Article Title: ARCHIVE | Criteria | Corporates | General: Bank Loan Rating Criteria in Singapore Data: Standard & Poor's has expanded its bank loan rating (BLR) service to the syndicated bank loan market in Singapore, adding to its growing list of such ratings in the U.S., Europe, and the Asia-Pacific. As of June 30, 1999, Standard & Poor's has assigned 1,053 BLRs to loan facilities totaling US$620 billion in the worldwide syndication market. In the Asia-Pacific, Standard & Poor's introduced BLRs in Australasia and Hong Kong in the past 12 months and, to-date, has assigned 14 BLRs to loan facilities totaling US$7.2 billion. BLRs are designed specifically for the syndicated bank loan market. A BLR goes beyond a traditional corporate credit rating (CCR) assigned by Standard & Poor's. A CCR represents Standard & Poor's opinion on a company's overall ability to meet its financial obligations in a timely manner and, as such, captures the likelihood of default. A BLR, however, captures both the borrower's default risk as well as the prospects of recovery in the event of default. BLRs are aimed at enhancing the liquidity and transparency of the bank loan market. For borrowers, a rating on a bank loan will help broaden their access to credit providers, and validate the extent of collateral protection and the structure of the loan. Arrangers will find BLRs valuable in accessing a wider group of potential lenders and investors for their syndication, as well as improving secondary-market liquidity. In general, the extent to which a lender is likely to ultimately recover principal and interest following default will depend on several factors. These factors include the security available to the lenders, the priority of the lenders' claim, covenants of the loan agreement, and other structural features that may mitigate the loss suffered by lenders. In some cases, where a loan is well secured and full recovery of principal and interest is likely in times of default, the loan may be rated up to four notches above the CCR of the borrower. For investment-grade borrowers, the probability of default is lower, and less security and other post-default protection are usually provided. For these reasons, bank loans of investment-grade borrowers usually are notched up from their CCRs to a lesser extent than loans of speculative-grade borrowers. In cases where security protection is sufficiently low, a borrower may have a BLR equal to its CCR. An unsecured loan that is effectively subordinated to other secured debt may be rated below the CCR. Rating Methodology Determining Default Risk. Before assigning a BLR, Standard & Poor's first assesses the borrower's general default risk by assigning a CCR. This CCR is based on an analysis of the company's business strength and level of financial risk. In assessing business strength, Standard & Poor's evaluates factors such as industry characteristics, the company's market position, cost position, operating efficiency, and management. In assessing financial risk, consideration is given to factors such as the company's financial policy, profitability, capital structure, cash flow protection, and financial flexibility. A meeting between Standard & Poor's analysts and the company's management is an integral part of the CCR process. At the meeting, the management team presents the company's key operating and financial plans, policies, and other credit factors, that have an impact on the rating. Once a CCR is assigned, the analysis then turns to the recovery aspects of the specific bank loan facility. Assessing Recovery Prospects. In assessing recovery prospects, Standard & Poor's reviews all relevant loan agreements and security documents to determine the legal structure, ranking, nature, and level of any security that supports the loan facility. Standard & Poor's also reviews legal opinions on the loan facility and security to ensure that, from a legal perspective, the loan and the security are enforceable and unlikely to face a successful legal challenge. Aspects of the legal environment on the effectiveness of enforcing collateral and the length of time required for recovery also are important considerations in assigning BLRs. In Singapore, there is a high degree of clarity and transparency in the legal system and judicial process, and collateral can be readily enforced so long as the lender's security interests are perfected. In the case of a loan secured by assets situated in Singapore, the lender legally can take control and dispose of the assets following a loan default. Unless the claim is contested, a summary court judgment could be obtained against the borrower within a couple of months. Speed of subsequent recovery then is subject to the selling process of the collateral, which may be affected by the nature of the assets as well as market conditions. While the analysis does not attempt to specifically predict the ultimate outcome of any bankruptcy proceeding, the recovery risk profile is established by assessing the characteristics of various asset types used as security, and subjecting the security values to stress testing under different post-default scenarios. A first-ranking security position, together with high levels of security coverage, can increase confidence that asset values will cover sufficiently the secured debt, even under adverse conditions. Collateral

