

How to Improve the Credit Rating Agency Sector  
June 24, 2008

Introductory Remarks

Alex J. Pollock

Welcome to our conference on “How to Improve the Credit Rating Agency Sector,” and thank you for being with us. We have an outstanding panel, whom I will introduce in a moment.

The great Housing and Mortgage Bubble of the 21<sup>st</sup> Century, which peaked in 2006, and the continuing painful and costly deflation of that bubble make a classic financial pattern. This time, the financial markets applied vast computer power and complex models with reams of data, including the models of the credit rating agencies, which—as it turned out—helped inflate the bubble. But whether the siren song of increasing risk and increasing leverage is turned into calculations with computers or with quill pens, the underlying logic is the same.

Part of the classic pattern is the inevitable political reaction. In the political debates which always follow in the wake of big financial busts is a Search for the Guilty. It is clear that among the candidates for the guilty role in the current bust are the major credit rating agencies. Our purpose today is not to pursue such a search, but is rather to dispassionately consider how the role of credit ratings can be improved going forward.

We have recent SEC proposals in this line and numerous other ideas and recommendations, ranging from much heavier regulation of ratings agencies to removing the government from any role in sponsoring certain credit rating agencies or mandating the use of their ratings. Our panel represents a range of views on these issues.

We will hear first from Erik Sirri, the director of the Division of Trading and Markets at the SEC, which is responsible for the regulation of stock and option exchanges, national securities associations, brokers, dealers, clearing organizations, and credit rating agencies. Erik is on leave from Babson College, where he is a professor of finance. He has previously served as chief economist of the SEC, a governor of the Boston Stock Exchange, a member of the regulatory board of the Boston Options Exchange, and has worked on planetary missions for NASA. We’re very pleased he is able to join us today.

Our next speaker will be Larry White, who is the Arthur E. Imperatore Professor of Economics and deputy chair of the economics department at the Stern School at New York University. During the last big housing finance bust in the 1980s, Larry served (perhaps I should say survived) as a member of the Federal Home Loan Bank Board. He has also served with the Antitrust Division of the Department of Justice and the staff of the President’s Council of Economic Advisers, and he is the general editor of the Review of Industrial Organization. Reading Larry’s articles on credit rating agencies several years ago introduced me to the issues we’re discussing today

Next will be Josh Rosner, a managing director of the research consultancy Graham Fisher & Co., where he advises regulators and institutional investors on housing and mortgage finance issues. Previously, he was with Medley Global Advisors, where he was among the first analysts to identify accounting problems at the housing GSEs, the mortgage bubble and the likelihood of resulting contagion in the credit markets, and issues in the credit ratings of CDOs. Josh called me early in 2007 to say the mortgage securities markets were heading for serious liquidity problems—a good call.

Our fourth speaker will be Sean Egan, a founding partner and the managing director of Egan-Jones Ratings Co., which was registered as an NRSRO by the SEC last year. Egan-Jones is 100% paid by investors and its only clients are institutional investors. It has provided early credit warnings on Bear Stearns, the monoline insurers, Countrywide, New Century, California utilities, Delphi, Enron and Global Crossing, among others. Sean was a commercial and investment banker before founding Egan-Jones and is never shy about sharing his views on the credit rating agency sector.

Sylvain Raynes will complete the panel. Sylvain is a founding principal of the new York-based R & R Consulting, where he specializes in securitization and project finance. He is also a faculty member at the New York Institute of Finance and Baruch College. Previously, he worked in structured finance at Paine Webber, risk management at Credit Suisse, and was a senior analyst at Moody's. He is the author of *Elements of Structured Finance* and *The Analysis of Structured Securities*.

Each panelist will speak for 12 to 15 minutes, after which we will give the panel members a chance to respond to each other. After that, we will open the floor for your questions.

We will adjourn promptly at 2:30 or when you are out of questions, whichever is first.