Article Title: ARCHIVE | General Criteria: Ratings Above The Sovereign: Foreign Currency Rating Criteria Update Data: (Editor's note: This criteria article has been superceded by the article titled "Methodology: Criteria For Determining Transfer And Convertibility Assessments," published May 18, 2009.) Standard & Poor's Ratings Services has conducted an extensive study of sovereign default and country stress scenarios, focusing on cases from the late 1990s through the present. As discussed in a companion criteria piece (see "Ratings Associated With Risk Of Foreign Exchange Controls Raised In 27 Countries," RatingsDirect, Nov. 3, 2005), the study provided evidence that the use and impact of exchange controls have diminished. Based upon that evidence, Standard & Poor's raised its transfer and convertibility risk assessment (T&C; assessment) ratings on 27 countries on Nov. 3, 2005. In order to determine a nonsovereign issuer's foreign currency rating, Standard & Poor's first determines the issuer local currency rating—which reflects Standard & Poor's opinion of that entity's willingness and ability to service its financial obligations in both local and foreign currency and in the absence of restrictions on the entity's access to foreign exchange needed to service debt. Standard & Poor's next factors in the relevant T&C; assessment to arrive at the foreign currency rating, which is usually the lower of (a) the issuer local currency rating, or (b) the T&C; assessment. However, other forms of sovereign risk (besides T&C; risk) may constrain the foreign currency rating. Issuer Foreign Currency Ratings Can Exceed The Sovereign Foreign Currency Rating When Standard & Poor's rates an issuer or issue above a sovereign, we are expressing the view that the entity's willingness and ability to service debt is superior to that of the sovereign and, ultimately, that if there is a sovereign default there is a measurable probability that the issuer or issue will not default. Therefore, issuers rated above the sovereign's foreign (or local) currency rating have operational and financial flexibility sufficient to deal with the sovereign indirect risk, even as it intensifies in a more difficult environment. For example, strong exporters are the type of issuer most likely to have foreign currency ratings above that of the sovereign, while banks are the least likely. Entities that demonstrate sufficient ability to mitigate country risk can have a foreign currency rating up to the level of the T&C; assessment. Issuer Foreign Currency Ratings Can Exceed The Sovereign T&C; Assessment The vast majority of issuer foreign currency ratings are expected to remain at or below the sovereign T&C; assessment. Indeed, it is unusual for an entity's local currency rating to exceed the level of the sovereign T&C; assessment. However, certain issuers judged very well insulated from both direct and indirect sovereign risk may achieve foreign currency ratings that exceed the sovereign T&C; assessment. These entities will tend to be those that demonstrated sufficient geographic diversification to repay foreign debt with cash flow generated by offshore subsidiaries or through implicit foreign parent or strong exporters, with moderate leverage, strong free-cash-flow generation, modest debt maturity schedules, and limited reliance on sales to domestic markets. Companies can be considered for foreign currency ratings above the sovereign T&C; assessment based upon a combination of one or more of the following, where the relative strength of the combination of factors will determine how much elevation is possible above the sovereign foreign currency rating: Low annual foreign exchange needs in terms of foreign debt service, imported raw materials, and imported capital goods compared to annual generation of foreign currency; Strong free-cash-flow generation that is not reliant on external financing in a sovereign stress scenario; A moderate debt maturity schedule; A high ratio of exports to total sales; Strong incentives to continue paying foreign debt through a sovereign stress scenario, judged by the degree of integration in global trading system and capital markets (i.e., geographical diversification of customer base, foreign debt and/or equity registrations, and track-record in previous macro crises, if relevant); A significant proportion of cash flow generated through operations located offshore; Substantial access to offshore accounts, to which access is expected to continue through a sovereign stress scenario; and Anticipated parent support in case of exchange controls. Financial Institutions The revised T&C; assessments generally have minimal effect on the credit profile of financial institutions. Banks and other financial institutions are regulated and subject to sovereign powers other than transfer and convertibility. These powers are typically inscribed in banking law. Equally important, financial institutions are directly vulnerable to the economic and political deterioration that typically accompanies a sovereign default, whether it be in foreign or local currency. Consequently, the collective credit profile of financial institutions operating in a country is closely linked with the credit profile of the sovereign. Government-Supported entities (GSEs) GSE ratings are generally not affected by the revised T&C;

assessments. Standard & Poor's assumes that GSEs would be harshly affected in the case of a sovereign default, such that it would be unusual for such entities to be servicing their foreign debt at a time when the sovereign is not. Standard & Poor's also view the creditworthiness of GSEs as highly correlated with that of the sovereign. How Standard & Poor's Factors Sovereign Or Country Risk Into Nonsovereign Ratings Standard & Poor's expressly factors country risk into all nonsovereign ratings. For example, the corporate, bank, and sovereign rating teams together develop sector-relevant, country-specific risk assessments. These assessments are then used to guide the determination of entity ratings. In some countries (e.g., Russia), country risk is considered quite high compared to the level of the sovereign rating. Therefore, most private sector ratings in Russia currently remain well below the sovereign ratings. Standard & Poor's uses increasingly more difficult country-specific stress tests—involving economic downturn, depreciation, and rising interest rates and inflation—as issuer and issue ratings further above the sovereign rating are assigned. The higher-rated nonsovereign issuer or issue has characteristics suggesting it is better equipped to deal with stress than the sovereign and other lower-rated credits. Some of the main country risk factors that we analyze are listed below. The risk factors most often lead to default when nonsovereigns are highly leveraged, have a poor debt structure, maintain unhedged exchange rate exposure, depend heavily upon increasingly expensive imports, rely on government sales or subsidies, are regulated, and/or sell products for which the demand is highly elastic. Industrials/utilities/projects Currency depreciation (a mismatched local currency revenue base vs. foreign debt); relative dependence on imports (which may become expensive or less available in a sovereign stress situation); regulatory risk, including potential price controls such as utility tariff freezes; potential sudden contraction of liquidity due to lack of market access or freezing of bank deposits; relative volatility of the business cycle, potential GDP contraction, and reduced domestic demand; delayed payments from domestic customers, including sovereigns themselves or sovereign owned entities; and hikes in export tariffs. Financial institutions Direct exposure to sovereign default risk due to holdings of government securities; sharply diminished asset quality due to direct lending exposure to a defaulted or distressed sovereign and weakened corporate, commercial, and individual credit quality; reduced liquidity due to capital flight; freezing of bank deposits; currency mismatch between liabilities and credit exposures.