Analysis: the Key Factor in BLR Collateral analysis involves assessing the values of pledged assets under a distressed scenario, and the expected time required to realize the assets and fully recover all amounts owed to the lender. The value of any security relative to the amount owed provides an indicator of how well the lender is secured. Security can consist of discrete assets (such as real estate, marketable securities, or vehicles) that have value independent of the business, or it may be the operating assets of the enterprise, where the value is a function of the business as a going concern. If the security consists of discrete assets, a liquidation value or discrete asset value analysis is conducted to determine the value of the assets that constitute the security. If, on the other hand, the security consists of the operating assets of the business unit that will remain as a going concern, an enterprise value analysis is conducted. Discrete Asset Value Analysis. Standard & Poor's has rated loans backed by a diverse range of assets, from real estate and forest plantations to drilling rigs and oil and gas reserves. Important considerations include the type and amount of security, whether its value is objectively verifiable and likely to hold up under various post-default scenarios, and any legal issues on perfecting and enforcing the security interest. The analytical starting point is the current market value of the assets. Several methods are used for this purpose, including recent sales of comparable assets and replacement cost, adjusted to reflect age and technology of the asset being valued. The potential of the assets to retain value over time is critical. Therefore, collateral is judged according to factors such as volatility, liquidity, special-purpose nature, and the correlation of its value with the health of the borrower's business. Market value is key, and, therefore, independent appraisals may be required. Independent appraisals, however, may not factor in, or to a very limited extent may factor in, the cyclical nature of the industry or cash flow sensitivities under distressed scenarios. Accordingly, an assessment is made of the assumptions and methodology of the valuation, the potential volatility of the industry cycle within the loan term, the liquidity of the assets, and the degree of severity of value deterioration in distressed scenarios. Costs expected to be incurred in realizing asset values also are considered in the analysis. These costs include legal and other costs of enforcing the security, costs incurred to put the asset in a saleable condition, costs of finding a buyer, and costs of completing the sale and ultimately receiving the sale proceeds. In Singapore, costs of enforcing a perfected mortgage over real estate as well as selling the real estate through a tender or auction are relatively minimal. However, depending on how urgently the sale is to be effected, forced-sale discounts off the prevailing market value can be significant. Enterprise Value Analysis. Enterprise value is established using a market capitalization approach. The company's level of earnings before interest, taxes, depreciation, and amortization (EBITDA) at the hypothetical point of default is multiplied by a representative cash flow multiple. EBITDA is projected to reflect the decline in cash flow that would normally accompany default. The analysis simulates alternative default scenarios. A borrower with a respectable business position, but a risky financial profile, would be most likely to default as a result of its high leverage, rather than a decline in its business strength. Such an entity is likely to be viable over the longer term if more appropriately capitalized. By contrast, a company with a weak business position, but no financial risk, most likely would default because of a decline in its business as a result of factors such as increased competition, changes in technology, or an economic downturn. The impairment of its business associated with the default scenario could seriously affect its cash flows and market value. Some companies could have both a weak business position and a weak financial profile, with the result that default might stem from either a decline in business, a lack of finances, or a combination of these two factors. In such situations, the analysis would attempt to determine the appropriate default scenario, based on company-specific information and industry fundamentals. The multiple employed in valuation is derived from the cash flow multiple of the borrower's peer group. This multiple is adjusted to incorporate the depressing effect that a liquidation scenario can have on asset value. A multiple of five times (x) is representative of many industries over time. For highly cyclical companies, the multiple is refined to account for cyclical variability. In a default scenario, the value of any priority claims, such as mortgage debentures, product liabilities, or environmental liabilities, is deducted from the enterprise value and reduces the residual available for repayment of the bank loan facility. Similarly, the value of other existing higher-ranking secured debt, such as secured lease finance or secured subsidiary debt, is deducted from the enterprise value. In some instances, trade creditors have a priority interest in merchandise inventory, and, hence, the secured bank loan lender would have a lower priority interest in the inventory. The analysis also assumes that any revolving portion of a bank facility is fully drawn at the time of default. Other Rating Factors Loan Maturity Profile and Amortization. Greater security protection may be afforded to shorter-term loans than longer-term ones. The ability to rely on asset valuations tends to diminish over a longer-time span; hence, the benefit that can be given for asset-based recovery potential is greater for shorter-term loans. For certain assets (for example, oil rigs, aircraft, and telecom equipment), there may be concern over potential loss of asset values in the longer term, as a result of factors such as uncertainty in outlook for product