

Eric Kolchinsky – retaliation complaint.

Factual Discussion

1. During the relevant period, I was a Team Managing Director in the Derivatives Group and reported to Yuri Yoshizawa, a Group Managing Director.
2. Prior to the retaliatory actions, my job performance evaluations were excellent. In fact, I was recently promoted to MD (announced in November 06, officially in January 07).
3. I was always concerned about the underlying credit of ABS CDOs. Many of the suggestions which I made to improve the credit of ABS CDOs were either rejected outright or blocked from implementation through constant and unnecessary delays by my supervisor Yuri. She is always concerned with the short term business opportunity versus the long term effect of the rating and Moody's reputation and potential civil (if not criminal) liability, thus directly affecting Moody's clients and shareholders.
4. This conflict relating to the quality of our ratings is generally known and was the subject of a WSJ story, "Ratings Raised a Red Flag". I did not speak to the author and cooperated with the Moody's press office.
5. During the spring and summer of 2007, the rating agency was criticized for being slow to downgrade bonds backed by subprime mortgages. For example, on August 30<sup>th</sup> 2007, the ABX.HE.06-2.BBB was trading at 42.5, a price approximately consistent with a Ca rating. At the time however, we had not yet taken any significant actions on the underlying tranches. The RMBS group hoped that loan modifications may reduce the delinquency pipelines in the deals and reduce the stress.
6. The CDO rating methodology used the ratings on the RMBS as a measure of credit risk to determine the ratings on CDOs. This portion of the process was mechanical and deterministic. Keeping everything else constant, a worse rating level on the underlying RMBS generally translated into a worse rating level on the CDO tranches.
7. In September 07, several CDOs backed by subprime were still in the pipeline. Many banks "warehoused" the underlying credits and sought to reduce their exposure through securitization in CDOs. The falling ABX prices made the bankers more anxious and increased the pressure to close deals.
8. On or about September 10, 2007, I found out that the surveys regarding the loan modifications (see #4 above) were discouraging – very few modifications were being made. It was my understanding that as a result: 1) rating actions were going to be taken on the 2006 vintage, 2) these actions were to be broad and 3) they were going to be severe. The RMBS group, however, needed time to calculate the appropriate ratings for all the affected tranches.
9. As a point of reference, when these actions did take place, we downgraded 3,083 tranches – including 83% of the 2006 Baa rated tranches (32% of the original Baa went to single-B and another 32% went to Caa or below).

10. With this knowledge, I reasonably believed that if we continued with to rate ABS CDO without any adjustments we would be committing securities fraud, devastating to our clients and shareholders. I discuss the legal aspects of the complaint further below.
11. I notified Yuri immediately and counseled that we should stop rating ABS CDOs until the rating actions took place. She admonished me for making this suggestion.
12. I was troubled by Yuri's lack of response and urgency. More importantly, I was concerned that she was not at all troubled about committing securities fraud. She seemed to be more concerned with market share issues, i.e., a short term profit vs. long term reputation and ultimate client and shareholder considerations.
13. I believed that I owed a duty to our clients and shareholders to make sure that we did not violate the law.
14. Because Yuri had admonished me at the suggestion, I reasonably believed that if I "went over her head", she would be very upset, so I asked a third party to facilitate a meeting with Andy Kimball, who was the Head of Credit Policy at the time.
15. That meeting took place on or about September 18, 2007. I explained to Andy my legal and credit concerns. I followed up by sending Andy some relevant outside research he requested.
16. Within the next few days, I was asked by Yuri to prepare a press release for immediate release establishing "notching" levels for the RMBS affected by the potential downgrades. This was a complete reversal from her previous views. I believe that Andy's intervention influenced this reaction, as well as showed that my concerns were valid and reasonable.
17. The notching involved lowering the nominal rating of a tranche for the purposes of rating CDOs. The level of notching was the Derivatives' group best guess as to the level of the final downgrades and varied by vintage, original rating and originator. That press release went out on or about September 21, 2007.
18. Also on that day, I received an email from Andy stating "Just wanted to thank you again for your views the other day. Good to get this agreed to and published....", referring to the press release above.
19. Retaliation for this started immediately following the press release, when Yuri began to exclude me from meetings, as well as from decisions involving ABS CDOs, the asset class in which I was an authority, her first act of retaliation.
20. Then, on or about the week of October 29, 2007, Yuri told me that the headcount in Derivatives needed to be reduced and I was no longer needed, her second act of retaliation.
21. The only position available for me, in the New Products Group, was evidently not budgeted for an MD. My base and target bonus were both reduced, her third act of retaliation. Note that it is well known that Yuri is an extremely political person and I expect that she called in certain political "clout" to effectuate this action with others for the purpose of short term company goals vs. long term reputational, legal and shareholder issues.

