Article Title: ARCHIVE | Criteria | Corporates | General: Harmonized Standards For Minimum Term Of Hybrid Capital Issues Data: On Jan. 11, 2007, Standard & Poor's Ratings Services issued a request for comments regarding a contemplated harmonization of its criteria for assessing the equity credit of hybrid capital issues. Having considered responses from a number of market participants, we have now decided to implement the refinement to our criteria as proposed. Specifically, we have decided to adopt a single maturity standard that will apply to all investment-grade financial institutions, insurance companies, and corporates, in all regions. Under this standard, we will require a hybrid capital issue to have a remaining term of at least 20 years to receive our "intermediate" equity classification. We continue to view undated (i.e., perpetual) and very long-dated (i.e., more than 20 years) securities as superior instruments from the perspective of equity content. But, as a practical matter, we believe a remaining life of 20 years is long enough to view the issue as being sufficiently permanent to warrant our "intermediate" equity credit classification when other issue features are consistent with this designation. In the case of financial institutions and insurance companies, we will not use the remaining term of the issue-–beyond 20 years--to differentiate between "intermediate-strong" and "intermediate-adequate" issues. Rather, these distinctions will continue to reflect other issue features, such as the flexibility of payments. In the future, "intermediate" issues with initial maturities of greater than 20 years that subsequently fall to less than 20 years of remaining maturity will be reduced to "minimal" equity credit at that point, and as such will no longer receive any formal equity treatment in our calculation of financial ratios. (There will not be any amortization period.) Nevertheless, as a qualitative matter, we will still be sensitive to the benefits afforded by such issues-–for example, the deferability of ongoing payments-–even where the "intermediate" equity credit determination is not warranted since the condition of a long remaining term is no longer met. In conjunction with this harmonization, we will also begin to treat all so-called "scheduled maturities" (where the issuer is required to undertake efforts to refinance the issue) as effective maturities, even where accompanied by legally binding replacement provisions. The latter indeed do not mitigate scheduled maturities, which still expose the issuer to a sharp increase in financing costs if its credit spreads have widened. We are not changing our view of call provisions. The ability to call always gives reason for pause. Nonetheless, where an issue contains a call provision, the issuer has the option to redeem the issue but no obligation to do so. As long as we believe the issuer intends either to keep the issue outstanding or refinance it with the proceeds of another issue warranting comparable equity credit, we do not view the call date as an effective maturity. Still, we would question the rationale for a call date less than five years after issuance. Similarly, we are not changing our view of instruments with call provisions coupled with step-ups. Step-ups are specifically designed to motivate the calling of the issue. They clearly signal to investors the issuer's initial intention to refinance the issue in time to avoid the step-up. Yet, as long as the extent of the step-up is moderate (100 basis points being the regulatory limit as well as the norm presently in most markets in the current interest rate environment), the issuer could still choose to keep the issue in place and not refinance it, if for example, the issuer's financial position or general capital market conditions made it undesirable for the issuer to seek to tap the capital markets. We would be concerned in such a scenario about the possibility of the issuer facing a backlash among investors who had not appropriately taken account of the so-called extension risk. Still, we do not necessarily view the time of the call and step-up as an effective maturity. In the regulated financial services area, the call is typically subject to regulatory approval: from the perspective of analyzing the equity content of the instrument, this neutralizes the potentially weakening effect of the call. For issuers that are not closely regulated where matters of capital are concerned, if there is a call and step-up between five and 10 years of the date of issuance, we require there to be a satisfactory, legally binding replacement covenant to address the risk of refinancing with a less equity-like security, in the case of "intermediate" issues. As a practical matter, we take a mix of 50% common equity and 50% debt to be an acceptable alternative to a refinancing with 100% hybrid capital. We do not consider less than full replacement by another hybrid capital issue to be adequate. Where the call and step-up are at least 10 years from the time of issuance, to achieve "intermediate" equity treatment it ordinarily suffices that there be a formal statement of management's intent regarding replacement--even though we appreciate that companies' financial policies can vary over time, future capital market conditions could limit the ability to issue specific types of securities, and legal enforcement is dubious. In the case of regulated entities, we don't have specific requirements for replacement language or formal statements of managements' intentions. Rather, we rely on our understanding of the regulator's intentions, and the need for issuers to maintain adequate capital. We pay close attention to the terms of the replacement covenant, even where a legally binding replacement capital covenant is not specifically needed under our criteria, since we believe the replacement covenant can act as a "roadmap" for management's future actions. Thus, if a replacement covenant expires before the maturity is reached, or if the covenant, beginning at some point, allows for only partial capital replacement (as described in the above paragraph), we could well view those points in time as defining the effective maturity date. For speculative-grade issuers, where debt maturities are typically far shorter than with investment-grade credits--and where, more broadly, the scope of our analysis necessarily extends a lesser number of years--we will not apply the same standard. That is, in this area hybrid capital issues with maturities shorter that 20 years can still achieve the "intermediate" equity credit designation, assuming other features make this appropriate. We do not believe it would be helpful at this time to promulgate a single alternative standard for speculative-grade issuers, given the wide range of circumstances among such issuers–-for example, between those that are near-investment-grade and those that face a significant risk of default within a few quarters. If and when the market for speculative-grade hybrid capital issues develops further, we may be able to offer more guidance, but for the time being our analysis will be on a case-by-case basis. To provide for an orderly transition to our new approach and to avoid disrupting the market, this criteria harmonization will not be applied to existing, shorter-term issues or to any pending issue where we had already reviewed the terms. The criteria modifications discussed here will not result in any changes in existing issue or issuer ratings. Through our discussions with issuers who have made significant use of hybrid capital, it will be important for us to gain an understanding of how our criteria change might affect future financing plans. For a general discussion of our hybrid capital criteria, see " Equity Credit for Bank and Insurance Hybrid Capital, a Global Perspective," published Feb. 16, 2006, on RatingsDirect, and "Criteria: Equity Credit for Corporate Hybrid Securities," published May 8, 2006. Standard & Poor's Ratings Services will hold a telephone conference call on Wednesday, Feb. 21, 2007, at 11:00 a.m. ET to discuss its harmonization of the minimum term of hybrid capital issues and related matters. The live call-in number for U.S. investors is 1-210-839-8781, and for European callers is 44-20-7943-5370. The Conference ID is 3924759 and the passcode is SANDP.