in the example) correspond with low volatility and high liquidity.[22]

In the case of the credit rating of a company itself, a downgrade can have greater effects than just causing interest rates to increase for that company. A downgrade is likely to affect other contracts, particularly debt covenants, causing an increase in other expenses. Furthermore, many credit facilities contain a clause that makes the balance of the loan due in full if the borrowing company is rated below a prescribed grade.

If the borrowing company is unable to repay the loan in full, it could be forced to enter into a significantly less favorable credit agreement or, worse, be forced into bankruptcy. As a result, companies are willing to pay exorbitant fees to rating agencies for "consulting services" on how to ensure high ratings, and rating agencies have been willing to accommodate those companies.

There are countless examples of when rating agencies were slow to downgrade securities and companies they knew to be at risk; and perhaps none better than the case of Enron. The rating agencies maintained investment-grade ratings on Enron up until four days before the company went bankrupt, despite evidence that they had been aware of Enron's problems for months.[23] In fact, a Senate report concluded that the rating agencies "did not perform a thorough analysis of Enron's public filings; did not pay appropriate attention to the allegations of financial fraud; and repeatedly took company officials at their word, without asking probing, specific questions — despite indications that the company had misled the rating agencies in the past."[24]

Since Enron, nothing has changed. In the past year, S&P, Moody's and Fitch gave high investment-grade ratings to at least 11 financial institutions that later faltered or failed.[25] Just before receiving what has amounted to more than $170 billion in government aid, insurer AIG was rated in the double-A category.[26] Likewise, investment bank Lehman Bros. maintained a single-A rating in the month before it collapsed into bankruptcy.[27]

Moreover, the rating agencies maintained triple-A ratings on thousands of subprime-related instruments well after foreclosures skyrocketed and the securities became nearly worthless. Indeed, the SEC confirmed in June 2008 that once they rated investment products, the agencies essentially stopped tracking the performance of those securities altogether.[28]

Rating agencies are exempt from liability for false and misleading statements.

In the summer of 2007 the rating agencies could no longer ignore the effects of the housing crisis and issued massive downgrades to MBS and to subprime MBS, in particular. On July 11, 2007, S&P downgraded ratings on 612 different bond issues, valued at about $12 billion. At the same time, Moody's downgraded ratings on 399 bond issues, valued at $10.2 billion.[29] Many of those downgrades lowered the ratings on bonds from investment-grade to below investment-grade, forcing most institutional investors to sell their holdings in order to comply with investment and regulatory guidelines. As a result of the downgrades and forced sales, CDO investors stood to lose as much as $250 billion, as estimated by Institutional Risk Analytics, a company that writes computer programs that help auditors detect portfolio risk.[30]

Both S&P and Moody's said they downgraded the bonds because homeowners were missing payments on subprime mortgages at much higher levels than

anticipated, and both blamed lenient lending standards during the housing run-up.[31] In response, and noting that the rating agencies were privy to those same lending standards when they rated the bonds triple-A and other investment-grade ratings at the time of issue, a group of Moody's shareholders sued the agency and its CEO for alleged violations of federal securities laws.[32] The action survived a motion to dismiss in February. Any recovery would be limited to the class of Moody's investors and would not benefit those investors who relied on the improper ratings when purchasing the bonds.

Credit Rating Agencies Typically Avoid Civil Liability

Unfortunately for harmed investors, even though ratings are a necessary and pervasive element of securities offerings and the securities markets, rating agencies typically avoid civil liability associated with their ratings, no matter how false or misleading the ratings may have been. Indeed, rating agencies are exempt from liability for false and misleading statements in a registration statement as "experts" under Section 11 of the Securities Act of 1933, 15 U.S.C. § 77k, and Rule 436(g)(1) promulgated there under.[33] Moreover, attempts to litigate around the Section 11 exemption and other statutory deterrents have been generally unsuccessful and have created even greater protections for the rating agencies through judicial precedent.

