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A Corporate Sleuth Tries the Credit Rating Field



Michael Falco for The New York Times

Jules and Jeremy Kroll in their Manhattan offices. Jules says of big ratings agencies, "They never really looked under the covers, which is what I have done all my life."

By JANET MORRISSEY

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FEW people ever penetrate the dark side of money, but Jules Kroll is one of them.

Fortunes plundered, ransoms paid, deals cut — the uncovering of such secrets, and the million smaller confidences that are his history, have made Mr. Kroll a rich man.

It was nearly 40 years ago, when he practically invented the business known as corporate intelligence, that he first came to the attention of crafty boardrooms. At a time when "private eye" still conjured images of cheating spouses and seedy hotels, Mr. Kroll built a sort of private [C.I.A.](#) and went corporate. If a Fortune 500 company or an A-list investment house wanted the dirt, it hired Kroll Inc. to dig it up. Which is why his latest venture seems at once so unusual and yet so very Kroll. At 69, an age when other multimillionaires are working on their backswings, he is getting into — of all things — the credit ratings business.

Yes, credit ratings: gilt-edged triple-A's, middling double-B's, ignominious D's. You might wonder why anyone pays attention to them anymore. After all, the financial crisis of 2008 and 2009 laid bare the conflicts at the heart of the ratings game. The world learned that the three dominant services — [Moody's](#), [Standard & Poor's](#) and [Fitch](#) — had stamped sterling ratings on mortgage investments that turned out to be nearly worthless. It was a lesson that nearly brought down the financial system.

Ratings agencies, to many, seem like Wall Street's enablers. What is Jules Kroll thinking? This is the man the Haitian government hired to track down financial assets linked to [Jean-Claude Duvalier](#). The man Kuwait hired to ferret out the oil wealth of [Saddam Hussein](#). One of Mr. Kroll's cases, involving kidnapping, inspired the movie "[Proof of Life](#)," and plans are in the works for [HBO](#) and [Scott Rudin](#), the producer of "The Social Network," to make a pilot for a television series loosely based on his exploits.

Mr. Kroll says that if he can do all of that, why, he can get to the bottom of an investment security, too. He and his son Jeremy, 39, are staking the family name on a venture called [Kroll Bond Ratings](#). They say the business will marry hard-nosed credit analysis with their trademark corporate sleuthing. Maybe the leading ratings agencies — a triumvirate some liken to an oligopoly — can learn a thing or two from the gumshoes of Wall Street.

"They never really looked under the covers, which is what I have done all my life," Mr. Kroll says. "If they were in any other business, they would be out of business."

THE pertinent question for Mr. Kroll is why anyone should listen to *him* on the subject. The fundamental problem with the dominant agencies, their critics say, is that they are paid by the companies whose securities they evaluate, under the so-called issuer-pay model. Some small ratings services have challenged the establishment by having investors — that is, the people who actually buy securities — pay for ratings. But for all his talk about shaking up this industry, Mr. Kroll is hewing to the status quo. Like Moody's, S. & P. and Fitch, Kroll Bond Ratings will be paid by the issuers, just as the big three are.

Wall Street types tend to look askance at credit ratings no matter who is providing them. Not even [Warren E. Buffett](#), whose [Berkshire Hathaway](#) owns about 12 percent of Moody's, says he depends on ratings in making investment decisions. Mr. Buffett prefers to make his own judgments on companies, he said last year while appearing before the [Financial Crisis Inquiry Commission](#).

But ratings services, despite their apparent failures, still play a crucial role in the capital markets. Virtually every investor, big or small, is affected by what they do. And even the pros have to pay attention, because ratings often figure into the investment guidelines of big money management firms, banks and insurance companies.

Some wonder if Mr. Kroll is out of his depth this time.

"What does he know about giving me a rating on a security?" asks Richard X. Bove, an analyst at Rochdale Securities.

Others aren't so quick to write off Mr. Kroll. Michael F. Price, the prominent value investor, is bankrolling Kroll Bond Ratings. So is Frederick R. Adler, one of New York's most successful venture capitalists. And William L. Mack, the big real estate investor. The [venture capital](#) firms Bessemer Venture Partners, RRE Ventures and NewMarket Capital Partners have invested a combined \$24 million in it. And Mr. Kroll has personally staked \$5 million.

