

Article Title: Guidance | General Criteria: Hybrid Capital: Methodology And Assumptions Data:

(EDITOR'S NOTE: —We republished this guidance document on March 8, 2023. See the "Revisions And Updates" section for details.) OVERVIEW AND SCOPE 1. This document provides additional

information and guidance related to our criteria, "Hybrid Capital: Methodology And Assumptions," published March 2, 2022. It is intended to be read in conjunction with those criteria. This guidance fully supersedes the guidance article "Assigning Equity Content To Hybrid Capital Instruments Issued By Corporate Entities And Other Issuers Not Subject To Prudential Regulation," published on Jan. 16, 2018. For a further explanation of guidance documents, please see the description at the end of this article. 2. Guidance documents are not criteria, as they do not establish a methodological framework for determining credit ratings. Guidance documents provide guidance on various matters, including: articulating how we may apply specific aspects of criteria; describing variables or considerations related to criteria that may change over time; providing additional information on nonfundamental factors that our analysts may consider in the application of criteria; and/or providing additional guidance on the exercise of analytical judgment under our criteria. 3. Our analysts consider guidance documents as they apply criteria and exercise analytical judgment in the analysis and determination of credit ratings.

However, in applying criteria and the exercise of analytic judgment to a specific issuer or issue, analysts may determine that it is suitable to follow an approach that differs from one described in the guidance document. Where appropriate, the rating rationale will highlight that a different approach was taken. KEY PUBLICATION INFORMATION This article is related to "Hybrid Capital: Methodology And Assumptions," published March 2, 2022. We may revise our hybrid guidance from time to time, when market dynamics warrant reevaluating the variables and assumptions we generally use in our analysis.

GUIDANCE Equity Content--General Framework Stress scenarios 4. We consider hybrid instruments as having equity content, despite their debt-like features, because they can absorb losses or conserve cash in stress scenarios, to the benefit of more senior creditors. 5. Examples of stress scenarios could include the following situations: The issuer has experienced a significant decline in creditworthiness, for example, into the 'B' rating category. An issuer initially rated in the 'B' category is now having difficulty accessing alternative sources of capital as a result of company-specific or market-related issues. For a bank that had an SACP of 'bbb-' or higher at the time of issuance, we generally expect its going-concern hybrid capital instruments to absorb losses early enough for the bank to maintain an SACP of at least 'b+'. Hybrid redemptions/repurchases and replacement 6. Generally, we consider that redemptions negate the potential availability of hybrid issuance to absorb losses or conserve cash.

Accordingly, the factors we consider when assessing redemption of a hybrid include the reason why the issuer chose to redeem the instrument. In particular, we assess what the redemption tells us about the issuer's intent to maintain the ability and availability of the hybrids to absorb losses and conserve cash, the use of hybrids within the issuer's capital structure, and the potential impact on the issuer's creditworthiness. 7. When assessing hybrid redemptions, we do not consider that hybrid replacement is necessary when the redemption amount is immaterial in the context of the issuer's credit profile.

Further, we typically consider redemptions of up to 10% over any 12-month period of aggregate hybrids outstanding, and up to 25% over any 10-year period, to be immaterial; therefore, they would not require replacement. We may allow for a higher percentage where we consider there has been a

transformational divestment in the company and such redemption would have no or minimal negative impact on creditworthiness. 8. That said, our assessment also considers the credit effect of any redemption on an individual issuer's overall credit profile, and we assess the issuer's intent in

redeeming the hybrids. If we anticipate the redemption will have a materially negative effect on an issuer's credit profile, a redemption without replacement may undermine our view of the equity content of the issuer's existing and future hybrids, even if the repurchase amount is within these guidelines. 9.

In practice, for corporate and other nonprudentially regulated issuers (excluding nonprudentially regulated insurance holding companies), we consider a mix of 50% common equity and 50% debt to be an acceptable alternative to refinancing with 100% hybrid capital, for hybrids receiving intermediate equity content. 10. For example, consider a corporate issuer that has a \$1 billion intermediate equity content hybrid which can be called now, plus several other hybrids that we classify as having intermediate equity content. The issuer calls the \$1 billion intermediate equity content hybrid, and funds the call and replaces the instrument with \$500 million of common equity and \$500 million of nonhybrid

debt. This financing would not lead us to question issuer intent and the intermediate equity content classification on the other hybrids (all other things being equal) because the issuer has replaced the hybrid with \$500 million of common equity.

