

# NAIC Rating Agency Working Group

## Municipal Bonds Discussion

November 18, 2009



## Agenda



### Background

- Allstate's Holdings
- Types of Municipal Bonds
- Municipal Issuers vs. Corporate Issuers

### Reform Issues

- Rating Agency Reform
- Global Ratings
- Monoline Insurer Issues

## Allstate Insurance Company



- **Allstate Insurance Company and its affiliates are major institutional purchasers of state and municipal bonds**
- **Approximately \$22.2 billion in par value as of September 30, 2009**
- **Holdings include:**
  - state and local general obligation and appropriation bonds,
  - bonds secured by sales, income and other special taxes,
  - bonds payable from revenues generated from the operation of airports, toll roads, water and sewer systems,
  - bonds payable by hospitals, colleges and universities, and
  - bonds payable by electric utilities

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## Types of State and Municipal Bonds



- **General Obligation Bonds – Payable from the full faith and credit of the issuer.**
- **Special Revenue Bonds – Payable from a limited or special source of revenue, e.g., water and sewer fees, excise taxes, sales taxes or other user fees.**
- **Appropriations Bonds – A type of special revenue bond, typically using a lease, payable from annual appropriations by a legislative body, subject to potential annual termination at the issuer's option.**

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## Municipal Issuers vs. Corporate Issuers



- **Regulator of each type of issuer**  
Corporate issuers are frequently regulated by the SEC  
Municipal issuers are not regulated by the SEC
- **Disclosure Requirements**  
SEC regulated corporate issuers must file quarterly and annual disclosure reports  
Municipal issuers are not required to file annual disclosure  
Rule 15c2-12 requirements apply
- **Accounting Requirements**  
SEC regulated corporate issues must use GAAP accounting  
Municipal issuers are not required to use GAAP accounting

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## Rating Agency Reform



- In 1975, the SEC created a “special status” for certain designated Nationally Recognized Statistical Rating Organizations (NRSRO).
- Allstate supports regulation that is critical to ensure market stability and integrity including:
  - Transparency of ratings
  - Proper regulatory oversight and enforcement
  - Firewalls to address conflicts of interest
  - Reducing statutory and regulatory reliance on NRSRO credit ratings

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## Global Ratings



- **Should municipal bond ratings mirror corporate ratings, based primarily on the historically low rate of municipal bond defaults?**
- **Using this approach may result in inaccurate broad scale rating upgrades.**
- **Currently the municipal market effectively uses its own rating scales to provide qualitative differentiation among issuers.**
- **Why the differences?:**
  - Different regulatory oversight.
  - The muni market is substantially larger than corporates.
  - Muni disclosure is not as transparent as corporate disclosure.
  - The types of bonds, types of issuers and types of repayment streams are more diverse.
  - Significant differences between Chapter 11 and Chapter 9 of the US Bankruptcy code.
  - State required regulatory interventions to assist local issuers.
  - More frequently required financial filings for corporates, e.g., quarterly vs. annually for most munis.

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## Monoline Insurer Issues



- **Recently, ratings of many monoline insurers have been downgraded.**
- **As a result the credit quality and rating of the bond issuer, rather than that of the insurer, has come into increased focus.**
- **Many bond issues were sold with a rating based on the insurer only, without an underlying rating.**
- **Some rating agencies have withdrawn the downgraded insurers rating so the bonds are left with no rating at all.**
- **Possible solutions:**
  - Issuers should request underlying ratings on downgraded or unrated bonds resulting from an insurer downgrade.
  - Issuers should make sure that all of their parity debt carries the same underlying rating whether they sold insured debt with no underlying rating or sold uninsured debt with an underlying rating.

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## Biographies



### **Robert M. Zubak**

Allstate Investments, LLC: Senior Portfolio Manager for 20 years  
Co-Manages the investment grade portfolio which totals approximately \$20 billion  
Member of the Chicago Municipal Analysts Society  
Member of the Board of the Municipal Securities Rulemaking Board (MSRB) from 2006 to 2009.  
Education: University of Illinois, B.S.  
Northwestern University: J.L. Kellogg Graduate School of Management

### **William Grady**

Allstate Investments, LLC: Senior Portfolio Manager for 14 years  
Co-Manages the investment grade portfolio which totals approximately \$20 billion  
Education: University of Notre Dame, Finance  
Chartered Financial Analyst designation

### **Mary Jo Quinn**

Allstate Investments, LLC: Corporate Counsel  
Has advised Allstate Municipal Bond Portfolio clients for 13 years  
Member of the Illinois, California and DC Bars  
Education: University of Wisconsin, Eau Claire, BS  
University of California, Hastings College of the Law