On the few other occasions where rating agencies have been targeted in lawsuits, typically after notorious defaults such as the Jefferson County, Colo., School District default in 1995 and the Orange County, Calif., default in 1996, courts have cloaked them with the protection of a qualified privilege for speech under the First Amendment. Courts have accepted the rating agencies' premise that their ratings are mere "opinions" regarding the likelihood that a particular debt security will be serviced over a given period of time, and not an opinion on the volatility of that security — and certainly not an opinion on the wisdom of investing in that security.

The rating agencies further contend that their advice constitutes only a "point in time" analysis and that they make clear that any change in circumstance regarding the risk factors of a particular offering will invalidate their analysis and result in a different credit rating, even if that change in circumstance occurs shortly after the initial rating.[34]

To overcome the afforded statutory safeguards and First Amendment protections, investors who relied on false and misleading ratings must show that the rating agencies did more than just evaluate the offerings and issue letter grade ratings. Several institutional investors that purchased a form of MBS called mortgage pass-through certificates are attempting to do just that, based on the premise that the agencies are liable for the role they played in packaging, promoting and selling the certificates. Specifically, these investors allege that the agencies are liable as "underwriters" of the certificates within the meaning of Section 11 of the Securities Act. There are about 10 such cases currently pending.[35]

A Need for Reform

Despite a lack of confidence in rating agencies and their processes, ratings still play a critical role in the financial marketplace. It would not be feasible or practical for regulators and/or investors to simply stop considering or using ratings. With that in mind, regulators are trying to investigate what went wrong and implement meaningful reform. In 2006 President George W. Bush signed into law the Credit Rating Agency Reform Act, Pub. L. No. 109-291, which enhanced the SEC's authority to oversee the credit rating agencies and made the selection of "approved" NRSROs more transparent. Subsequently, and in consideration of its June 2008 report outlining the deficiencies in the rating agencies' rating process and their role in the credit crisis, the SEC in February 2009 adopted new rules designed to increase transparency of rating methodologies, strengthen the NRSROs' disclosures, prohibit certain conflicted practices, and enhance their recordkeeping.

Courts have accepted that credit ratings are mere opinions.

During her first congressional hearing since being confirmed as the head of the SEC, Mary Schapiro told the House Appropriations Subcommittee on Financial Services and General Government that the SEC may need to seek even broader authority from Congress to oversee the credit rating agencies.[36]

In addition she recently called for an examination into how rating agencies are compensated, how they

manage conflicts of interest and what role they should play in the markets.[37] Toward those goals, Schapiro held a roundtable discussion on the SEC's oversight of the rating agencies April 15 that included industry leaders and leading academic experts. The roundtable discussion topics included:

- The rating agencies' perspective on what caused the current credit crisis;
- The remedial steps they are taking to address the causes;
- Competition issues that present barriers to entry for competing rating agencies;
- Ratings users' perspectives on the rating industry; and
- Approaches to improving rating agency oversight.[38]

As suggested by the roundtable agenda, Schapiro's ultimate goal is for the SEC to explore ways to diminish the market's dependence on the inherently unreliable ratings by the large agencies.[39]

Leading up to the SEC roundtable, S&P released its own report April 10 calling for regulatory changes to eliminate conflicts of interest and require more disclosure regarding rating methodologies.[40] S&P acknowledged that some changes are in order and said it would support regulatory change to "enhance the rating process and restore investor confidence."[41] However, critics of the rating agencies remain skeptical of their intentions to implement meaningful change. While officials at S&P, Moody's and Fitch have said they have already taken steps to avoid a repeat of past mistakes, the three agencies have made few fundamental changes to the way they assess debt.[42]

New York's state insurance superintendent has argued for more aggressive change, calling for the issuer-payment rating model to be abolished in favor of a user-payment model.[43] In support of his position Eric Dinallo pointed to a recent report by the Group of 30 (a group of international economic experts led by Paul Volcker, the former chairman of the Federal Reserve and the current chairman of the newly formed Economic Recovery Advisory Board under President Obama) recommending that regulators encourage the development of payment models that "improve the alignment of incentives" and permit rating users to hold rating providers accountable.

