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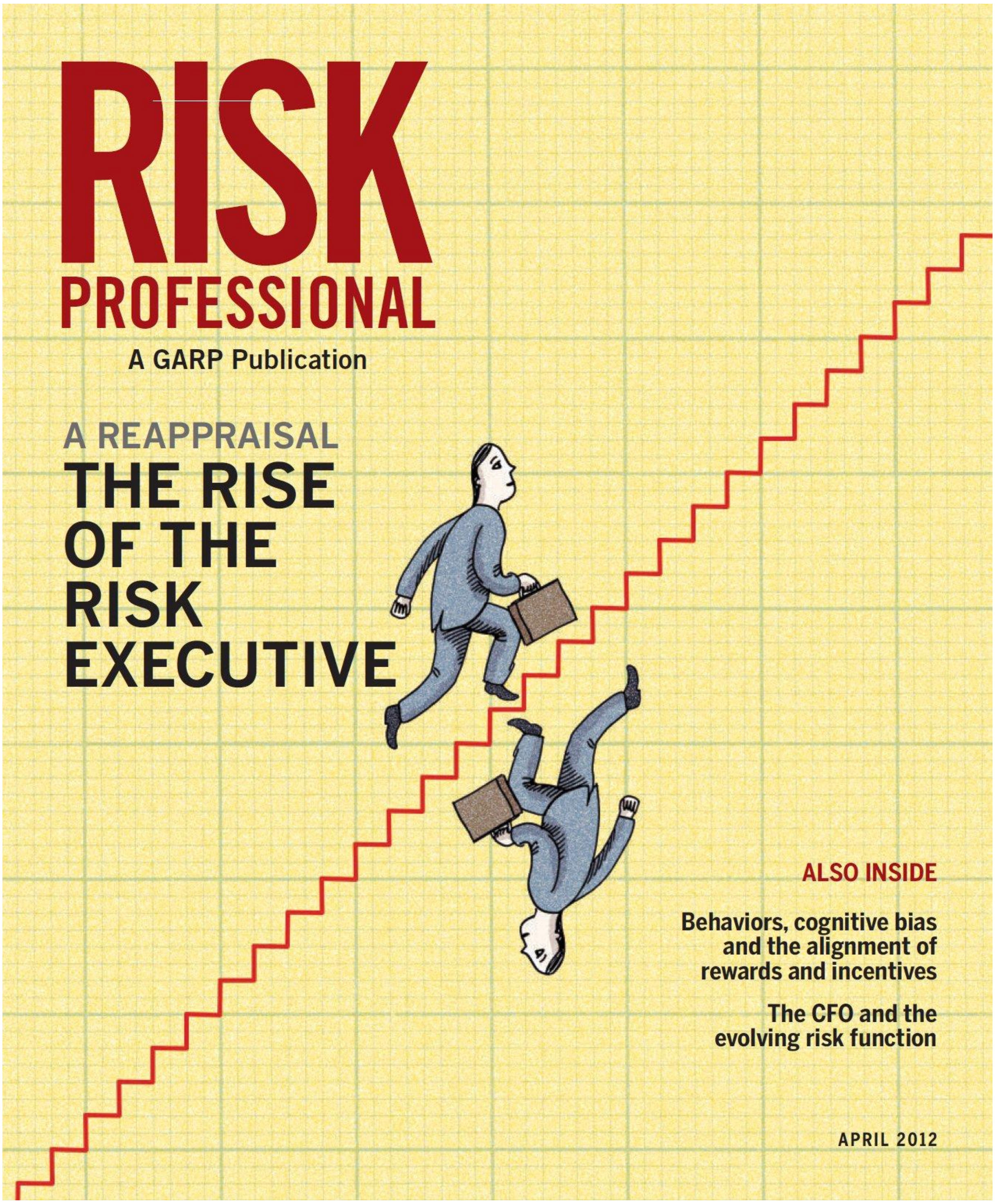
Wikirating is mentioned in article "Unflinching on MF Global, Ratings Upstart Gains Following", p. 8



# Unflinching on MF Global, Ratings Upstart Gains Following

2012-04-02T10:53:00, by Katherine Heires

Should a CEO's reputation, experience and contacts influence a firm's credit rating? Should interaction with company management have an impact on ratings, either good or bad?