markets, risk of technological obsolescence, or changes in regulatory conditions. Amortization of a loan reduces the amount of debt that has to be covered by the value of the assets and thereby improves loan-to-value coverage over time (unless the borrower is allowed to reduce the amount of security pledged in tandem). Thus, one tranche of a loan facility could be rated higher than another tranche, if the former tranche amortizes more quickly or is significantly shorter in tenor. Standard & Poor's reviews the adequacy of insurance cover in cases where asset values can be diminished by the event that causes the default; for example, contamination of stock, or destruction of plant and equipment by fire or other disaster. Covenants. In the absence of collateral, covenants alone seldom result in superior protection for lenders. In fact, a company's default risk may be heightened by covenants that place it at the mercy of its bankers. Nonetheless, a strong covenant package is an important part of a secured bank loan facility. Covenants can play a significant role in protecting creditors of a subsidiary of another, perhaps, riskier company. Tight covenants also can help prevent the borrower's assets from being removed by the parent company. For noninvestment-grade credits, a covenant package typically should include at least the following: Limitations on incurring additional debt; Maintenance of fixed-charge covers at some specified levels; Restrictions on dividends and distributions to junior classes of debt holders and equity holders; Limitations on liens and further security being assigned; and Restrictions on the sale of assets. Legal Considerations. The assessment and weight given to the security value in the rating process depends on the priority and type of charge over the assets. A first registered mortgage or charge over the fixed assets of a company will give the lender significantly more comfort than other types of security or charges, and therefore enhances the post-default recovery. In Singapore, mortgages over real estate must be registered with the Registry of Land Titles and Deeds, in addition to mandatory filings with the Registry of Companies and Businesses. Lodgment determines the order of priority. Charges over other types of assets without such specific registration may entail greater uncertainty on ultimate recovery in times of default. Security interests lodged over intangible assets, such as patents and trade marks, are more difficult to value and assess. Further, some assets, such as vessels or merchandise inventory, may be easy to perfect and value, but hard to locate and recover at the time of loan default. Uncertainty about gaining possession of some or all of secured assets can be offset by providing additional security. Notching Criteria The extent to which a bank loan facility will be rated or notched above the CCR of the borrower depends on two factors: the degree of confidence with respect to full recovery of principal and interest owed, and the time it takes to realize the ultimate recovery. The ability of assets to retain value over time also is critical. In the worst case, Standard & Poor's would not give any credit to a payment that might be significantly delayed beyond 24 months. Also, the policy of credit enhancement based on ultimate recovery prospects does not apply unless 100% recovery can be reasonably expected. Table 1 systematically summarizes the notching factors for BLRs. Table 1 Ultimate Recovery Rating Criteria Framework ———TIME PERIOD FROM DEFAULT TO FULL RECOVERY——— CORPORATE CREDIT RATING LEVELS WITHIN 24 MONTHS WITHIN 6 MONTHS WITHIN 60 DAYS FOR 'BB' & 'B' RATING LEVELS Reasonably confident of full recovery of principal (over 1x collateral cover, after stress) +1 notch +1 or 2 notches +2 or 3 notches Highly confident of full recovery of principal (over 1.25x collateral cover, after worst-case stress) +2 notches +2 or 3 notches +3 or 4 notches Highly confident of recovering principal & interest (over 1.65x collateral cover, after worst-case stress) +3 notches +3 or 4 notches +4 notches FOR 'A' & 'BBB' RATING LEVELS Reasonably confident of full recovery of principal (over 1x collateral cover, after stress) +1 notch +1 notch +1 notch Highly confident of full recovery of principal (over 1.25x collateral cover, after worst-case stress) +1 notch +2 notches +2 notches Highly confident of recovering principal & interest (over 1.65x collateral cover, after worst-case stress) +2 notches +2 notches +2 or 3 notches With respect to short-term ratings, the importance of timeliness is paramount. Accordingly, there is no enhancement of short-term ratings based on ultimate recovery. Under Singapore law, a financially distressed company may be placed under judicial management to allow an otherwise viable business the opportunity to rehabilitate. During this time, a secured lender's right to enforce his collateral is stayed, although his priority of claim is fully preserved at all times, and the lender still can seek the court's consent to enforce his collateral. The time taken for a rehabilitation plan to be worked out, presented to the court for approval, and finally implemented is likely to be longer than 60 days. Hence, Standard & Poor's views the prospect of a secured lender recovering his loan fully within 60 days to be uncertain and unlikely to be reflected in a loan's rating. In contrast to well-secured bank loans, which may be rated higher than the borrower's CCR if the security provides adequate protection to lenders in a projected post-default scenario, subordinated debt or unsecured debt, whose repayment prospects are adversely affected by their relative position in the capital structure, may be notched down from the CCR.