Dinallo suggests that to fund a buy-side rating system, insurance commissions could collect a small fee from insurance companies, which hold nearly $3 trillion in rated bonds and comprise the largest industry sector that relies on the credit ratings. According to Dinallo, the New York Insurance Department estimated that for less than two basis points (0.02 percent) per year on that $3 trillion, insurers in partnership with insurance regulators could purchase transparent, conflict-free and cost-effective ratings.

Moody's COO Michael Madelain dismissed Dinallo's proposal: "The potential for conflicts of interest exist in any model in which the payer has an interest in the rating outcome. … Insurers as investors, for example, are as interested in particular ratings outcomes as bond issuers, since ratings can affect both price and capital required to hold bonds. Similarly, oversight authorities may also have an interest in rating outcomes for firms in their area of responsibility."[44]

According to Madelain, a change in the payment model for credit rating agencies will not eliminate potential conflicts of interest; instead, the discussion should focus on the proper management of those conflicts. In fact, Madelain argues that merely asserting that alternative business models might eliminate potential conflicts is "dangerous" because it "de-emphasizes the strong focus on prudent management that all models demand."

Despite their best intentions, regulators, including the SEC's Schapiro, may not yet be equipped with the authority needed to force rapid reform upon the rating agencies without their cooperation. And, as foreshadowed by Madelain, rating agencies are certain to resist making any significant changes to their business models as they continue to reap windfall profits under the current system.

The Impact of Reform on Institutional Investors

In light of increasing reform initiatives by the SEC and several states, the Council for Institutional Investors commissioned law professor Frank Partnoy, director of the Center on Corporate Securities Law at the University of San Diego School of Law, to examine how the reforms would affect institutional investors.[45]

Partnoy's report called for enhanced oversight of the rating agencies by either a more powerful SEC or a new agency altogether. He also suggests removing rating agencies' exemption from liability under the

Securities Act and otherwise making NRSROs subject to private rights of action under the anti-fraud provisions of securities laws.

Partnoy points out that rating agencies, unlike most other financial gatekeepers, have not been subject to serious threats of civil liability for wrongdoing. Like other information intermediaries, the agencies "will function best when they have reputational capital at stake and will suffer a loss if their fair assessments are biased, negligent or false," and private civil litigation could become a viable tool for ensuring rating agency accountability, the report says.

Regulators are trying to investigate what went wrong.

Fittingly, Partnoy's report was released two weeks after U.S. Sen. Jack Reed, D-R.I., circulated a bill seeking to, among other things, amend Section 21D(b)(2) of the Exchange Act, 15 U.S.C. 78u-4(b)(2), to allow for a private right of action against credit rating agencies for failing to conduct a reasonable investigation of a rated security.[46] Moreover, the proposed Rating Accountability and Transparency Enhancement Act of 2009 would eradicate the First Amendment protections that judges have liberally afforded to rating agencies in the past.

In addition to creating a private right of action, the proposed law (in its current form) would require rating agencies to implement written control policies, greater disclosures, recordkeeping, and new compliance measures to deal with conflicts of interest and model issues. The law would also grant the SEC more authority to oversee the rating agencies, which is a complement to legislation introduced in the House by New York Democrat Gary Ackerman that would prohibit agencies from issuing SEC-recognized ratings on debt securities without a "documented history" showing how the particular pool of assets would likely perform.[47]

In the absence of meaningful reform, including an enforceable private right of action for civil liability, the rating agencies will continue to flourish at the expense of investors, and the securities markets will remain vulnerable to another crisis in the future. In fact, the rating agencies are expected to earn windfall profits from the government bailout programs designed to remedy the current financial crisis that they helped cause.