11. Timing of issuance of a replacement hybrid: A replacement hybrid can be issued up to or on the date the original hybrid is redeemed. We must be confident that it is being issued to replace the original hybrid, and that it otherwise qualifies for intermediate or high equity content. A new issuance of common equity can also be used to replace a hybrid.

12. Terms and conditions: A replacement hybrid need not have the same terms and conditions as the original instrument to qualify for intermediate or high equity content. For example, a hybrid with a noncall period of 10 years could be replaced by a hybrid with a noncall period of five years, assuming the replacement hybrid otherwise meets the criteria for intermediate equity content. If the original hybrid had intermediate equity content, the replacement hybrid must have intermediate or high equity content, or be a new issuance of common equity.

13. Assessing equity content when an exchange or tender offer does not receive 100% take-up: In the following examples, we are indifferent as to whether the redemption takes place as an exchange or a tender offer.

14. Consider, for example, a situation where an issuer issues a \$1 billion replacement hybrid two years before the five-year, first call option date on an existing \$1 billion intermediate equity content hybrid, and then immediately tenders for the original instrument, but attracts only 50% take-up under the tender offer. If we are confident that the replacement instrument is intended to replace the original instrument, and it meets our criteria for intermediate equity content, we would ascribe intermediate equity content to the full amount of the new hybrid.

15. The residual amount of the original hybrid would be regarded as having no equity content if we expect the issuer to redeem the remaining amount at the call date or repurchase it before the call date. Such a scenario would not adversely affect our view of the equity content of the group's other existing or future hybrid issuances, all other things being equal.

16. Consider, for example, a situation where an issuer undertakes an exchange offer with an existing \$1 billion intermediate hybrid two years before a five-year first call date, but attracts only 80% take-up under the exchange offer: If the new instrument qualifies for intermediate equity content and we consider that the issuer remains committed to maintaining the total \$1 billion of hybrid capital as a permanent part of its capital structure, we would generally continue to maintain intermediate equity content on both the remaining portion of the existing instrument and the new instrument. If, on the other hand, we expect the total outstanding amount of hybrid capital to reduce, we could reassess issuer intent toward its hybrid capital instruments, depending on the magnitude and potential impact on the issuer's creditworthiness.

17. Assessing equity content if instruments remaining outstanding following an exchange or tender offer are redeemed without replacement: If, for example, 20% of a hybrid remains outstanding following an offer and is redeemed without replacement, this would not necessarily disqualify the issuer from intermediate or high equity content on all current and future hybrids. The level of equity content for the replacement hybrid would depend on our assessment of the feasibility of replacing the residual hybrid amount and the impact on the issuer's credit profile of not replacing it. If we consider that due to the size of the residual amount, it is not practical to issue equity or to raise a new hybrid as a replacement, we may continue to assign intermediate or high equity content to the issuer's existing and future instruments. However, this would assume that the reduction in hybrid capital is immaterial to the issuer's credit profile, and that the issuer's intentions toward its remaining hybrid capital remain supportive.

18. To illustrate this further, if we assume that the initial instrument was \$250 million, and hence, the residual 20% was \$50 million, we may consider it unfeasible to raise equity or issue a replacement instrument for the remaining amount. Accordingly, assuming that a redemption without replacement would have no material impact on the issuer's credit profile, we may continue to ascribe equity content to the issuer's existing and future hybrids. However, if the initial instrument was \$1.5 billion, and the remaining 20% was \$300 million, we would be less likely to consider redemption without replacement as consistent with having intermediate equity content.

19. Replacing a hybrid with a larger instrument: If an issuer issues an intermediate replacement hybrid that is larger than the one being replaced, we may assess the equity content of the full amount of the replacement instrument as intermediate if: It meets our criteria for intermediate equity content; We do not expect the hybrid issuance to exceed any applicable limits or typical thresholds over the financial forecast horizon; and We consider issuer intent supportive of this assessment.

