Moody's Ratings Agency Corrupt to the Core

by Henry Blodget via fleet - BI *Saturday, Aug 20 2011, 12:31am*
international / injustice/law / other press

Is anyone surprised?

> A former senior analyst at Moody's has gone public with his story of how one of the country's most important rating agencies is corrupted to the core. The analyst, William J. Harrington, worked for Moody's for 11 years, from 1999 until his resignation last year.

Harrington has made his story public in the form of a 78-page "comment" to the SEC's proposed rules about rating agency reform, which he submitted to the agency on August 8th. The comment is a scathing indictment of Moody's processes, conflicts of interests, and management, and it will likely make Harrington a star witness at any future litigation or hearings on this topic.

The primary conflict of interest at Moody's is well known: The company is paid by the same "issuers" (banks and companies) whose securities it is supposed to objectively rate. This conflict pervades every aspect of Moody's operations, Harrington says. It incentivizes everyone at the company, including analysts, to give Moody's clients the ratings they want, lest the clients fire Moody's and take their business to other ratings agencies.

Moody's analysts whose conclusions prevent Moody's clients from getting what they want, Harrington says, are viewed as "impeding deals" and, thus, harming Moody's business. These analysts are often transferred, disciplined, "harassed," or fired.

In short, Harrington describes a culture of conflict that is so pervasive that it often renders Moody's ratings useless at best and harmful at worst.

Harrington believes the SEC's proposed rules will make the integrity of Moody's ratings worse, not better. He also believes that Moody's recent attempts to reform itself are nothing more than a pretty-looking PR campaign.

We've included highlights of Harrington's story below. Here are some key points:

> Moody's ratings often do not reflect its analysts' private conclusions. Instead, rating committees privately conclude that certain securities deserve certain ratings--and then vote with management to give the securities the higher ratings that issuer clients want.
>
> Moody's management and "compliance" officers do everything possible to make issuer clients happy--and they view analysts who do not do the same as "troublesome." Management employs a variety of tactics to transform these troublesome analysts into "pliant corporate citizens" who have Moody's best interests at heart.
>
> Moody's product managers participate in--and vote on--ratings decisions. These product managers are the same people who are directly responsible for keeping clients happy and growing Moody's business.
>
> At least one senior executive lied under oath at the hearings into rating agency conduct.

> Another executive, who Harrington says exemplified management's emphasis on giving issuers what they wanted, skipped the hearings altogether.

Harrington's story at times reads like score-settling: The constant conflicts and pressures at Moody's clearly grated on him, especially as it became ever clearer that his only incentive not to "cave" to an issuer's every demand was his own self-respect.

But Harrington's story also makes clear just how imperative it is that the ratings-agency problem be addressed and fixed. The current system, in which the government anoints organizations as deeply conflicted as Moody's with the power to determine sanctioned bond ratings is untenable. And the SEC's proposed rule changes won't fix a thing.

Harrington's story is startling, both in its allegations and specificity. (He names many Moody's executives and describes many instances that regulators and plaintiffs will probably want to take a closer look at.)

Given this, we expected Moody's might want to share its side of the story--or denounce Harrington as a disgruntled ex-employee. Instead, Moody's did not return multiple calls seeking comment.

http://www.businessinsider.com/moodys-analyst-conflicts-corruption-and-greed-2011-8