That is pocket change by Wall Street standards. But Rob Stavis, a partner at Bessemer, says Kroll Bond Ratings could well pay off. "We often go after industries where there are significant incumbents when we believe they're ripe for disruption," he says. His firm was an early investor in [Skype](#).

Mr. Kroll, for his part, is thinking big — as he always has. He wants to grab 10 percent of this \$4 billion-a-year industry within five years. But even that seemingly modest goal may be a reach. Moody's and S.& P. each have about 40 percent of the ratings market. The remainder is spread among Fitch and several lesser-known agencies.

"I think it's a tough industry to break into, but if anyone can do it, it's Jules Kroll," says Michael Charkasky, the chief executive of [Altegrity](#), which acquired Kroll Inc. last year. (Mr. Charkasky had worked for Kroll for more than a decade.)

IN the aftermath of the Panic of 1907, a self-taught financial analyst named John Moody pioneered the idea of assigning ratings to public securities. For much of its history, the industry he founded was a relative backwater — a steady if unglamorous moneymaker that tended to attract wonks or analysts who might not land jobs at a Goldman or a Morgan.

Then, in 1975, the [Securities and Exchange Commission](#) promulgated rules that anointed a handful of Nationally Recognized Statistical Ratings Organizations. The S.E.C. argued that assessing the safety of investments was so important to the soundness of the nation's banks and brokerage firms that only respected ratings agencies should be allowed to do the job. In the early 1980s, there were seven of these organizations. By the mid-1990s, mergers had reduced that number to three. The S.E.C. has since added seven, bringing the total to 10.

Kroll Bond Ratings is one of them.

It is certainly an uncomfortable time for ratings agencies, big or small. A report by the Congressional panel that chronicled the financial crisis called the big three services "essential cogs in the wheel of financial destruction."

But the S.E.C. wants to wean the financial industry from its dependence on all ratings. In February, the commission unveiled a plan to strip references to ratings from rules that govern securities offerings, the first of several such moves the S.E.C. must make under the [Dodd-Frank Act](#). The commission is also supposed to create its own Office of Credit Ratings to police the agencies, although the S.E.C. has delayed that move because of a tight budget.

"It's a bit daunting, but I've always enjoyed a challenge," Mr. Kroll says of his venture.

JULES KROLL loves a good story. The bookshelf in his 12th-floor office in Midtown Manhattan is stocked with titles that speak to a life spent weighing risks — books like "The Threat Closer to Home: [Hugo Chávez](#) and the War Against America" and "Surviving and Thriving in Uncertainty: Creating the Risk Intelligent Enterprise."

But Mr. Kroll has plenty of his own stories to tell. Like the time in 2003 when [Edward S. Lampert](#), the billionaire hedge fund manager who controls Sears, was kidnapped on the Connecticut Gold Coast. Mr. Kroll was brought in to help the [F.B.I.](#) and pointed out that someone — it turned out one of the kidnappers — was using Mr. Lampert's credit card to buy pizza.

"These guys were real geniuses," Mr. Kroll says dryly. Mr. Lampert was later released unharmed.

Over the years, Mr. Kroll has helped to secure the release of about 185 other kidnap victims, mostly overseas.

He clearly relishes his cloak-and-dagger image. In 2005, for instance, he paid \$27,000 at a charity auction for a walk-on part on "CSI: New York." He gave away the role so a friend could raise more money for another charity.

But Mr. Kroll has never quite fit the corporate mold. He sold Kroll Inc. in 2004 to [Marsh & McLennan](#), the giant insurance brokerage firm, for \$1.9 billion in cash and pocketed about \$117 million.

In 2008, Mr. Kroll resigned as chairman and made an unsuccessful bid to buy his old company back. When that failed, he and Jeremy struck out on their own and opened [K2 Global Consulting](#), whose name refers to the two Krolls. K2 provides anticorruption, due diligence and [forensic](#) accounting services that compete with the old Kroll. It will do much of the due diligence for Kroll Bond Ratings. (Marsh & McLennan sold his old company to Altegrity in 2010.)

Jeremy Kroll is being groomed for the family business, but his father says he never pressured his children to follow in his footsteps.

"I've seen too many situations where families and business split families apart," Jules Kroll says. (Mr. Kroll's daughters, Dana and Vanessa, have worked off and on for Kroll. His son [Nick](#) is an actor and comedian who recently appeared on Comedy Central.)

