

Kroll BondRatings™

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New York, NY 10022

August 23, 2011

Mr. Kevin Fry, Chair
NAIC Valuation of Securities Task Force
c/o Illinois Department of Insurance
320 West Washington Street, 4th Fl.
Springfield, IL 62767-0001

Re: Kroll Bond Rating Agency and NAIC "Acceptable Rating Agency" Standing

Dear Chairman Fry,

We are writing to provide you, as chair of the Valuation of Securities Task Force (the "Task Force"), and the Task Force members with updated information about interactions we have been having with Task Force members since last November. We are also hopeful that the members will decide that they already have, or will soon have, sufficient information to move to designate Kroll Bond Rating Agency ("Kroll") an "Acceptable Rating Organization" for NAIC purposes.

As you know, Kroll's executive team met with Task Force members and others at the November, 2010, biannual meeting of the Task Force in New York City. Since that time, Kroll has welcomed questions from regulators and has met with you and Matti Peltonen, Vice-Chair of the Task Force, in our offices to discuss and demonstrate our capabilities. We appreciate the time you allowed us on your July 15 conference call, during which we explicitly invited all of the members of the Task Force to take the opportunity to talk or meet with us. Following that call, we have called on or written to members of the Task Force as a continuing part of our outreach. We have also conducted informational calls and scheduled meetings as a result.

During our discussions and meetings with Task Force members, we have had the opportunity to address many issues concerning the addition of Kroll as an NAIC ARO. We thank you, personally, and the Task Force members for their thoughtful consideration and excellent questions during our discussions.

Meeting the Current Standard for Determination as an ARO

As you are aware, there are two alternative means for qualifying as an ARO. If Kroll applied today for ARO status, it would not meet the threshold, established before the financial crisis, of rating at least 10 percent of the industry's investment assets. Obviously that would be an extremely high hurdle for any new rating agency. It is also possible, however, for the Task Force simply to find that the addition of a rating agency is "necessary for the administration of any component of state based financial solvency monitoring of insurance company investments." This is the present standard that must be met, whether an NRSRO applies for ARO status or that status is simply conferred by a vote of the VOSTF. We believe that Kroll meets this standard.

As we will describe in more detail below, we believe it is necessary for Kroll to be added as an ARO as a continuation of the steps the NAIC has taken following the financial crisis. Despite its decision to reduce reliance on rating agencies, the NAIC continues to use ARO ratings to determine NAIC Designations for the overwhelming share of securities owned by insurers. We do not believe it is in the public interest to exclude the ratings of Kroll, a qualified NRSRO, when the use of its ratings has the potential to result in more accurate NAIC Designations. Even if this move initially impacts relatively few securities, the consequences of the NAIC adding a new competitive force could spur the incumbent rating agencies in ways that might avoid a repetition of the very unfortunate recent rating missteps. In other words, we believe it is necessary for the NAIC to recognize Kroll to improve those NAIC Designations that are determined by ARO ratings. We also believe that it is necessary to do this now to break from the *status quo*.

We note that the revisions being considered in the NAIC Credit for Reinsurance Regulation will use NRSRO ratings as one of the key factors in determining how much collateral an unauthorized reinsurer must post for assumptions from licensed insurers. These revisions, which arguably are more material to the oversight of licensed insurers than the designations of individual securities, do not exclude the ratings of any NRSRO. Accordingly, as presently discussed and drafted, Kroll ratings will be recognized for this important regulatory function. We think the proposed revision is reasonable and believe the NAIC should be consistent in determining which rating agencies it finds acceptable.

We would briefly summarize the main rationales for Kroll's qualification as an ARO as follows:

1. Enhanced SEC Oversight Over NRSROs – Since the financial crisis, the SEC has become increasingly accountable for regulating NRSROs, of which Kroll is one of ten. SEC oversight now includes heightened rigor with respect to the standards, disclosures, monitoring and annual on site examinations to which all NRSROs are subject, as well as new powers to sanction, fine and even expel underperforming NRSROs. Much of this is detailed in a 517 page exposure draft of SEC rules

<http://www.sec.gov/rules/proposed/2011/34-64514.pdf>. Kroll itself is preparing for its next on-site SEC examination.

