Article Title: ARCHIVE | Criteria | Corporates | General: Distressed Exchange Offers: Tantamount to Default Data: Editor's Note: This criteria article is no longer current. It was superseded by the article titled, "Rating Implications Of Exchange Offers And Similar Restructurings," published on Jan. 28, 2009. That article was then superseded by the article titled, "Rating Implications Of Exchange Offers And Similar Restructurings, Update," published May 12, 2009. From Standard & Poor's rating perspective, a distressed exchange offer recognizes, in effect, that the company will not meet all of its obligations as originally promised. The rating treatment is identical to a default on the specific debt issues involved--even though the investors, technically, accept the offer voluntarily and no legal default occurs. Accordingly, on consummation of such an offer, Standard & Poor's has been rating the affected issues 'D'. The corporate credit rating is usually 'SD' (which stands for selective default), since the company continues to honor its other obligations. In a distressed exchange offer, there exists the prospect that the company will not be willing or able to meet its debt service absent the restructuring involved in the exchange. Such offers are deemed "coercive" by virtue of the investor's contemplation that refusal to accept the offer may lead to an even worse alternative. To the extent that the company making the offer may face insolvency and bankruptcy, the investor could fare even worse by holding out for what was originally promised. Offers that merely reflect changes in debt trading values as a result of interest rate swings are not distressed offers. They have no bearing on credit quality at all. Similarly, opportunistic open-market purchases of securities that are trading poorly--for any reason--are not treated as defaults, whether the purchases are by the company itself or others. Standard & Poor's distinguishes between such purchases and exchange offers that formalize the company's stance regarding its obligations, tacitly reneging on the original promise. Whenever the terms of an offer are patently less than par value, it can be generally presumed that there is some coercive element at work. Why else would an investor accept such an offer? If, however, Standard & Poor's were to conclude that a given company was not in distress (i.e., that its prospects for continuing debt service were reasonably good), the offer would not be viewed as coercive, notwithstanding the investors' perspective. Of course, if there were a compensating feature that accounted for the lower offer, it might cast the deal in a different light. For example, a higher interest rate would be one potential offset. The offer to exchange for lower-risk securities, such as government bonds (or U.S. government bonds in exchange for another, less creditworthy government's bonds), could be similarly acceptable as a fair exchange relative to par. The situation following retirement of debt under an exchange offer is analogous to emergence from bankruptcy. The default ratings are reviewed and then raised to the level that accurately depicts future prospects for credit quality. Indeed, those prospects may be better for remaining debt than they were prior to the exchange offer, when the debt burden was that much larger.