Article Title: ARCHIVE | Criteria | Corporates | General: Methodology And Assumptions: Analysis Of Corporates' Swap-Indexed Bank Lines Data: (EDITOR'S NOTE: — This criteria article is no longer current. It has been superseded by the article titled "Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers," published Dec. 16, 2014.) Bank facilities, including backup facilities, provide liquidity for corporate borrowers. We think that such facilities are needed as a matter of prudence for all corporates that issue commercial paper (CP). Liquidity is currently among the key credit drivers for rated corporates globally. In recent weeks, we have observed a fairly new phenomenon when U.S. and European corporates have renegotiated, extended, or arranged new committed credit lines with various banks, either to substitute or complement existing arrangements: The line's credit spread over market indices is not fixed but linked to certain market variables. This article endeavors to explain how we factor such structures into our credit analysis. We believe a differentiated approach is best suited to the potentially broad variety of structures. Key Features Of Recent Transactions Under the new structures, the line's spread is typically indexed to the price of the issuer's one-year or five-year credit default swaps (CDS), often averaged over a very short period, between one day and one month. In many cases, the indexation ratio (the ratio of the line's spread change divided by the CDS spread change) is 1.0x and uncapped, but in some cases a cap and floor are included. In at least one instance, the lender's CDS was also a component of the interest rate calculation. Other features, such as market disruption event clauses, may also be present. We believe these can potentially weaken the issuer's liquidity, as explained in "Credit FAQ: Credit Crunch Sharpens The Focus On European Corporate Liquidity," published Oct. 28, 2008, on RatingsDirect. Commitment fees appear to be lower than on committed lines that have fixed or quasi-fixed pricing, which seems to be one of the reasons why companies have entered into such agreements. Most of the corporates concerned have strong investment-grade ratings; they are businesses that operate in a variety of industries exhibiting various degrees of volatility, including utilities, nondiscretionary consumer products, and telecommunication equipment. Implications For Liquidity Analysis In our view, the notion of a liquidity line whose cost isn't fixed, in absolute total-cost terms or as a spread over LIBOR, but market-linked and, in particular, issuer-credit-linked, calls into question the value of the line as a contribution to the issuer's liquidity. However, even if in some cases we don't believe a CDS-indexed line affords any liquidity benefit, its existence doesn't change our view on other existing lines and liquidity arrangements left unchanged by the market-linked line (we don't currently anticipate that CDS-indexed lines will represent a high proportion of a company's total credit lines) . Our general approach is to factor committed credit lines into our liquidity analysis as a type of funding insurance mechanism, providing funds precisely if and when the company undergoes a degree of credit stress and finds market refinancing difficult and/or very expensive. The credit risk the lender takes on is compensated by commitment fees payable through the facility's life, including when no particular stress affects the issuer or wider credit markets and the line is not tapped--at such times, the company taps the bond market at affordable rates. Conversely, when market access is difficult, committed lines are used. Indexing the lines' price to market prices may therefore negate their benefits in our analysis of the company's liquidity. More specifically: Factoring into the price of the line the lender's own cost of obtaining credit further weakens the risk transfer and the line's benefit to the corporate's liquidity, in our view. Pricing and availability of a line may become inter-related when the price gets too high. We may doubt that very highly priced liquidity really posts the high degree of availability and modest impact on underlying credit measures that we would normally expect from a credit line. Market indicators, especially those on individual credits, may fluctuate widely and fairly unpredictably in a credit squeeze--as we have seen in 2008--at just the time that corporates face difficulties in obtaining bond refinancing. We also believe that signaling issues may deter some companies from using this type of credit line. A company drawing on a very expensive credit line gives out a signal that it is under extreme stress, even if this is not so. Because of this end result, the company might restrain itself from drawing the line. Finally, in our experience, issuers in need of liquidity will choose among several options. In extreme cases, if cash burn was significantly accelerated by drawing on extremely costly lines to avoid an outright payment default, a company might prefer to file for creditor protection or propose below-par debt exchanges, two situations associated with defaults under our rating definitions. The very significant spreads--sometimes above CDS--paid in recent weeks by solid investment-grade European

and North American rated corporates for multi-year bond issuance is a separate issue. We take such liquidity into account essentially only upon issuance, rather than relying on these companies being able, or willing, to accept such a price in the future; also, the tenor of these issues is often five years or more. However, we note that market-linked lines don't appear less weak than easily puttable bonds or debt with rating triggers close to current issuer credit ratings. Implications For Analytical Surveillance When analyzing liquidity lines that are specifically for CP backup purposes, we wouldn't give credit to facilities whose cost could be raised by more than a few hundred basis points. In our more general liquidity analysis, we will distinguish between two broad categories of issuer-CDS indexation mechanisms: We would typically not retain in our analysis, as core liquidity resources, those lines whose pricing structure would render liquidity access extremely costly. For a company already incurring significant credit stress, drawing on such a line would likely merely slow, rather than avert, default. Alternatively, the company might not be willing to draw at all. The characteristics of such a line would typically be an absence of any capping combined with an indexation ratio that passes on a substantial portion of a CDS spread increase (for example, a line with a ratio of more than 0.5x would probably fall into this class). Indexation to a broad portfolio could lead us to retain the line as a liquidity resource in our analysis, notably as volatility would probably be lower than indexation to a single name, reflecting broad market repricing. In contrast, our current guidance for corporates based in North America and Western Europe is that we would typically include in our liquidity analysis lines whose price would not be raised more than several percentage points over LIBOR--whatever the exact mechanism, including an indexation ratio well below 0.5x--or would not be raised above a moderate absolute level. In such circumstances, as we typically wouldn't expect any downgrade due to higher interest expense to exceed a couple of notches, such a downgrade would be consistent with our analytical framework for rating stability. (For more details, see "Standard & Poor's To Explicitly Recognize Credit Stability As An Important Rating Factor," published Oct. 15, 2008.) While underlying credit quality erosion can't usually be eliminated by a credit line, we consider that the latter provides at least additional time for the company to seek access to more stable, long-term refinancing. At the same time, our analysis factors in the various aspects of local borrowing markets, volatility of rates, and other aspects of documentation, such as market disruption clauses (see our Oct. 28, 2008 article, referenced above). In both cases above we would typically inquire of managements why they have opted for market-linked facility-rate structuring, and whether they include or exclude these lines in their view of liquidity resources. If they rely on these lines for overall liquidity provisions in times of stress (for example, because such lines have actually replaced some existing lines, rather than being additional ones), we would factor this view into our analysis of the company's risk tolerance and enterprise risk management. These criteria represent the specific application of fundamental principles that define credit risk and ratings opinions. Their use is determined by the issuer-specific or issue-specific facts, as well as Standard & Poor's assessment of the credit and, if applicable, structural risks for a given issuer or issue rating. Methodology and assumptions change from time to time as a result of market and economic conditions, issue-specific or issuer-specific factors, or new empirical evidence that would affect our credit judgment.