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Moodys Email from Ray McDaniel Regarding Fitch Criticism of Ratings of CPDOs

Raymond McDaniel

Christopher Mahoney

From: McDaniel, Raymond <Raymond.McDaniel@moodys.com>
Sent: Tuesday, April 17, 2007 11:38 PM (GMT)
To: Clarkson, Brian <Brian.Clarkson@moodys.com>
Subject: Fw: Fitch criticises ratings of CPDOs

We can use this.

-----Original Message-----
From: Mahoney, Christopher
To: Clarkson, Brian; Murray, Chester; McDaniel, Raymond
Sent: Tue Apr 17 19:36:01 2007
Subject: Fitch criticises ratings of CPDOs

Fitch criticises ratings of CPDOs
By Paul J Davies, FT.com, Apr 17 2007 22:5
Derivative Fitch, the specialist rating agency, will on Wednesday stir up controversy around a high-profile complex structured product by declaring that these deals do not deserve the top-notch ratings that its rival agencies have offered.

The agency will say in a report out on Wednesday that the first generation of constant proportion debt obligations (CPDOs) should not be given a top-notch AAA rating even though deals done so far have received this label from Standard & Poors or Moody's.

The verdict is likely to gain much attention. CPDOs hit the headlines when ABN Amro launched the first deal late last summer and they have continued to attract strong interest ever since.

CPDOs are essentially a fixed-income investment backed by a highly leveraged bet on the creditworthiness of US and European investment grade corporate borrowers.

The structures caused huge excitement and almost equal disbelief when they emerged because they promised to pay out up to 2 per cent more than risk-free interest rates annually, which is unusually high for an investment rated AAA.

"We think the first generation of CPDO transactions are over-rated," said John Schiavetta, head of global structured credit at Derivative Fitch in New York. "We think the structure is inherently sound and investment grade, but just not double A or triple A."

Fitch's historic back-testing showed that many of the CPDO structures would probably not have been able to withstand high investment grade stresses.

In the first generation of deals, investors' money is used as collateral to sell default protection worth up to 15 times their stake on the main indices of investment grade credit derivatives in the US and Europe.

As such, the instrument's main exposure is to movements in the value of the premiums or spreads paid to sellers of protection on these indices.

One of Fitch's main problems with the initial deals is that data on credit derivative index spreads only go back four years, compared to the typical maturity for a CPDO of 10 years.

Moody's and S&P, the rival agencies that have rated CPDO deals, spent weeks re-evaluating their ratings models and stress tests at the end of 2006, but this has not led to any downgrades and both have said they are comfortable with their views of the products they have rated.