20. Follow-on issuances: In some cases, a hybrid we regard as having intermediate

equity content may be issued, and then, several months later, the size of the original hybrid is increased by making a follow-on issuance to raise additional proceeds. 21. We generally treat all hybrid follow-on issuances (such as tap issuances and top-ups) as stand-alone issuances for the purposes of assessing equity content. Accordingly, in this case, the follow-on issuance would need to qualify as having intermediate equity content in its own right, including having at least five years from the date of issuance until the first call date. 22. Assessing improvement of creditworthiness: For corporate issuers (excluding nonprudentially regulated insurance holding companies), when assessing whether creditworthiness has improved, we look at the company's creditworthiness pro forma for the redemption of the hybrids and any replacement financing. We then compare that to the date when the most recent additional hybrid was issued (excluding refinancings). Although we do not require that the rating has been raised to indicate improved creditworthiness, we do not consider that marginal improvements in creditworthiness offset the impact of redeeming a hybrid without replacing the instrument to be redeemed. Furthermore, in assessing redemptions without replacement, we would typically expect at least five years to have elapsed since issuance. A shorter time frame could lead us to question whether the issuer intends the hybrids to be available to absorb losses or conserve cash when needed. 23. For insurance groups subject to prudential regulatory oversight, we anticipate that the regulator would expect the insurance group to hold certain levels of hybrid or higher-quality capital, to maintain its solvency. Therefore, if an insurer (or its NOHC) calls or redeems a hybrid without replacing it, we would expect that its creditworthiness would not be harmed, and that the group will continue to maintain sufficient capital adequacy to support its ratings. Hybrid instruments issued by operating companies 24. Where a group subsidiary issued the hybrid to a third party and we anticipate that the instrument's loss-absorption capabilities will benefit the group, we may include the instrument's equity content in our analysis of the GCP, if the hybrid meets the relevant criteria for intermediate or high equity content. 25. Consider an example where an insurance operating subsidiary issues a hybrid security to a third party. We would expect a close alignment of the operating subsidiary's business risks with those of the broader group. In this case, we would expect the group to benefit because the hybrid would absorb losses or conserve cash at the operating subsidiary, thus reducing or removing any need for support from the group. Hybrids issued by nonprudentially regulated entities with one or two investors 26. In our view, issuers of hybrid securities will likely find it more difficult to defer coupon payments in times of credit stress if just one or two investors hold the hybrid series and expect to receive the entire payment. Such investors may have a strong influence, which we consider detrimental to the likelihood that the issuer will choose to defer payment to absorb losses or conserve cash for the benefit of more senior debtholders. 27. In some cases, investors in hybrids are under common control. We consider the nature and extent of that control in our assessment. For example, if several funds controlled by a single fund provider invest in a hybrid issuance, we may consider those funds a single investor. 28. We may consider hybrid instruments that have only one or two investors to have equity content if they were issued to the investors during a period of credit stress, giving rise to our reasonable expectation that the one or two investors were aware of the realistic prospect that these hybrids may be required to absorb losses or conserve cash. In this regard, we consider stress to include scenarios where the issuer would otherwise have difficulty raising capital, or we believe that, due to the credit stress facing the company, the hybrid capital is being provided on more favorable terms than would otherwise be available. In addition, we may assign equity content to a hybrid that was originally sold to one or two investors if that hybrid has the same Terms and Conditions as existing intermediate equity content hybrids, subject to the condition that the single or dual investor in the new hybrid will hold 25% or less of the aggregate notional amount of intermediate (equity content) hybrids outstanding, and provided that all other criteria to achieve intermediate equity content are met. Make-whole clauses 29. For hybrid instruments, the term "make whole" can be used for different types of clauses. 30. A "make-whole clause," for example, can specify a period during which the issuer may redeem the instrument by paying the net present value of future cash flows until the first call date or the maturity, in addition to the principal amount and any accrued coupons. In such cases, the net present value calculation is typically based on a discount rate that is lower than the coupon rate on a similar hybrid. 31. We do not consider that this type of make-whole clause creates an expectation that the issue will be redeemed during the make-whole period. Accordingly, we do not view it as a call feature in our hybrid analysis, even if it is referred to as a