As part of the bailout, the Federal Reserve Board announced the creation of the Term Asset-Backed Securities Loan Facility program, or TALF, in November. The program is intended to help market participants meet the credit needs of households and small businesses by supporting the issuance of asset-backed securities collateralized by student loans, auto loans, credit card loans and loans guaranteed by the Small Business Administration.[48] Under TALF, the Federal Reserve will lend up to $200 billion on a non-recourse basis to holders of certain ABS backed by newly and recently originated consumer and small-business loans. Notably, TALF requires financial institutions to have the new securities rated at triple-A by two or more "*major*" NRSROs, which only qualifies S&P, Moody's and Fitch to provide those ratings.[49]

Depending on the ultimate size of the TALF program and the kinds of securities issued, the rating agencies stand to earn anywhere between tens of millions and hundreds of millions of dollars.[50] Critics such as Connecticut Attorney General Richard Blumenthal and others are openly questioning why up to $400 million in federal bailout money is going to S&P, Moody's and Fitch after they helped create the economic meltdown, while shutting out their six smaller competitors.[51] The bigger concern, however, is whether TALF's requirement that the ABS receive a triple-A rating might cause the rating agencies to fall prey to the same conflicts of interest that doomed the MBS offerings at the heart of the financial crisis TALF aims to remedy, and ultimately end up causing more harm than good.

Conclusion

Institutional investors are among those harmed most by the recklessness of the rating agencies and the inherent conflicts in their issuer-pay business models. While several governmental regulators are seeking to gain control over the agencies, institutional investors must recognize the arduous and lengthy process involved and do all they can to support those initiatives that will enact meaningful change. In the meantime, institutional investors must be vigilant and innovative in their attempts to hold rating agencies accountable whenever possible, or they will continue to suffer the negative effects of a flawed system.