### Legal Discussion – General

22. Moody's Investors Service is a NRSRO regulated by the SEC.
23. The principal federal securities anti-fraud provision is Rule 10(b)-5 of the Securities and Exchange Act of 1934. According to a memorandum drafted by Skadden Arps on behalf of Moody's and addressed to the SEC, rule 10(b)-5 applies to Moody's. This memo is available at <http://www.sec.gov/comments/s7-04-07/s70407-63.pdf>.
24. According to the memo, “Without getting into the specifics of Rule 10b-5 jurisprudence, it is clear that a rating agency would be liable if it knowingly published a report that falsely misrepresented its own evaluation of a security.”
25. The conduct of Moody's analysts is covered by the Code of Professional Conduct (the “Code”) substantially similar to the one promulgated by the International Organization of Securities Commissions (“IOSCO”, an international umbrella group for securities regulators).
26. The sections of the Code relevant to my complaint are 1.6, 1.16 and 1.17.
27. Anti-fraud clause 1.6: “MIS and its Analysts will take steps to avoid issuing any credit analyses, Credit Ratings or reports that knowingly contain misrepresentations or are otherwise misleading as to the general creditworthiness of an Issuer or obligation.”
28. Duty to report clause 1.16: “While Employees are not expected to be experts in the law, they are expected to report activities of which they are aware that a reasonable person would question as a potential violation of the law or this Code. Any MIS Manager or officer who receives such a report from an Employee is obligated to report it promptly to the Legal Department or the Office of Compliance, which will take appropriate action, as determined by the laws and regulations of the jurisdiction and the rules and guidelines set forth by MIS...”
29. Anti retaliation clause 1.17: “Management will prohibit retaliation by any Employee or by MIS itself against any Employee who, in good faith, reports a possible violation of the law or this Code.”
30. Clearly, I reasonably believed I was following the law.

### Legal Discussion – Potential Securities Fraud

31. The prohibition against securities fraud is covered by both Rule 10(b)-5 and Section 1.6 of the Code. The language in the Code and the Skadden interpretation of Moody's responsibility are similar. Both require “knowledge” and “misrepresentation”. I will also address materiality.
32. Knowledge. Knowledge can be broadly applied to the Rating Agency as a whole. Once it was clear that the RMBS group determined that rating actions need to be taken, the duty passed to all other analysts. In any case, the Derivatives group had actual knowledge of such rating actions because of my conversations as well as any

discussions that may have taken place at a more senior level (e.g. under the auspices of the Subprime Working Group).

33. Misrepresentation. Using RMBS ratings which we knew were in flux to calculate CDO ratings would clearly produce ratings that “falsely misrepresented” our evaluation of a security. We knew at that point that the ratings we would be using were no longer valid. Because the downgrades were to be broad, it was clear that any deal would be affected. The actual experience post-downgrade on the few deals which we had in the pipeline showed this to be the case.
34. Moody's has acknowledged this relationship between the rating of the underlying and a derivative thereof in a press release dated September 22, 2008. The press release is entitled “Moody's enhances its approach to rating U.S. RMBS resecuritizations” and states “...Moody's announced that it will not assign a rating to any security issued by a resecuritization transaction backed by one or more RMBS without first reviewing the ratings (and, if appropriate, taking rating actions) on the underlying RMBS...” It is worth recalling that an ABS CDO is nothing more than a “resecuritization transaction backed by one or more RMBS.”
35. Materiality. The rating differences would have been significant. Sample runs on deals in the pipeline showed that some junior Aaa tranches would fall to approximately the Baa-Ba range.
36. Standard of Proof. While I believe that my credit and legal analysis is correct (and bolstered by the memo in 34, above), the standard of proof under the Code (and similar Sarbanes-Oxley “whistleblower” legislation) is much broader. For example, section 1.16 mandates a reasonableness standard. It refers to activities which “a reasonable person would question as a potential violation of the law or this Code”.
37. In correspondence, Moody's acknowledged that at the very least “credit matter” existed at the time and that it was addressed.
38. I believe that I have more than met these standards and my actions constitute protected activity.

#### Legal Discussion – Retaliation

39. Reduction in pay and status, as well as exclusionary conduct, is considered retaliation. For example, OSHA, the administrator of the Sarbanes-Oxley whistleblower law lists reduction in pay as one of potentially “unfavorable employment actions.”
40. Retaliation in my case is evident from the timing of the events. The proximity between my complaint to Andy and my dismissal from Derivatives is a clear indication of retaliatory intent.
41. Retaliation is also evident from subsequent events. In September 2008, the Derivatives group announced several major promotions, including the promotion of Yuri to a newly formed Senior MD position and the promotion of a third MD specializing in CDO surveillance into what should have been a position given to me

under the circumstances. Surveillance is a task for which I would have been ideal since the vast majority of the work since my departure involved ABS CDOs.

42. While I was told that I was being let go from Derivatives as part of a Reduction In Force in order to cut costs, the new structure includes one additional Senior MD and one additional Team MD, so the pre-textual nature of this situation is self-evident. Moreover, these promotions occurred in light of a CDO market which has deteriorated severely from the time of the retaliatory actions. As I have shown in a previous email, the deterioration in the actual business as well as the future pipeline has approximately been between 75% and 85% (based on outside sources).
43. Additionally, during the RIF approximately 20% of the analysts in the Derivatives group were let go or reassigned, but the same is true of 50% of the MDs (another TMD was promoted to a new role at the time). The disparate reductions of the managerial and analytical staffs only make sense given the subsequent (September 08) promotions. It is clear that there was no long term intention to have a “two TMD” structure in Derivatives, but it was a temporary situation created to support the pre-textual nature of the retaliatory act against me.
44. Moody's also continued to hire and promote into newly created senior positions (MD and above) for which I would have been highly qualified, but was not offered.
45. The subsequent promotions and hires in a severely deteriorating market undermine the premise for my dismissal and leave pre-text and retaliation as the only explanation.

Hopefully this will help you with further investigations. I am happy to help with any questions you may have.

Sincerely

Eric Kolchinsky