make-whole call clause in the hybrid documentation. 32. Another type of make-whole clause is designed to ensure that hybrid noteholders are compensated if the issuer subsequently issues a new instrument on terms more favorable to the new hybrid noteholders. Such a clause may push up the coupon rate on the original instrument when a similar instrument is issued with a higher coupon rate, for example. Alternatively, it may lower the conversion price for a convertible instrument when common shares are issued at a lower price. Such make-whole clauses are not consistent with intermediate or high equity content, in our view. EQUITY CONTENT CATEGORIES High Equity Content Mandatory convertible securities 33. If we come to believe that an MCS will not absorb losses through conversion before default or the point of nonviability, we may reassess it as having no equity content, even if we previously considered it to have high equity content. This may occur if the issuer undergoes such a precipitous decline in its creditworthiness that we no longer expect it to be able to convert the hybrid to common equity before becoming a nonviable entity. 34. In some cases, the risk of failure to absorb losses may be mitigated; for example, if the instrument has a contingent capital feature, such as a credit-related trigger that absorbs losses through conversion or some other means, and this feature would be triggered before the issuer became a nonviable entity. Mismatched mandatory convertibles 35. Mandatory convertible instruments usually convert directly into common stock. An alternative structure, known as equity units, comprises a debt instrument and a forward contract that obliges the investor to purchase common equity. In the mismatched equity unit version, the debt remains outstanding after the common stock issuance, and the common stock issuance raises a second set of proceeds. If we believe that the issuer will immediately use the equity proceeds to repay the debt, and it meets the other criteria for high equity content, we will assign high equity content to the equity unit at the time of the initial issuance. Otherwise, we treat the two transactions--the initial debt and the subsequent equity issuance--as separate transactions in our analysis, and would only factor in the equity issuance once it occurs. Intermediate Equity Content Restriction on the issuer's ability to defer payments 36. To attain intermediate equity content, the instrument must be free from features that would materially delay deferral, such as look-back or similar features that last more than a year. Other examples of such features include: A clause that requires coupons to be paid as long as a prudentially regulated issuer meets the minimum regulatory capital requirements to maintain its license; A clause that requires coupons to be paid if an issuer has sufficient distributable reserves according to the most recent financial statements; A clause indicating that the issuer can defer coupons when a certain condition is met (for example, the issuer can defer coupons as long as it has not made payments on junior or pari passu instruments within a set period) if any resulting delay to the deferral could be material. Pusher circularity--a situation where pusher clauses on two or more parity instruments refer to each other, potentially preventing deferral of distributions on any of the instruments. Treatment of step-ups that use a floating rate 37. For a step-up where a floating rate is used, we assess the credit spread before and after switching the floating rate. 38. Consider a scenario where a fixed coupon of 954bps changes at year 10 to a floating benchmark rate plus 675bps. In this case, we consider the 10-year swap rate at issuance to be a 10-year fixed-interest base rate. Therefore, a 10-year swap rate of 504bps at issuance in our scenario implies a credit spread during the first 10 years of 450bps (= 954bps-504bps). We therefore recognize the step-up as 225bps (= 675bps-450bps). 39. In some markets or under some regulations, the 10-year swap rate (504bps, in this example) is split into the 10-year government bond yield and the swap spread. Assuming a 10-year government bond yield of 442bps, this gives a swap spread of 62bps (= 504bps-442bps). We can also represent the amount of the step-up as below, giving the same result of 225bps. Step-up = credit spread in the floating coupon rate after the step-up - (initial credit spread to the 10-year government bond yield - swap spread) Replacement capital covenants and public statements of replacement intent 40. In some jurisdictions, such as Japan, RCCs are not feasible under local laws. For corporates in these jurisdictions, an issuer's public statement of intent regarding future hybrid replacement may mitigate steps-ups of up to 100bps for issuers rated 'BBB-' or higher (and up to 200bps for issuers rated below this level). 41. In Japan, a statement of intent can mitigate a step-up of this magnitude in a corporate hybrid instrument when the following conditions are met: The statement of intent is publicly available, typically in the indenture or agreement of the hybrids and in one of the following: the issuer's annual report, an individual press release, or a statement issued at a public investor relations meeting; and Any step-up

