

Q&A

'We put ourselves in the investors' shoes,' says Kroll Ratings



Jim Nadler



Gary Krollenstein

Kroll Bond Ratings issued its first municipal bond rating, a AA to the state of Connecticut, this year. President and chief executive officer **Jim Nadler** and managing director **Gary Krollenstein** responded to questions about the company's push into municipals e-mailed by Municipal Market's Joe Mysak.

Q: Why should I buy a Kroll rating, as an issuer?

A: Kroll is recognized by the SEC as an NRSRO and by the NAIC as a CRP (Credit Rating Provider) and the cornerstone of our business is transparency, due diligence, ratings accuracy and continued surveillance. Our team consists of seasoned analysts from all segments of the credit markets – rating agency, buy side, lender, etc. – so that our approach to ratings is informed by different disciplines. This gives us an ability to assess credit risk from all perspectives, as well as an ability to be nimble and respond quickly.

Q: What does a Kroll muni rating mean for me, as an investor?

A: Our organization reflects a culture of putting investors' interests first. A Kroll muni rating for an investor means transparency, due-diligence and expertise. We

adopt superior corporate governance principles to ensure we will never lower our standards in pursuit of business, always keeping the interests of investors above all other concerns. Kroll has an alignment with investors – we put ourselves in the investors' shoes, and take an approach to analysis and due diligence based on what we would want to know if it was our capital at risk. Our commitment to investors is supported by the fact that investors already trust Kroll: more than 40% of Kroll Bond Ratings is owned by foundations, pension funds and venture firms.

Q: Has the public been ill-served by the rating companies?

A: There are definitely areas in which rating agencies have made errors and inaccuracies including and not limited to the municipal finance area in the 1930s, Enron, Worldcom and the most recent subprime crisis. However, the public has also benefited from rating agencies in many areas. Rating agencies are responsible for having introduced important items including short term ratings and other disciplines into growing areas such as structured finance. Looking ahead, competition amongst rating agencies will help alleviate some of the problems witnessed in the past and force all agencies to provide more information, do better credit work and in turn aid the public.

Q: Do raters have a "watchdog" capacity? I think here especially of the use of interest rate swaps by municipalities in the early 2000s. Their use was apparently exploding, but the raters never barked.

A: Our post-issuance surveillance is robust and we provide a timely feedback loop to both existing ratings and our ap-

proach to new ratings. We monitor not just asset pool performance, but also the issuer, the trends in an industry and other factors that could affect transaction performance. In delivering accurate ratings, we pay close attention to trends affecting each issuer and sector we rate - origination and underwriting trends, the industry environment, where we are in the credit cycle, etc. We continually assess whether our models reflect the current environment or whether they need to be adjusted to be more forward looking.

Q: Insurance once covered 50% of the market. Do you think the use of insurance will survive? If so, will Kroll take it into account?

A: We will see insurance come back but it will be more targeted. Bond insurance will most likely not come back in Structured Finance but we will see it in the Municipal market where underlying credit risk is a stronger foundation.

Q: What do you think of "demographic determinism" — i.e., the belief on some analysts' part that taxes and bad public policy will make people "flee the coasts"?

A: Many studies have been published since the 1970s regarding the demographic and economic considerations and their impact on municipalities which have led to mixed results (Migration and the Public Sector: A Survey – University of AZ; The Effect of Expected Income on Individual Migration – J. Walker Kennan). However, when looking at California - it has the highest marginal tax rate of 10.3% and still has a population of 37.6 million. Meanwhile, Wyoming doesn't collect state income tax and only has a population of 568,000.