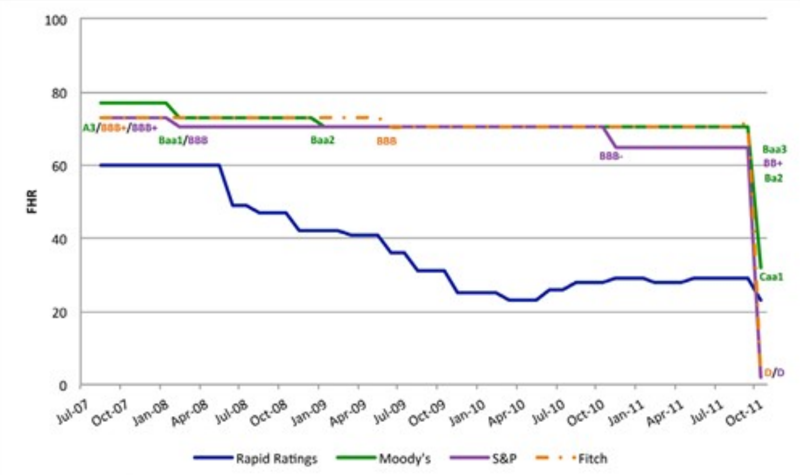
Not in the least, says James Gellert, chairman, president and CEO of Rapid Ratings. The New York-based company has set itself apart from the Big Three in the field -- Standard & Poor's, Moody's Investors Service and Fitch Ratings -- with an approach that does not require armies of human analysts. It is computer-based and quantitative, and it eschews what Gellert calls "the Corzine effect." Named for former MF Global CEO Jon Corzine, it refers to instances where prestige or personality -- Corzine had led Goldman Sachs Group and served as a U.S. senator and governor of New Jersey -- may unduly influence a company's rating.

"The Big Three issuer-paid agencies ... maintained investment grade ratings on MF Global for years," Gellert said in February testimony to a House Financial Services subcommittee. "This was neither an early warning of inherent risks, nor a reflection of emerging risks," said Gellert, emboldened by Rapid Ratings' very different record in this case (see timeline). He asserted that the Big Three's ratings "showed very little deterioration, despite the multitude of qualitative and empirical factors that pointed to decreased health and increased risktaking." He attributed the lag to a combination of factors, including the fact that ratings surveillance by the Big Three firms is less frequent than the quarterly reviews undertaken by Rapid Ratings; the fact that corporate issuers pay for the ratings while Rapid Ratings employs the user-pays model; and the impact of Corzine's reputation and star power.

Rapid Ratings had deemed MF Global High Risk more than two years prior to the brokerage firm's collapse, and it remained in that category until its bankruptcy filing. Gellert said that based on his firm's ratings systems, MF Global was High Risk in debt service management by March 2010; Very High Risk in both sales performance and overall profitability; Mediocre in terms of leverage; Undernourished in terms of equity backing; and Sub-Investment Grade for both working capital efficiency -- including liquidity -- and cost structure.

On Rapid's Financial Health Rating (FHR) scale of 0 to 100, MF Global was downgraded from 41 to 36 on June 29, 2009. It carried an FHR of 29 into October 2011, and then dropped even further, to 23, based on the quarterly numbers released the week of the bankruptcy filing. Rapid estimates its 29 and 23 are equivalent, respectively, to CCC and CCC-, or eight to 10 notches below where the Big Three agencies had MF Global during that period.

"A key point about Rapid's system is that because its early warnings warnings had fully reflected emerging risk in 2008-2010, as the last-minute shocks of the MF Global crisis emerged in October 2011 and the Big Three were making significant adjustments to move MF Global to a lower rating, Rapid's ratings were adjusting very little," Gellert said.