Jeremy Kroll, who studied languages and fine arts at Georgetown, took a series of odd jobs after college. He went to Italy to paint for a year. Later, he scouted film locations and cleaned toilets for a film company before joining his father's company in 1996.

At Kroll, he handled things as diverse as missing-person cases and corporate litigation. And he quickly picked up his father's work ethic: in 2001, he insisted on leading a team into Bosnia to complete a [United Nations](#) case that involved finding stolen money in the Bosnian banking system, even though, several weeks earlier, Kroll auditors had been beaten and taken hostage by Croats. "I couldn't ask people on my team to go there if I wasn't willing to go there myself," Jeremy Kroll says.

One of his paintings hangs at K2's headquarters. It is a gloomy, abstract self-portrait that he painted in Florence. In the painting, one eye is muddled over. Jeremy says it represents people who see only one side of things. "There's always more to the story," he says.

Kroll Bond Ratings hopes to pick apart some of the trickiest investments ever devised. Those include securities backed by residential mortgages as well as other "structured" products. Such investments, many of them linked to risky home loans, were at the heart of the

financial crisis.

When they rated those securities, the dominant agencies often relied heavily on the banks that underwrote them. Indeed, the two camps often worked hand-in-glove.

Mr. Kroll vows that his venture will dig deeper, all the way down to the individual mortgages behind such investments. That would be a daunting task, given that thousands of individual home loans often back a single mortgage security.

"I wouldn't do a rating unless that information was available — otherwise, how the hell are you going to make a judgment?" Mr. Kroll asks.

But already, his ratings venture has had some embarrassments of its own. Last year Mr. Kroll bought Lace Financial, a boutique credit rating service, to kick-start his firm. No sooner was that deal made than the S.E.C. fined Lace \$20,000 for playing down a potential conflict of interest and failing to disclose steps that led to rating upgrades favorable for a big client.

Mr. Kroll dismisses the episode. "This was all just procedural stuff," he says. Lace's old management has since been replaced. Mr. Kroll has also recruited some heavy hitters from established agencies — that is, from the same agencies that have come under so much criticism. Among his hires are Jim Nadler, who headed the structured finance group at Fitch, and Kim Diamond, a former managing director at S.& P. For K2, Mr. Kroll has hired former C.I.A. agents, forensic accountants, academics, litigators and investigative journalists.

But breaking the grip of the big three won't be easy. "It's tough to break into any industry where the three incumbents have 97 percent of all ratings," says Brett R. Gordon, an assistant professor of business at Columbia Business School.

Spokesmen for Moody's, S.& P. and Fitch say their companies welcome competition. But Daniel Noonan, a managing director at Fitch, points out that his agency has 50 offices in 36 countries. Moody's and S.& P. are even bigger. Start-up companies lack the geographical reach and industry expertise of the established players, Mr. Noonan says.

Kroll also faces competition from new entrants like [Meredith Whitney](#), a banking analyst who is getting into the ratings business, and [Morningstar](#), of [mutual fund](#) fame, which recently acquired an agency called Realpoint.

Sean Egan, the president of another small ratings service, [Egan-Jones Ratings](#), says Mr. Kroll is playing by the old, discredited rules. The issuer-pay model lets companies shop around for the best ratings, putting pressure on the agencies to inflate their grades, Mr. Egan says. "If a firm is being paid primarily by one side, it's very difficult to argue that they can adequately represent the other side," says Mr. Egan, whose firm has investors subscribe to its service. "One cannot serve two masters."

Mr. Bove, the analyst at Rochdale, says of Mr. Kroll: "If he thinks he's going to make his name by knocking down the ratings of one security after another, who's going to pay him?"

BUT if Jules Kroll can deliver accurate credit ratings, he just might have a shot. Michael Millette, the head of structured finance at [Goldman Sachs](#), says he would consider turning to Kroll. In the old days, if a security wasn't rated by the big three, investors wondered why. To many, such securities seemed a bit dodgy. Now, in the post-crisis world, "that's all changed," Mr. Millette says.

Mr. Kroll is, naturally, undaunted. "I would be foolish not to tell you there is a hill to climb here," he says, "but we're not climbing a cliff." He says that the big three agencies lost considerable investor confidence during the financial crisis, and that the sector is ripe for new blood. And, anyway, he says, he would rather be right than popular. "Our name is on the line," he says.