

Article Title: ARCHIVE | General Criteria: Criteria Clarification On Hybrid Capital Step-Ups, Call Options, And Replacement Provisions Data: (EDITOR'S NOTE: —This article has been superseded by "Hybrid Capital: Methodology And Assumptions," published July 1, 2019.) 1. S&P; Global Ratings is clarifying its methodology and assumptions for classifying the equity content of hybrid capital instruments that have step-up features, issuer call options, or replacement provisions. This article provides a summary of our criteria across various sectors from existing articles. It only revises existing criteria in one aspect: Previously (that is, before Oct. 18, 2012), we considered a clause that allows an issuer to call a hybrid capital instrument within five years of an issuance to be consistent with an "intermediate" equity content designation for a regulated issuer when the hybrid capital instrument has no step-up (or an immaterial step-up) and no other financial incentive to redeem. We now consider such a clause to be consistent with a "minimal" but not with an "intermediate" equity designation. However, this revision does not change the equity content of a bank hybrid capital instrument in practice because such hybrids must be included in regulatory capital to be eligible for "intermediate" or "high" equity content and bank regulatory rules tend to forbid calls being made within five years of an issuance. 2. This article fully supersedes "Criteria Clarification On Replacement Provisions In Hybrid Securities," published Dec. 12, 2008, and "Criteria Assumptions Regarding Coupon Step-Ups In Equity Hybrids Issued By Banks And Insurers," published Sept. 16, 2009 and is related to "Principles Of Credit Ratings," published Feb. 16, 2011. SCOPE OF THE CRITERIA 3. This article summarizes the criteria that apply to step-ups, call options, and replacement provisions for all existing and future hybrid capital instruments issued by any entity including, but not limited to, industrial corporates, utilities, insurers, and those financial institutions that are not in scope of "Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions" ("Bank Hybrid Criteria"), published Jan. 29, 2015. The criteria do not apply to sovereigns, multilateral banks, local and regional governments, or entities in the scope of the Bank Hybrid Criteria. They do not apply either to instruments issued to shareholders and other affiliated parties, including national governments (even if they are not shareholders). The criteria regarding call options do not refer to call options that are created by external events such as tax, regulatory, accounting, or rating agency methodology changes. SUMMARY OF THE CRITERIA 4. Whether a hybrid capital instrument that includes an issuer call option qualifies for the intermediate equity content designation or not depends on several key factors: The time between the issue date and the first call option date; Whether or not there is a step-up in the coupon rate or equivalent financial incentive to redeem the instrument at the call date or subsequent call date; The strength of such a financial incentive, if any (including the size of a step-up); The time between the issue date and when such an incentive arises; and The issuer's credit profile, as represented by either the issuer credit rating (ICR) or the stand-alone credit profile (SACP). 5. How to combine these factors depends on whether the issuer is a prudentially regulated insurer or another entity (see respective sections below). Our criteria differentiate between nonregulated entities (see "Other issuers," below) and prudentially regulated insurers such that a hybrid capital instrument with the same features may be assessed as having higher equity content when issued by a prudentially regulated insurer. This is because regulators generally have the authority to intervene in the operations of an insurance company, and the redemption of a hybrid capital instrument is often subject to regulatory review. 6. This paragraph has been deleted. METHODOLOGIES AND ASSUMPTIONS 7. The methodology and assumptions for classifying the equity content of hybrid capital instruments with step-ups, issuer call options, or replacement provisions into either "high," "intermediate," or "minimal" vary by sectors as below. 8. Under our criteria, we define the length of time to a step-up or a call option as the period from the issuance date, not from the assessment date. 9. For a hybrid capital instrument to achieve an "intermediate" or "high" equity content designation, it must be consistent with the other criteria outlined in the related criteria articles, in addition to the assessment of step-ups, call options, and replacement features outlined in this article. Banks 10. This paragraph has been deleted. 11. This paragraph has been deleted. [Table 1 has been deleted.] Prudentially regulated insurers 12. For prudentially regulated insurers, table 2 summarizes the methodology and assumptions for classifying the equity content of hybrid capital instrument with step-ups, issuer call options, or a replacement provision. Prudentially regulated insurers are companies (or groups of companies) that are subject to regulation that includes the adequacy of their capitalization. The criteria summarized in table 2 below can be also found in