Notes

1 *See* SEC Proposed Rule 17 C.F.R. Parts 240 and 249b, Release No. 34-55231; File No. S7-04-07.
2 *See* Frank Partnoy, *Rethinking Regulation of Credit Rating Agencies: An Institutional Investor Perspective* (Apr. 14, 2009) (identifying 10 NRSROs as of April 2009), ***available at*** http://www.cii.org/UserFiles/file/CRAWhitePaper04-14-09.pdf; *see* SEC Proposed Rule, *supra* note 1 (identifying five NRSROs as of March 2007).
3 Partnoy report, *supra* note 2.
4 *Id.*
5 Dave Collins, *Conn. AG questions credit-rating companies,* Associated Press, Apr. 7, 2009.
6 "Credit and Credibility," Pub. Broad. Sys. (Dec. 26, 2008).
7 Serena Ng & Liz Rappaport, *Ratings firms see a windfall in bailout program,* Wall St. J, Mar. 23, 2009.
8 *Id.*
9 J. Levine, *The Hot Seat,* Forbes, Mar. 24, 2008.
10 "Credit and Credibility," ***supra*** note 6.
11 *See Bienstock v. Moody's Investors Servs. et al.,* No. 09-CV-2858, *complaint filed* (S.D.N.Y. Mar. 25, 2009).
12 Vanessa Drucker, ***Face Value***, Wealth Manager, Mar. 1, 2009.
13 "Credit and Credibility," ***supra*** note 6.
14 *See* Sub-Prime Slump Sours Bond Ratings, L.A. Times, July 11, 2007; Mark Pittman, *Moody's May Cut $5 Billion of Subprime-Backed CDOs,* Bloomberg News, July 11, 2007.
15 Ng & Rappaport, *supra* note 7.
16 John Mauldin, *$250 Billion in Subprime Losses?,* Safehaven.com, June 30, 2007.
17 Greg Farrell, *SEC slams credit-rating agencies over standards,* USA Today, July 8, 2008.
18 *Id.*
19 Partnoy report, *supra* note 2.
20 Pittman, *supra* note 14.
21 Henry C.K. Liu, *US Government throws oil on fire,* Asia Times, Oct. 23, 2008.
22 *Id.*
23 *See, e.g.,* Edward Wyatt, *Enron's Many Strands: Warning Signs; Credit Agencies Waited Months To Voice Doubt About Enron,* N.Y. Times, Feb. 8, 2002.
24 *See Newby v. Enron Corp.,* 511 F. Supp. 2d 742 (S.D. Tex. 2005), citing Staff of the Senate Comm. on Governmental Affairs, Financial Oversight of Enron: The SEC and Private-Sector Watchdogs 108 (Oct. 8, 2002).
25 Partnoy report, *supra* note 2.
26 Sudeep Reddy & Liam Pleven, *For AIG, A Buy and Hold Strategy,* Wall St. J., Mar. 3, 2009; Partnoy report, *supra* note 2.
27 Partnoy report, *supra* note 2.
28 Sec. & Exch. Comm'n, Summary Report of the Issues Identified in the Commission Staff's Examinations of Select Credit Rating Agencies (July 8, 2008), *available at* http://sec.gov/news/studies/2008/craexamination070808.pdf.
29 Pittman, *supra* note 14.
30 *Id.*
31 *See* Sub-Prime Slump, supra note 14.
32 *See In re Moody's Corp. Sec. Litig.,* No. 1:07-CV-8375-SWK S.D.N.Y.).
33 *See* 15 U.S.C. § 77k; Securities Act Rule 436(g)(1) (Notwithstanding the provisions of paragraphs (a) and (b) of this section, the security rating assigned to a class of debt securities, a class of convertible debt securities, or a class of preferred stock by a nationally recognized statistical rating organization, or with respect to registration statements on Form F-9 by any other rating organization specified in the Instruction to paragraph (a)(2) of General Instruction I of Form F-9, shall not be considered a part of the registration statement prepared or certified by a person within the meaning of sections 7 and 11 of the Act).
34 Partnoy report, *supra* note 2.
35 *See, e.g., Boilermaker-Blacksmith Nat'l Pension Trust v. Wells Fargo Mortgage-Backed Sec. 2006-AR1 Trust et al.,* No. 09-CV-833, *complaint filed* (S.D.N.Y. Jan. 29, 2009); *Pub. Employees' Ret. Sys. of Miss. v. Goldman Sachs Group Inc. et al.,* No. 09-CV-1110, *complaint filed* (S.D.N.Y. Feb. 6, 2009); *W. Va. Inv. Mgmt. Bd. v. Morgan Stanley Capital I Inc. et al.,* No. 09-CV-4414, *complaint filed* (S.D.N.Y. May 7, 2009).
36 Sarah Lynch, *SEC Could Have Wider Sway Over Ratings Firms,* Wall St. J., Mar. 11, 2009.
37 Mary Schapiro, Address to the Practicing Law Institute's "SEC Speaks in 2009" Program (Feb. 6, 2009), *available at* http://www.sec.gov/news/speech/2009/spch020609mls.htm.
38 Roundtable to Examine Oversight of Credit Rating Agencies Agenda (Apr. 15, 2009), ***see*** http://www.sec.gov/spotlight/cra-oversight-roundtable/agenda.htm.
39 Collins, *supra* note 5.
40 *See* S&P, "An Examination of How Investor Needs Are Served by Various Ratings Business Models: Ensuring Analytical Independence and Freedom From Conflicts of Interest at Credit Rating Firms" (Apr. 10, 2009).
41 *Id.; see also* Sarah Lynch, *S&P Calls for Global Reform on Credit-Rating Firms,* Wall St. J., Mar. 4, 2009.
42 Ng & Rappaport, *supra* note 7.
43 *See* Eric Dinallo, *Buyers Should Pay for Bond Ratings,* Wall St. J., Mar. 3, 2009.
44 *See* Madelain, M., Letter to the Editor, Wall St. J., Mar. 8, 2009.
45 Partnoy report, *supra* note 2
46 See Rating Accountability and Transparency Enhancement Act of 2009, S. 1073, 111th Cong. (2009).
47 Jesse Westbrook, *Reed Seeks Expanded Liability for Rating Companies,* Bloomberg News, Apr. 1, 2009.
48 Press Release, Fed. Reserve Sys., Federal Reserve Announces the Creation of the Term Asset-Backed Securities Loan Facility (TALF) (Nov. 25, 2008), *available at* http://www.federalreserve.gov/newsevents/press/monetary/20081125a.htm.
49 Collins, *supra* note 5.
50 Ng & Rappaport, *supra* note 7.
51 Collins, *supra* note 5.