of more than 25 bps will not occur before year 10 and there is no call option before year five. Look-back periods 42. The concept of the look-back period applies not only to pushers but also to cases where an issuer can choose to defer after breaching certain financial tests. For example, the terms and conditions provide that the issuer may defer payment of interest on a hybrid when it has reported losses in two consecutive years. In practice, this means that the issuer can't defer interest for more than a year after it starts to generate losses. We consider this equivalent to a look-back period of more than one year. 43. When we calculate the length of any look-back period, our calculation typically starts from the date of the last payment on, or repurchase of, a junior or pari passu instrument mentioned in the look-back or pusher clause. Also, our calculation extends only until the last hybrid payment date when the pusher pushes the issuer to pay. 44. For example: A hybrid includes a three-month look-back based on common dividend payments. The hybrid pays in arrears on Jan. 1 and July 1 of each year, and the issuer typically pays common dividends on Jan. 2, April 2, July 2, and Oct. 2. On April 2, 2016, it pays a common dividend. On April 3, the company's business prospects suddenly worsen and the issuer considers deferring payments on the hybrid. However, the pusher clause requires the issuer to pay on the hybrid on July 1 because it has made the April 2 common dividend payment. Therefore, assuming the company pays no further common dividends, it will not be allowed to defer payments on the hybrid until Jan. 1, 2017. As such, the first nonpayment date on the hybrid will occur almost nine months after the previous common dividend payment, or 12 months from the hybrid payment on Jan. 1, 2016. However, we interpret this as a three-month look-back, from April 2, 2016, until July 1, 2016, not a nine-month or 12 month look-back. Features that mitigate concerns about APM usage 45. A timely payment APM gives the issuer an incentive to repurchase the stock issued under the APM. Therefore, we typically consider that a hybrid with this feature has no equity content unless it prohibits repurchasing of the stock for at least 12 months from the cure date. 46. Coupled with an optional deferral feature, we consider that a settlement APM discourages issuers from deferring coupon payments. Therefore, we typically consider that a hybrid with this or a similar feature has no equity content. 47. A hybrid instrument that has a settlement APM may achieve intermediate equity content if it incorporates adequate protection to limit the extent of potential equity dilution, such as in the following examples: Where the APM requires the issuer (whether legally or on a best-effort basis) to settle any optionally deferred payments by issuing a new instrument, such requirement does not occur prior to five years after the initial deferral and the new issuance; If the APM requirement to issue a new instrument occurs only when the issuer chooses to settle after the optional deferral at any time but (1) common shares that are required to be issued for such optional settlement are limited to a maximum 2% of the total number of shares outstanding during the period the deferral continues and (2) additional hybrids that are required to be issued for such optional settlement are limited to a maximum 25% of the initial hybrid principal amount. Treatment of contingent capital instruments that have mandatory conversion features issued by Australia-regulated financial institutions and insurers 48. Contingent capital instruments that have mandatory conversion features that have been issued by a regulated Australian financial institutions or insurance entity, or a New Zealand financial institution or insurer that is a subsidiary of such an Australian group can generally be eligible for intermediate equity content, on the basis of the current applicable regulatory framework, if they meet all of the following characteristics, even when there are more than three years remaining to the mandatory conversion date: The conversion price floor cannot be below 50% of the common share price at the time of the initial issuance; The ICR is 'BBB-' or higher; The underlying instrument is preferred stock or its equivalent; Absent the conversion feature, the instrument would qualify as intermediate equity content under our criteria; We expect that the issuer will not reverse the share issuance (via conversion) with share repurchases; and We expect that the regulator intends that the issue will remain a component of the issuer's capital base for a long time, both before and after conversion. 49. We could extend this treatment to other jurisdictions in the future if the regulatory expectations are similar to those in Australia. No Equity Content 50. An instrument that we classify as having no equity content is generally treated as akin to debt in our analysis of the issuer's credit profile. However, if a rating committee considers that a hybrid with no equity content provides a meaningful incremental benefit to an issuer's credit profile, beyond that of traditional debt, our analysis may still incorporate these benefits. 51. For example, if a corporate entity has issued a hybrid that has material credit-supportive features, but no

