

SECRETARY GALVIN OPENS INQUIRY INTO RATING AGENCY PRACTICES (9-23-09)

Secretary of the Commonwealth William F. Galvin

Contact: Brian McNiff 617-727-9180

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Secretary of the Commonwealth William F. Galvin has begun an inquiry into how credit rating agencies will evaluate and rate securitization of life settlements-life insurance policies that ill and elderly people sell for cash.

Citing a number of cases brought by the Massachusetts Securities Division over the past few years, the Division directed DBRS, a registered ratings agency based out of Toronto with offices in the U.S., to provide information on how it rates these longevity-related securitized instruments, how it is compensated for the rating, and how it monitors the securities after the rating is assigned.

"Recently, we have seen investors victimized by new investment products that carried an assuring investment rating that appealed to individuals and institutions seeking a prudent investment only to see those investments collapse or even evaporate due to the underlying weakness of their component parts," Secretary Galvin said. "For credit rating agencies to have credibility, investors must have confidence in the research that underlies their pronouncements."

In the letter to DBRS, the Securities Division said its concern with bundling of life settlements stemmed from two cases it brought for fraudulent sales of such instruments, namely complaints against local entities. The life settlement pitches have also been made at free lunch seminars to seniors.

"Moreover," the letter states, "taking a product that has demonstrated misrepresentations and fraudulent selling practices and then bundling the policies to create another investment opportunity closely parallels the subprime mortgage market and subsequent meltdown - whose effects investors are still reeling from."

Noting that ratings agencies have been faulted by many in the mortgage crisis, the letter states that "it was the high ratings that induced investors, mutual funds, and pensions to purchase the securitized mortgage products because the high rating acted as a security blanket."

"While the inflated rating garnered investors and profits for the issuers, it wasn't the issuer who was harmed when the rating plummeted, rather it was the investors holding onto a now near-worthless security in an illiquid market," the letter observes.

The Division seeks from DBRS the names of life settlement securitization instruments that have been shown the agency, what communications it had with that company, how it was compensated, what its rating methodology is and what due diligence is conducted, and what ratings DBRS assigned to such instruments that have closed.

The agency was directed to respond by October 7.