"Hybrid Capital Handbook: September 2008 Edition," published Sept. 15, 2008, table 6. 13. Insurance entities that are not prudentially regulated insurers are subject to the criteria in "Other issuers," below. Table 2 Criteria For Prudentially Regulated Insurers HYBRID NATURE EQUITY CONTENT CLASSIFICATION Both moderate step-up and call option before year five "Minimal" (even with legally binding replacement capital covenant). Moderate step-up at year five or later but before year 10 (regardless of non-call period) "Intermediate" possible only with legally binding replacement capital covenant. Moderate step-up at year 10 or later (regardless of non-call period) "Intermediate" possible without any replacement language if there is no clause to allow the issuer to call before year five. Immaterial step-up (i.e. 25 basis points or less, regardless of step-up timing) or no step-up "Intermediate" possible without any replacement language if there is no clause to allow the issuer to call before year five. 14. In table 2, a "moderate step-up" means a step-up of 26-100 basis points for issuers assigned an ICR of 'BBB-' or higher, or of 26-200 basis points for issuers assigned an ICR of 'BB+' or lower. When market spreads rise dramatically, a variant to the definition of a moderate step-up may be accepted where it is explicitly accepted by insurance regulators. In these circumstances, a step-up equivalent to no more than 50% of the original credit spread is viewed as "moderate," subject to a cap of 200 basis points. Other issuers 15. For other issuers such as industrial corporates, table 3 summarizes the methodology and assumptions for classifying the equity content of hybrid capital instruments with step-ups, issuer call options, or replacement provisions. 16. In table 3, a "moderate step-up" means a step-up of 26-100 basis points for issuers assigned an ICR of 'BBB-' or higher, or of 26-200 basis points for issuers assigned an ICR of 'BB+' or lower, or any equivalent mechanism. Table 3 Criteria For Other Issuers HYBRID NATURE EQUITY CONTENT CLASSIFICATION Call option before year five "Minimal" (even without any step-up and with legally binding replacement capital covenant). Both moderate step-up and call option at year five or later but before year 10 Not "high." "Intermediate" possible only with legally binding replacement capital covenant. Moderate step-up at year 10 or later and call option at year five or later Not "high." "Intermediate" possible 1) with legally binding replacement capital covenant that is consistent with the criteria in "Methodology And Assumptions: Assigning Equity Content To Hybrid Capital Instruments Issued By Corporate Entities And Other Issuers Not Subject To Prudential Regulation," Jan. 16, 2018 or 2) with an intent-based replacement language in countries, such as Japan, where legally binding replacement capital covenant is impracticable. Immaterial step-up (i.e. 25 basis points or less, regardless of step-up timing) or no step-up, and no call option before year five "Intermediate" or "high" possible without any replacement language. 17. The criteria described in this article do not assess hybrid capital instruments issued by leveraged buyout companies. Please see "The Treatment Of Non-Common Equity Financing In Nonfinancial Corporate Entities," published April 29, 2014. APPENDIX A: FREQUENTLY ASKED QUESTIONS Question 1: Where an existing hybrid capital instrument documentation includes a clause that gives the issuer the right to call the instrument in circumstances where the instrument loses "equity content" due to a downgrade of the issuer's credit rating, can an undertaking--provided by the issuer and notified to the hybrid securityholders--not to exercise that call option sufficiently mitigate the risks created by the presence of that call option, and enable the hybrid instrument to achieve better than minimal equity content? 18. Potentially yes for existing hybrids if the rating committee's analysis, informed by legal analysis, is that: the undertaking is an unconditional and irrevocable legally binding obligation on the part of the issuer not to exercise the rating-driven call option embedded in its hybrid documentation (and where the right to modify is sufficiently limited and no wider than the right to modify any other material term of the hybrid under their original terms and conditions), and the risk that an issuer would breach or seek to modify their undertaking is remote. 19. In addition, for such an undertaking to enable an instrument to qualify for intermediate or high equity content, all other features of the hybrid must be consistent with such equity content categories, the undertaking must be made public, and the issuer's objective in providing the undertaking must be to neutralize the call option that we consider to be inconsistent with our concepts of permanence and loss absorption commensurate with intermediate equity content. (We expressed this in our Oct. 27, 2015, announcement ("Standard & Poor's Affirms Various Ratings Following Review Of Corporate Hybrid Equity," Oct. 27, 2015) that certain instruments had been reclassified as having minimal instead of intermediate equity content.) 20. Unlike replacement capital covenants (RCC)--which to be effective under our hybrid capital criteria,