## Wider Recognition

After the collapse of MF Global and his congressional testimony, Gellert reported that Rapid, which currently rates over 6,500 public and thousands of private companies from 71 countries, for firms such as Amgen, Microsoft and Nasdaq, gained four new clients, with many more queries coming from potential clients. They are attracted, Gellert says, to the fact that the firm bases its ratings on financial statements and by utilizing 24 global, industry-specific models and 62 financial ratios drawing from approximately 30 years of data from more than 300,000 public and private companies.

Rapid has no contact in the ratings process with issuers, bankers or advisers.

"Some companies or their advisers do a better job of representing themselves than others," Gellert explains. "You can be coopted by management, and this does not make it easy for a ratings firm to produce consistent, apples-to-apples ratings."

For the first time in its history -- founder and executive vice chairman Patrick Caragata developed the FHR framework in 1991, and Gellert has been in charge since leading an acquisition effort in 2007 -- Rapid has caught the interest of the futures industry. "Players in the futures market are now paying close attention to counterparty risk, and we are seeing the benefits of that from the 80 to 90 futures commission merchants and their parent companies, but also regulators and institutional investors," Gellert tells *Risk Professional*.

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Charles Van Vleet, director of pension investments for United Technologies Corp., a Rapid customer for three years, uses its ratings in fixed-income portfolio monitoring. "We work with Pimco and BlackRock, and having access to Rapid's ratios sharpens my ability to test and question a manager," says Van Vleet. He says he is more interested in looking at ratings like Rapid's, which are reviewed on an ongoing basis, as opposed to those that are issuance-oriented and updated far less frequently.

**Three Still Dominate**

Yet some observers question a relative upstart's ability to gain significant market share. Peter Appert, a senior analyst at Piper Jaffray & Co., says that in credit ratings, "There's the Big Three, and then there's everybody else." The three incumbents command roughly 95% of the market for rated securities. A.M. Best, focused on the insurance industry, is at No. 4, followed by Toronto-based DBRS (Dominion Bond Ratings Service), and then the likes of Egan-Jones Ratings Co., Kroll Bond Rating Agency (which In 2010 acquired an incumbent, LACE Financial) and Rapid Ratings. There is even a new open source credit rating effort, Wikirating, which Australian mathematician Dorian Crede developed in October 2011, and efforts by academics such as Frank Partnoy, a professor of law and finance at the University of San Diego, to promote the use of credit default swaps as an alternative to traditional credit ratings.

To date, says Appert, "the alternative rating agencies really haven't generated traction." Although the biggest agencies have been vilified for failing to capture risk in the mortgage market, they performed well in other asset classes and "continue to offer clear value," says Appert. He expects the Big Three will maintain their market dominance despite provisions in the Dodd-Frank Act aimed at reducing investor reliance on ratings.

Lawrence White, a professor at New York University's Stern School of Business, states that while the top agencies "occasionally will stumble and stumble big, as they did with MF Global, Lehman and Enron, in the corporate, municipal bond and sovereign bond areas, their reputation is pretty good." White hopes bank examiners will do their own credit assessments going forward.

**Counterparty Value**

Rapid's Gellert, on the other hand, sees the Dodd-Frank era as "a very good time" to be an alternative rating agency, because "people are looking for new ways to assess the companies they are investing in." He believes Rapid's focus on company health, rather than the default perspective, allows for much more robust sets of data for risk managers and others to work with.

Gellert is upbeat also because, in addition to serving the market for new issues, Rapid covers companies that have not issued debt for a long time as well as those that may never be long-term bond issuers. "There is greater emphasis today on knowing who you are doing business with," he says, and Rapid can provide a better sense of the financial health of suppliers, other supply-chain participants and counterparties.

"While the more sophisticated investors are doing more of their own due diligence, they are also looking at alternative ratings services like Rapid to help in the decision-making process," says Gellert.

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