longer qualifies as having intermediate equity content because its effective maturity date is less than 20 years away, we may reflect the benefits of the hybrid in other aspects of our corporate methodology. Similarly, if a corporate hybrid with no equity content includes a PIK feature that is being utilized, and we consider that this materially benefits the issuer's credit profile, we may focus our analysis of the issuer's financial risk profile more heavily on certain supplemental ratios, such as funds from operations cash interest coverage. Real estate investment trust (REIT) hybrids 52. We typically assign no equity content to hybrids issued by a REIT or a similar tax-driven ownership structure if the instrument includes a dividend stopper that requires that ordinary dividend payments must be stopped before the hybrid coupon can be deferred. In our view, the loss of favorable tax treatment that would result from a failure to distribute taxable income if the dividend stopper was triggered would more than outweigh the cash flow benefit of any coupon deferral. We consider that this gives the issuer a strong incentive to avoid coupon deferral on the hybrid instrument, or to redeem it before deferring hybrid coupons. 53. That said, we may assess REIT hybrids as having intermediate equity content if the hybrid issuer can continue to distribute sufficient taxable income to ordinary unitholders to maintain the REIT's tax status, while deferring on its hybrid coupon payments. PIK instruments 54. PIK instruments do not typically meet our criteria to be treated as having intermediate or high equity content, for a variety of reasons. In their simplest form, PIK instruments pay interest in kind for a predetermined period (which may be the life of the instrument) and are similar to zero-coupon bonds. Although such issues do not require companies to pay cash during the period, their generally steep interest rate and rapid accretion give the issuer a strong incentive to refinance the issue, undermining its availability to absorb losses or conserve cash. Moreover, issuers often issue PIK instruments to achieve a short-term objective; as such, we are typically skeptical about their willingness to maintain PIK instruments over the longer term. 55. Although PIK (or similar) instruments lack cash payments, which can help issuers to avoid cash outflows for a specified period, we generally consider that paying in kind or accreting on an ongoing basis (as opposed to only in a stress scenario) could harm an issuer's creditworthiness. If an issuer experiences any stress just before a mandatory PIK period ends, the accreted amount could exacerbate the damage to its creditworthiness. In our view, features that allow issuers to defer payments offer most benefit when the flexibility is reserved for periods of financial distress. PIK and similar instruments can also incorporate other features that undermine the potential availability and ability of the instrument to act like equity in a time of stress. For example, they may feature a dividend stopper that applies while the instrument is accreting/paying-in-kind. ASSIGNING AN ISSUE CREDIT RATING TO A HYBRID INSTRUMENT Deferral Triggers And Impact On Notching For Corporates And Prudentially Regulated Insurance Entities 56. When hybrids have multiple deferral triggers, the notching is based on the trigger that we expect to be reached or exercised first. 57. We do not impose a limit on the number of notches that we may deduct for payment risk. Examples of where more than one notch may apply--either at issuance or later--include: Instruments with optional loss absorption and cash conservation, where the issuer is experiencing greater financial distress or cash availability is constrained; Instruments where the ICR from which it would be notched includes support that would not be attributable to the hybrid instrument; or Instruments that have a mandatory coupon deferral trigger that could be reached when the entity is still a going concern and that it materially increases payment risk. 58. Mandatory triggers include those related to an issuer's financial statements and financial statement metrics that can be reached when the entity is still a going concern (that is, a going-concern trigger). Examples may include features requiring coupon deferral if the issuer's earnings have been below a certain threshold, or if distributable items are insufficient to cover the coupon. 59. When rating hybrids, we consider how much payment risk is already incorporated into the ICR. We expect that as the risk of nonpayment increases--for example, as a mandatory deferral trigger point approaches or we gain increasing confidence that an optional deferral could be exercised--hybrid instrument ratings will generally follow a measured transition to default. This could come through the lowering of the ICR, resulting in a lower hybrid rating based on standard notching; the widening of the notching between the hybrid rating and the ICR; or a combination of both. 60. When we anticipate that coupon deferral is likely within the next 12 months, we apply our 'CCC' criteria to rate the hybrid instrument. 61. Where the ICR would encompass a deterioration in creditworthiness that makes a deferral more likely (for example, reduced solvency level) and would be at or close to default when a deferral trigger would be