2. Kroll's Capabilities – In discussions with state insurance regulators, we have made it clear that Kroll's credentials and capabilities to act as an effective NRSRO are well established as evidenced by its registration with the SEC in all five rating sectors. Just as there are significant barriers to new rating agencies becoming SEC-designated NRSROs, it is also the case that, without NAIC designation as an ARO, it is difficult, or even impossible, for even the most highly qualified rating agency to achieve a significant market position in rating assets owned by insurers. Intentionally or not, the NAIC effectively controls access to this market.
3. Minimal Cost, Minimal Risk and Ancillary Benefits to the NAIC – Kroll has agreed to provide its ratings at no cost to the NAIC. The NAIC has experience in adding new ratings to its systems and because we will agree to submit our ratings in precisely the same format as other rating agencies, we foresee few, if any, technical or operational issues in adding our ratings. If such issues should arise, we will do our best to minimize their impact.

We would also like to stress our keen interest and willingness to work collaboratively with state insurance regulators and the NAIC, including the SVO and Capital Markets. We believe that we have significant resources that we can share and which can be of significant benefit to the NAIC. A number of our senior staff members have established communication channels with the insurance regulatory community in the past and we would envision that same relationship in the future as an ARO.

4. Competition in the Rating Agency Sector – The financial crisis, and the performance of the incumbent rating agencies during the crisis, convinced the founders of Kroll that a new approach to ratings – and more competition for the incumbent rating agencies – is essential. There have been many responses to the crisis by financial regulators. The NAIC, for its part, has decided to rely less on rating agencies, and it commissioned new risk quantification measures both for RMBS and CMBS. We understand these measures and believe being designated an ARO by the NAIC will allow Kroll to compete with the other NRSROs for insurance industry business. We believe that competition in the rating agency arena is in the best interest of insurance regulators, the NAIC and the public. Prior to the SEC's aggressive role in regulating NRSROs, there was a belief, shared among some in the NAIC, that there could be a flood of new rating agencies seeking NAIC recognition. Because of current and prospective barriers to entry, this has not come to pass, nor is it likely to do so. Of the ten NRSROs today, two are based in Asia and appear to have little impact on investments by US insurers.

Given this situation, we do not see a justification for the NAIC to have standards that differ from those of our federal regulator as to what constitutes an "acceptable" rating agency. This is particularly true now that we, as an NRSRO, are being held to very high standards by regulators who are accountable for maintaining a robust regulatory regime. Further, we do

not believe the NAIC wants to be in a position of monitoring, evaluating or sanctioning rating agencies, as this falls under the purview of the SEC. Expending scarce NAIC resources to decide which rating agencies are "acceptable," particularly when that function is already being performed by a fellow regulator, may not be optimal from a cost/benefit perspective, especially given the lack of standards or procedures for performing an oversight function for rating agencies.

In summary, we think you will agree that we have been conscientious in reaching out to you and your members and transparent in our discussions. Of course, we are willing to make additional presentations to the Task Force, as you or your members wish. However, we believe that, since last November, we have been forthright in discussing the relevant points with each of the members. We hope that all of our efforts in this regard will persuade you and your members to move to designate Kroll Bond Rating Agency as an NAIC "Acceptable Rating Organization" now so that we can begin to make a positive competitive difference. We thank you for your attention to this important matter and ask that this letter be shared with Task Force members and made a matter of record.

Sincerely Yours,



James Nadler
President

copy:

Valuation of Securities Task Force Vice Chair (Mr. Peltonen)

Valuation of Securities Task Force Staff (Messrs. Evangel and Newman)