Article Title: ARCHIVE | Criteria | Corporates | General: Identifying Rating Triggers and Other Contingent Calls on Liquidity Data: Standard & Poor's has been working on ways to identify for investors corporate exposure to contingent calls on liquidity. The concern regards any provision in financing or operating agreements, but particularly ratings triggers, that could cause a liquidity crisis. Without these provisions, a company that faces adversities may be able to stabilize itself and ultimately improve. Indeed, there are hundreds of non-investment grade companies that operate normally and finance normally—and, certainly, the majority of them are not expected to default. Yet, if, for example, certain lenders are allowed to demand repayment or terminate credit facilities merely upon a change to non-investment grade, the result could be a crisis that puts the company on the brink of default. (See "Playing Out the Credit Cliff Dynamic," published Dec. 12, 2001, on RatingsDirect. See below.) Standard & Poor's Survey As a first step, Standard & Poor's initiated a survey early in 2002 of investment-grade corporate entities in the U.S. and Europe—where ratings triggers are most prevalent. The text of the questionnaire follows: Standard & Poor's is conducting a survey of all investment-grade-rated corporate entities regarding any and all instruments that contain contingent requirements that could affect liquidity—be they acceleration, redemption, termination, exchange, or posting of collateral. In responding to this request for information about these, please be as comprehensive as possible. We are inquiring about all instruments with such provisions, whether financings --public, private, on- and off-balance sheet, securitizations, and those of affiliates-- or other contracts-- such as trading and derivatives contracts. (However, there is no need to include debt with pricing grids or event-risk covenants that merely call for a rate step-up.) Please list all such instruments—and, for each one, provide the following details: Type of instrument Face amount Specifics of the contingency (for example, rating downgrade—by which agency and to what level; 'material adverse change'; financial benchmark or ratio—how defined and to what level; share price change—to what level and for how long; corporate 'event'; etc.) Specifics of the consequence (for example, put in x days; termination of contract-- with payment/settlement in x days; inability to access line of credit; need to post collateral—how much and how soon; etc.) Potential follow-on consequences (for example, put of $x amount of some financing(s) leads to cross-acceleration of another financing). In addition, there are situations where possession of a credit rating of a particular level is a qualification to engage in certain business activities--or, at least, to do so without sundry requirements, such as having to post a surety bond. If this applies to your company, we ask you to include information on such situations too. Similar surveys will focus on companies elsewhere around the globe. Note that this inquiry is not limited to ratings triggers; rather, it attempts to comprehend similar provisions—such as equity price level triggers, 'material adverse change' clauses, and financial benchmark covenants—that can produce identical results. In today's environment, there is a much higher level of concern over banks' willingness to invoke 'MAC' clauses or refuse waivers if any covenant is breached. Preliminary Findings To date, Standard & Poor's has received responses from approximately three-fourths of the companies surveyed. The analytical staff was asked to sort the responding companies into three categories, to reflect the relative exposure. The key considerations were: how close is the company to trigger thresholds; how severe/immediate are the consequences; what amounts are involved—and how material are they in the context of the specific company. Additionally, companies might have contingency plans to address or mitigate the concerns. In this preliminary effort, very few companies were viewed as having a high degree of risk. Nonetheless, the perceived differences in risk supports the need for greater disclosure, additional consideration for incorporation in ratings, and greater advocacy for addressing this risk. Next Steps In the coming weeks, Standard & Poor's will continue to seek additional data. Apart from the companies that have yet to respond, follow-up requests will be needed in some cases where the data supplied was incomplete. More importantly, the preliminary assessments will be reviewed for consistency. And, with more experience should come greater clarity. The existence of multitude of trigger types, and nuances of each, rules out simple, standardized categorization, but risk differentiation will become more precise as cases are reviewed in detail. Standard & Poor's intends to publish its findings—that is, the individual company assessments, although the exact format has yet to be determined. In the interim, Standard & Poor's will notify the companies of its assessments. Presumably, some companies will want to address their high level of perceived risk by endeavoring to remove the troubling provisions from their financial arrangements.

There are companies that are already doing this. Their prospects for accomplishing this are improved by growing recognition on the part of lenders and other counterparties that triggers can backfire. Although a trigger may be intended to extricate a lender from a deteriorating credit, it may instead precipitate a bankruptcy that ensnares all parties. Of course, replacing a rating trigger with a financial benchmark of similar consequence accomplishes nothing! Rating Criteria While recognizing the value of tight covenants, Standard & Poor's has always viewed them as potentially problematic—since they increase default risk by placing the company at the mercy of their bankers. (See "Corporate Ratings Criteria," pages 28 and 76, on RatingsDirect.) Moreover, it does not reflect well on financial management of a firm if they countenance such risks! Generally, the perception of management as aggressiveness or imprudent is a negative rating factor. Accordingly, the impact on ratings from contingent liquidity provisions could be both direct and indirect. Standard & Poor's will consider additional ways to more explicitly incorporate contingent liquidity concerns in its credit ratings. In some cases, the analytical challenges are formidable, especially with respect to rating triggers. For one thing, there is a certain circularity to lowering a rating because of the risk you might lower that rating! Furthermore, in some cases, lowering the rating to reflect the added risk would not be commenting on the credit risk, but determining it. Consider an extreme case to illustrate the point: a company currently rated 'BBB-' introduces a rating trigger into debt of a substantial amount, allowing it to be put back to the company if the credit rating falls one notch, to non-investment grade. A downgrade would precipitate the very crisis that was the cause for concern. Another dilemma involves anticipating the possibility of other rating agencies tripping a ratings trigger. Standard &Poor;'s would not want to speculate about the potential of such outcomes, which could involve an agency taking a view contrary to Standard & Poor's own perception of the credit. Still, triggers do elevate default risk, and it would be appropriate if ratings could address this added risk. Two companies identical in every respect—except that one had put provisions in much of its debt with very tight triggers—certainly could not be considered equivalent credit risks! Footnote Standard & Poor's has never encouraged companies to utilize ratings-related triggers or covenants. In fact, we regularly have told companies that doing so was troubling to us—if for no other reason than its potential for embroiling Standard & Poor's in a company crisis. Now Standard & Poor's is considering a more active posture, one that encourages companies that have triggers to remove them or perhaps face a downgrade! On the other hand, Standard & Poor's has not shied away from changing a rating where that was deserved—even knowing full well that the rating action would trip ratings triggers. Standard & Poor's behaves responsibly and takes pains to communicate to the company well ahead of time its ratings vulnerability—and the need to anticipate liquidity contingency. But Standard & Poor's would not maintain a rating that was inconsistent with its credit judgment merely because the rated company would suffer the consequences. ("Corporate Ratings Criteria" is a permanent volume. The commentary, "Playing Out the Credit Cliff Dynamic," was published Dec. 12, 2001. Both are on RatingsDirect, Standard & Poor's Web-based credit analysis system. They can also be found on Standard & Poor's Web site, www.standardandpoors.com. Go to Resource Center; under Ratings Criteria, choose Corporate Finance.)