breached, then wider notching between the hybrid and ICR is not as necessary. 62. In circumstances where ICR is more resilient to these deteriorations, but the risk of default via deferral increases, then notching can widen, to manage the transition of the hybrid rating. 63. For insurance hybrids, in order to assess the relationship between ICR and hybrid rating, we consider how both would respond to stress or volatility. This is informed by a number of factors, including: The insurer's risk appetite and business profile; The actions that management could take to preserve or repair capital (for example, purchasing reinsurance or implementing hedges); Volatility (historical and expected) of an insurer's regulatory solvency; Insurer's target solvency levels and group support; Current and expected proximity to mandatory deferral triggers; Expectations regarding regulatory actions; and Market conditions and the insurer's operating environment. 64. Based on our understanding of these factors, we believe that certain jurisdictions, such as the European Economic Area, Switzerland, Australia, Bermuda, Canada, and the U.S., the minimum notching described in the criteria would generally be sufficient to reflect the incremental payment risk for hybrids issued by insurers with regulatory solvency ratios of at least 165%. In these jurisdictions, the capital regulatory solvency capital requirement is calibrated to a robust level (for example, it may be based on a one-in-100- or one-in-200-year confidence level). 65. For hybrid instruments issued in these jurisdictions by insurers with solvency ratios of below 140%, we anticipate that payment risk will be higher and that the rating will typically be below investment grade. Ratings may be higher than indicated above in circumstances where the factors mentioned in paragraph 63 specific to a company or a particular regulatory regime--for example, Canada's Life Insurance Capital Adequacy Test--result in solvency ratios that may be less sensitive to shocks, or payment risk otherwise significantly less, than would typically be expected. 66. For other markets, where the regulatory solvency requirement that will trigger coupon deferrals is calibrated to a less-onerous 95th percentile confidence level, standard notching would typically apply for hybrids issued by insurers with solvency ratios in excess of 3x the trigger level. For hybrid instruments issued in these jurisdictions by insurers with solvency ratios of below 2x the trigger level, we expect the rating will typically be below investment grade. As in other jurisdictions, ratings may be higher than indicated here if company- or market-specific factors lead us to consider an issuer's solvency ratio less sensitive to shock than may otherwise be expected. 67. Conversely, we may apply wider notching when payment risk is greater than that indicated in the previous examples. Consider, for example, an 'A+' rated issuer in a jurisdiction with robust capital requirements. It has a solvency ratio of 170%, but exhibits significant exposure to catastrophe risk which could lead to material volatility in its regulatory solvency. In this situation, we may widen the notching on the hybrid rating to reflect the potential for a decline in solvency and increased payment risk. 68. For prudentially regulated insurance entities, if the predefined regulatory solvency ratio trigger is set at a level where, upon a breach or likely breach, the regulator might require or expect measures to be taken that are intended to help preserve or repair the insurer's solvency position, we would typically classify these as going-concern level triggers. For example, if an insurance operating company within a prudentially regulated insurance group issues a hybrid with a mandatory deferral trigger based on a group solvency ratio, we treat this as a going-concern trigger if it corresponds to a going concern level for the operating entity. 69. Where insurance hybrids have mandatory deferral triggers based on a group solvency ratio, we may apply a different notching to hybrids issued by an insurance holding company than we apply to hybrids issued by an operating company in the same group, if we consider the payment risk is materially different. For example, in cases where we rate an insurance holding company lower than its operating subsidiaries to reflect the holding company's reliance on distributions from operating subsidiaries to honor its obligations, we may consider a group solvency ratio trigger to be at the point of nonviability for the holding company, but at a going-concern trigger level for the operating subsidiaries. In such situations, we may consider the lower rating on a holding company's hybrids already reflects the increased payment risk and additional notching may not be required. We may also assess the holding company's other sources of income and liquidity to service the financial obligation when determining whether that trigger is set at the point of nonviability. We may also assess the holding company's other sources of income and liquidity to service the financial obligation when determining whether that trigger is set at the point of nonviability. Starting Point For Notching For Insurance Subsidiaries Of Banking Groups 70. When the ICR of an insurance subsidiary of a banking group includes additional loss-absorbing capacity (ALAC) support,