must be provided for the benefit of nonhybrid creditors and confer an obligation on the issuer to take a specific action (namely, issue a new replacement hybrid instrument)--the undertaking by contrast prevents (rather than requires) the issuer from taking a certain action--namely, exercising the call. The use of the undertaking could be consistent with intermediate equity content if the rating committee considers that the undertaking provides a clear and certain outcome that if the event triggering the call option were to arise, the issuer would not call the hybrid and the three other conditions described in the paragraph 19 are also met. This criteria interpretation applies to hybrid capital instruments issued before Oct. 27, 2015. (noting that we clarified publicly our views of call options linked to rating downgrades on that date and that the inclusion of these calls following our clarification would give rise to questions regarding management intent). 21. We also note that if an issuer were to breach its undertaking (or to the extent it is able to modify that undertaking seeks to do so) our criteria, "Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers," published on Nov. 13, 2012, would apply. In that case, we would likely lower our ratings on an issuer and reclassify its other hybrid capital as minimal equity content due to our expectation that management does not intend to have those hybrid instruments act as a layer of loss-absorbing protection for its senior creditors. Question 2: If given the prevailing interest rate environment, a step-up combined with a coupon reset from fixed to floating would significantly lower the interest cost of a hybrid instrument and, thus, would create little economic incentive to call the issue, can an instrument with a step-up clause receive "intermediate" equity content if there is no legally binding replacement capital covenant? 22. The criteria views call provisions that are combined with material step-ups as specifically designed to motivate calling of the issue to avoid the step-up. For this reason, the criteria looks for replacement language such as RCCs when there is a material step-up, as discussed earlier in this criteria article. Without such an RCC, an instrument would receive "minimal" equity content. However, in a situation when the interest rate environment is such (and is expected to remain such for the near future) that the step-up combined with a change from fixed to floating interest rates, actually lowers the rate at which a security accrues interest, the motivation for calling the issue to avoid the step-up disappears. In effect, these specific instruments no longer have a step-up feature. 23. This situation could be considered equivalent to that of a security with an immaterial step-up or no step-up when the call date is close enough that the committee can feel reasonably comfortable about the potential evolution of interest rates, taking account of our views on the interest rate environment. In addition, this analysis would only apply when the step-up is no higher than 100 basis points (bps) as higher step-ups are not considered to be moderate under our criteria and could signal a lower willingness to maintain the instrument, at least, at inception. 24. Therefore, instruments that comply with all of the five conditions below could be assigned intermediate equity content, provided that there is a sufficiently long time to maturity after the coupon reset date (in line with the residual maturities in "Hybrid Capital Handbook: September 2008 Edition," Sept. 15, 2008): The call date is within 12 months; At the time of issuance of the instrument, it received either "high" or "intermediate" equity content under our criteria; The step-up is not higher than 100 bps (that is, consistent with what would be considered a moderate step-up) Under our formal expectations, interest rates will remain at a level such that the rate reset as estimated by the rating committee will imply a lower interest cost; and The committee expects that the issue will not be redeemed, based on the intention of the issuer as expressed in our discussions with the issuer and our assessment of the issuer's financial policy. 25. All five conditions must apply for a rating committee to determine that there is no longer a step-up. For the instrument to be classified as "intermediate" equity content, our expectations would be that the instrument will not be redeemed based on discussions with the issuer and our assessment of the issuer's financial policy, and that the servicing cost will decline at the reset date. If the instrument were later to be redeemed at the step-up date, this could have an impact on our overall assessment of the issuer's creditworthiness including its financial policy.

REVISIONS AND UPDATES We originally published this article on Oct. 18, 2012. Changes introduced after original publication: We republished this article on Oct. 22, 2012, to (i) clarify our criteria in respect of immaterial step-ups as described in table 2 and for certain types of call options as discussed in paragraph 3 and (ii) to update criteria references. We republished this article on Nov. 13, 2015, to add frequently asked questions, currently in Appendix A. On Sept. 28, 2016, as a result of our annual review of the criteria, we updated the

contact information and deleted paragraph 6, which was related to the initial publication of our criteria and no longer relevant. On Sept. 28, 2017, as a result of our annual review of the criteria, we deleted paragraphs 10 and 11 and table 1 because they were superseded by the criteria "Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions," published Jan. 29, 2015. For the same reason, we updated paragraphs 3 and 5 of the criteria. We also updated paragraph 13 to clarify criteria application for all insurance entities that are not prudentially regulated insurers. On Jan. 16, 2018, we published "Methodology And Assumptions: Assigning Equity Content To Hybrid Capital Instruments Issued by Corporate Entities And Other Issuers Not Subject To Prudential Regulation," which supersedes references to "high" equity content in these criteria. On March 1, 2018, we republished this article to update the criteria reference in table 3 to "Methodology And Assumptions: Assigning Equity Content To Hybrid Capital Instruments Issued by Corporate Entities And Other Issuers Not Subject To Prudential Regulation," published on Jan. 16, 2018. Following our periodic review completed on Sept. 20, 2018, we updated the contact information. RELATED CRITERIA AND RESEARCH Related Criteria Methodology And Assumptions: Assigning Equity Content To Hybrid Capital Instruments Issued by Corporate Entities And Other Issuers Not Subject To Prudential Regulation, Jan. 16, 2018 Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015 The Treatment Of Non-Common Equity Financing In Nonfinancial Corporate Entities, April 29, 2014 Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012 Principles Of Credit Ratings, Feb. 16, 2011 Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008 Feasibility Of Replacement Capital Covenants Under Japan's Legal Framework, July 3, 2007 These criteria represent the specific application of fundamental principles that define credit risk and ratings opinions. Their use is determined by issuer- or issue-specific attributes as well as Standard & Poor's Ratings Services' assessment of the credit and, if applicable, structural risks for a given issuer or issue rating. Methodology and assumptions may change from time to time as a result of market and economic conditions, issuer- or issue-specific factors, or new empirical evidence that would affect our credit judgment.