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**Statement and Testimony by Chris Evangel  
Before the NAIC's Rating Agency Working Group  
Public Hearing – November 18, 2010**

To the Members of the Rating Agency Working Group:

I want to thank Chairmen Michael McRaith (IL) and Superintendent James Wrynn (NY), along with Commissioners Thomas Considine (NJ) and Commissioner Dean Dilweg (WI) and the members of the Rating Agency Working Group (RAWG) for inviting me to speak today at this hearing. I will provide you with a brief overview on how the Securities Valuation Office (SVO) of the National Association of Insurance Commissioners (NAIC) utilizes municipal credit ratings from the NAIC's list of Acceptable Rating Organizations (AROs). I will also provide some analytical insights on the appropriateness and reliability of continued reliance on these municipal credit ratings for insurance companies' regulatory reporting. Let me say upfront, to avoid getting buried in this testimony and the day's events, that insurance regulators have a unique regulatory tool called the SVO. At the end of the day, despite our modest size compared to the larger AROs, the SVO is the model for others to emulate in order to provide transparent, unbiased, independent, and conflict-free credit risk determinations of debt issuers. We serve as your professional staff to evaluate credit risk of insurance companies' securities holding, which I believe is unique within any regulatory community.

As you well know, I am Chris Evangel, the Managing Director of the SVO of the NAIC. As background, my credit experience has crossed over the quarter-of-a-century mark. I have held the SVO position since November 1999, almost 11 years to this day, where I also serve as the Chairperson of Senior Credit Committee. Prior to joining the SVO, I spent nearly 15 years in the Public Finance Department of Moody's Investors Service, where upon my departure in November 1999, I served as a Senior Vice President, head of a regional ratings' group, and a member of the Public Finance's Senior Credit Committee.

While at Moody's, I was intimately involved in many of the department's credit policy decisions, along with participating as a Chairperson and member of the Public Finance Credit Committee. I can safely say that I participated either as an analyst or as a credit committee member on several thousand municipal credit ratings during my Moody's tenure. However, for the purposes of this hearing, my knowledge of policy and/or credit rating decisions undertaken internally by Moody's ceased upon my departure – other than what is generally available in the public domain.

Therefore, any comments by me, as to credit rating practices by Moody's, Standard and Poors (S&P), and Fitch emanates from prior experience. My SVO responsibilities do require me to stay educated on all the developments within the municipal market sectors. In addition, we are subscribers to all the three rating agencies mentioned above of their municipal ratings. Although prior to the rating demise in late-2008 of the mono-line bond issuers (e.g., ACA, Ambac, CFG, FGIC, FSA, MBIA, Radian, and Syncora/XL Capital), most the SVO's municipal credit determinations were for non-ARO municipal issuers.

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As background for those attending today's hearing who may not be as familiar with the SVO, we handle approximately 10,000 debt issuers and represent some \$650 billion in insurance companies' holdings. The municipal issuers were slight over 800 prior to 2008, and through year-to-date 2010 increased by 400 to 1,200 municipal debt issuers within our database. The vast majority of the credit determinations assigned by the SVO are for corporate debt issuers. In turn, my SVO tenure and as Chair of the Senior Credit Committee I have been involved mostly with corporate debt issuers.

As my corporate credit experience quickly closes in equally on my municipal experience, I have gained an enormous level of understanding of the *nature* of credit risk among debt issuers. I also see more similarities than differences among municipal and corporate issuers. It is for this reason that I strongly support efforts to "harmonize" municipal and corporate ARO ratings. If this was done, there would be no need for mono-line bond issuance for general obligation and many municipal revenue bonds would never be needed. In fact, on a historical basis, if the AROs had appropriately rated municipal issuers, mono-line bond insurance firms would not have been able to arbitrage the ARO rating distinctions, which they created for municipal issuers. The mono-line insurance underwriting standard for zero loss largely reflects the near zero default rate of municipal issuers, which does not necessary reflect the due diligence of the mono-line insurer, but does reflect the practical reality that the municipal issuers have a near zero probability of default.

In Attachment One, we conducted an analysis of municipal defaults to support the above position stated immediately above. We believe anyone evaluating municipals must recognize that the term "municipal obligations" encompasses a variety of activities that issue debt, but are not or may not be what a casual observer considers municipal debt issuance beyond general obligation bonds. For example, municipal debt issuance includes funding for state, county, city, school districts, improvement districts, colleges and universities, hospitals, toll roads, bridges, airports, transit systems, waste-to-energy plants, utilities (water, sewer, electric) and a host of many others. Each of these activities requires a look-through to the pledge made to bondholders.