but we do not expect such support to benefit a hybrid issued by the insurance subsidiary, the starting point for notching would exclude the ALAC support. 71. Consider a situation where an insurance entity is rated 'A', based on an SACP of 'bbb' and three notches of uplift for group support as a strategically important subsidiary of a banking group. The banking group has a GCP of 'a+', which benefits from one notch of ALAC support; the group SACP is 'a'. If we determine that ALAC support does not apply to hybrid instruments issued by the insurance subsidiary, but that group support applies to the hybrid, we would remove the ALAC support in determining the starting point for notching and limit uplift for group support to one notch below the group SACP. Thus, the starting point would be 'a-'. If neither ALAC nor group support applies to the hybrid, the starting point is the SACP--'bbb'. Rating The Hybrid Instrument: Additional Considerations For Banks Standard notching: Further details on Step 1b 72. We deduct a notch for a hybrid with restrictions on coupon deferral because these instruments offer a bank the legal right to defer paying coupons. Standard notching: Further details on Step 1c 73. We deduct a notch where we consider a mandatory contingent capital clause applies. Such a clause may be included in an instrument's documentation or the relevant regulatory or legal framework may imply an equivalent clause. We do not deduct a notch if a contractual clause is discretionary and we do not expect regulators to enforce it. 74. The deduction would generally apply to Tier 3 instruments when we consider that there is incremental default risk due to the instrument's possible conversion or write-down relative to the default risk represented by the SACP. For example, we would typically not apply the 1c notch if the Tier 3 instrument was only expected to absorb losses after the full conversion or write-down of more junior instruments, including Tier 1 and Tier 2 regulatory capital instruments, and if the bank's SACP adequately captured the Tier 3 instrument's risk of conversion or write-down. Additional notching: Further details on Step 2a 75. Examples of a mandatory going-concern regulatory capital-based trigger described as a specific regulatory capital ratio include where the hybrid documentation states the loss absorption on an instrument is mandatory if a specified capital ratio falls below a defined level expressed as a number, for example, 10%, or where the regulation or legislation defines a mandatory loss absorption trigger ratio as a number, such as 10%. 76. We typically treat the entry of a capital ratio into a regulatory capital conservation buffer range as a discretionary trigger. The notching for this risk is in step 2b instead of step 2a. Additional notching: Further details on Step 2b 77. Where we see risks such as those listed below, we typically deduct one notch, but can increase this to two or three notches, depending on our view of the likelihood of the clause being triggered. If reporting a loss in a particular accounting period leads to mandatory deferral on an instrument and prevents the bank from using its reserves to offset the impact of the loss; If a bank is at risk of insufficient distributable reserves for a regulator to permit payment on a hybrid capital instrument--even though nondistributable reserves are available; If there is a risk of a statutory or regulatory ruling that prohibits or restricts coupon payments, as has occurred, for example, when the European Commission required banks to stop coupon payments or otherwise bail-in bank hybrid capital instruments after ruling that the banks had received state aid; If we see a heightened risk of a bank or regulator activating a discretionary deferral clause. For example, when a bank's regulatory capital position means that it is at heightened risk of being subject to restrictions on capital distribution applicable for ratios within the ranges specified by Basel III's conservation buffer. This notching typically applies only to hybrids issued by banks whose regulatory capital levels are within the buffer ranges. However, we would also apply this notching if we see a heightened risk that a bank's regulatory capital will fall into the capital conservation buffer range that applies to that bank, and that this would trigger a decision by the bank or regulator to stop payments; or If we see an increased likelihood of default for a hybrid issued by an NOHC because: 1) the NOHC relies on dividend flows from the operating entity to service its instruments; or 2) the NOHC has a higher likelihood of regulatory intervention that would be detrimental to creditors than the operating bank. We typically apply at least one notch under this step for an NOHC hybrid unless we consider that it is clear the operating company hybrid will absorb losses earlier than an equivalent NOHC hybrid. This may be the case, for example, where the regulatory approach would impose losses on similar instruments issued out of the operating bank before a default on the NOHC instrument. Bank non-deferrable subordinated debt (NDSD) hybrids 78. We rate bank NDSD as hybrids in countries where the regulatory and legal frameworks, including bank resolution regimes, could cause NDSD debt to be converted into bail-in capital, or cause untimely or partial payment of coupon or

principal without provoking a legal default or the bank's liquidation. In such jurisdictions, the government is unlikely to support the payment of NDSD, even though it may support a bank's senior debt. 79. This makes the bank's SACP (or the group SACP for NOHC issues) the appropriate starting point for the issue credit rating on NDSD that is considered a hybrid. To determine whether Table 2 applies for a bank NDSD, we assess whether the legal and regulatory frameworks allow the authorities to instigate restructuring of a failing bank to the detriment of the NDSD holders. 80. For example, in some jurisdictions, the authorities could order the write-down of principal or transfer a nondeferrable subordinated instrument to a different legal entity from that carrying the senior debt, while also protecting the senior creditors. Such flexibility may be written into legislation, or be indicated by previous regulatory actions or the statements of those authorities. 81. Although the authorities may have power to force a default on NDSD to protect senior creditors in some jurisdictions, as described above, it may be uncertain whether they will use this option. In rare circumstances, a government may indicate its intention to prevent losses on NDSD. Under our rating methodology, we would then notch down from the ICR, instead of from the SACP. Revisions And Updates On June 17, 2021, we republished this guidance document to update paragraph 38 for the impending phasing out of LIBOR benchmark rates. On March 2, 2022, we republished this guidance document to update criteria cross-references to reflect the publication of "Hybrid Capital: Methodology And Assumptions," including updates to table numbers. On Oct. 11, 2022, we republished this guidance document to update paragraph 41 to clarify the conditions on an issuer's public statement of intent regarding future hybrid replacement. On March 8, 2023, we removed the reference to Japan in paragraph 66 to prepare for the expected change in the solvency margin regulation in Japan in a few years. Once this expected regulatory change takes effect, paragraph 66 may no longer be applicable for Japan. Related Criteria Hybrid Capital: Methodology And Assumptions, March 2, 2022 Related Research Criteria And Guidance: Understanding The Difference, Dec. 15, 2017