Blair A. Nicholas, Partner

Mr. Nicholas has successfully represented numerous institutional investors in high-profile actions involving federal and state securities laws, accountants' liability, and corporate governance matters.

He served as one of the lead trial counsel in In re *Clarent Corporation Securities Litigation*, a securities fraud class action prosecuted before the Federal District Court for the Northern District of California. After a four week jury trial, in which Mr. Nicholas delivered the closing argument, the jury returned a securities fraud verdict in favor of investors against the former Chief Executive Officer of Clarent.

Recently, Mr. Nicholas served as lead counsel on behalf of prominent mutual funds, hedge funds and a public pension fund in an opt-out securities fraud against Tyco International, which was resolved for $100 million. This opt-out recovery represented a significant multiplier over the recovery in a related securities class action. Mr. Nicholas also served as one of the principal attorneys responsible for prosecuting *In re Williams Securities Litigation*, resolved for $311 million; *In re Informix Securities Litigation*, resolved for $142 million; *In re Gemstar Securities Litigation*, resolved for $92.5 million; *In re Legato Systems Securities Litigation*, resolved for $85 million; *In re Network Associates Securities Litigation*, resolved for $70 million; and *In re Finova Group Securities Litigation*, resolved for $42 million.

Mr. Nicholas was named by *The American Lawyer* as one of its "Fab Fifty Young Litigators" -- one of the top 50 litigators in the country, 45 and under, who have "made their marks already and whom [they] expect to see leading the field for years to come." He was also honored in the *Daily Journal*'s January 2007 issue, as being among the "Top 20 Under 40" attorneys in California, "rack[ing] up a string of multi-million dollar victories for investors." He has been named one of the *San Diego Super Lawyers* and was honored with the selection by *Lawdragon* magazine as one of the "Top 100 Securities Litigators You Need to Know."

Mr. Nicholas has presented at institutional investor conferences throughout the United States and has written articles relating to the application of the federal and state securities laws, including the articles "South Ferry: Applying Tellabs, 9th Circuit Lowers The Bar for Pleading Scienter Under the PSLRA," *Securities Litigation & Regulation Reporter* (October 2008); "The 7th Circuit Sends a Strong Message: Institutions Must Monitor Securities Class Actions Claims," *The NAPPA Report* (August 2008); "Industry-Wide Collapse Defense Falls Flat in Recent Subprime-Related Securities Fraud Decisions," *Securities Litigation & Regulation Reporter* (July 2008) (co-author); "Auditor Liability: Institutional Investors Pursue Opt-Out Actions To Maximize Recovery of Securities Fraud Losses," *Securities Litigation and Enforcement Institute* (PLI 2007) (co-author); and "Reforming the Reform Act and Restoring Investor Confidence in the Securities Markets," *Securities Reform Act Litigation Reporter* (July 2002).

Mr. Nicholas served as Vice President on the Executive Committee of the San Diego Chapter of the Federal Bar Association and is an active member of the Association of Business Trial Lawyers of San Diego, Litigation Section of the State Bar of California, and the San Diego County Bar Association.

Ian D. Berg, Associate

Mr. Berg's practice focuses on securities fraud litigation, subprime litigation and derivative claims. As a member of the firm's new matter department, he counsels institutional clients on potential legal claims and causes of action.

Mr. Berg has litigated a number of cases on behalf of public pension funds and shareholders, including In re Delphi Corp. Securities Litigation and In re Tyco International Ltd. Securities Litigation, which recovered over $3 billion for harmed shareholders. In addition, Mr. Berg has extensive experience in implementing and managing electronic discovery initiatives.