For purposes of this hearing, let me concentrate on general obligation bonds which typically carry a pledge of the taxing authority of a governmental entity. The ability to issue debt is governed by statute in each state, which in many cases, particularly at the local level, requires approval by an entity's voters. This may include a dedicated tax to repay the debt obligation. If I were to reference my corporate credit experience, municipal issuers by contrast have low levels of indebtedness. Their debt service is a modest portion of their annual expenditures, and, their debt has a principal amortization schedule, unlike a corporate issuance that generally pays only interest with full principal paid at maturity.

While seeking to avoid getting too deep into the weeds, and in order to keep these discussions at a high level, one cannot avoid the need to be clear about terms and terminology. Otherwise, people find themselves at diametrically different end-points in their points of view, given they differ on some fundamental premises.

What are some of the basic premises? For one, if you accept the AROs definition, a credit rating is the probability of default...period. Two, the ARO rating symbols (e.g., AAA, AA, A, BBB, etc) have the same probability of default across all their sectors whether it is structured, corporate, or municipal. Third, there are two generally-accepted fundamental standards upon which any credit assessment relies upon: a.) an issuer's ability to repay their debt obligation; and, b.) an issuer's willingness to repay their debt obligations. As such, ARO credit ratings should combine the three premises of an issuer's ability and willingness to repay and assign a probability, through the credit rating, that the issuer won't default.

I can tell you that my credit agency experience never included a credit committee discussion of default probability. In fact, I truly believe that municipal debt issuers, in the general obligation category, should have a bright line test of “pay or no-pay”. Understandably, this is not practical in the current credit rating environment, as regulators have found a need to rely upon ARO ratings.

Insurance regulators adopted the rules to exempt filing of the ARO rated securities for reasons of efficiency and effectiveness. Prior to the year 2000, all insurance companies’ debt issues were submitted to the SVO for conversion to the NAIC designation rating equivalent which insurance companies would utilize for reporting their investment. This would provide an associated risk-based capital (RBC) to these investments. Beginning in 2000, the NAIC instituted Provisional Exemption (PE) for all corporate and municipal securities, rated by the NAIC and recognized as AROs of BBB-/Baa3 and higher. This removed the requirement of submitting these securities for review and conversion by the SVO. The PE initiative basically removed all municipal debt filings with the SVO. In 2004, the NAIC adopted the filing exempt (FE) rule that expanded ARO exemption for submitting securities to the SVO to any ARO rated security. However, the FE rule has limited the additional impact on municipal security holdings, as nearly all were already exempt from filing with the SVO as a result of the PE rule.

Nevertheless, insurance regulators always retained the authority to submit ARO rated securities for SVO input. The SVO credit committee could make and assign any credit determination it deemed appropriate to the regulator submitted security. However, the SVO was precluded from assigning a NAIC designation greater than the credit rating equivalent of any security assigned by an ARO. The NAIC rule not to exceed a AROs rating was lifted in 2008 for municipal debt as a response to the downgrade of the mono-line insurers. This action allowed insurance companies to submit to us any municipal security for our credit assessment determination that might otherwise be reported to regulators at the mono-line’s ARO credit rating.

In closing, insurance regulators must constantly balance the varying demands placed upon them. Some reliance on ARO ratings for municipal issues at the surface seems reasonable, while full or complete reliance on ARO municipal ratings would seem imprudent. Regulators need to retain their authority to reject or alter any ARO ratings, similar to what you have chosen to do with RMBS and CMBS securities. We should never lose sight that ARO ratings are a product directed by a commercial enterprise and their ratings are not a public utility, while the SVO’s NAIC designations are a public utility. We should never lose sight that AROs have their own guiding principles, whereby they need to maintain the viability and, most importantly, the commercial value of their rating product. Unlike a public utility, they are beholden to either their sole-owner, a parent company, or their shareholders. An ARO’s internal determination of what securities receive a rating (and de facto become admitted assets), as well as risk standards they deem appropriate bypass any regulatory input. Therefore, complete and unfettered reliance on ARO ratings has unintended consequences and I would strongly recommend an expanded role of the SVO to test and validate ARO municipal ratings.

Thank you for providing me with this opportunity to address the working group and welcome any questions.