Article Title: ARCHIVE | General Criteria: Guarantee Default: Assessing The Impact On The Guarantor's Issuer Credit Rating Data: (EDITOR'S NOTE: —This article is no longer effective after Aug. 7, 2020. Its contents were moved in their entirety into "S&P; Global Ratings Definitions" (see "Issuer Credit Ratings On Guarantors" and "Types Of Obligations" in "Appendix") without any change in substance. These contents are primarily definitional in nature and characterized as either fundamental attributes of our rating products, clarifications of the meanings of our ratings, or specific applications of our rating definitions.) 1. The purpose of this article is to explain S&P; Global Ratings' methodology for assessing when a guarantor's failure to honor a payment obligation under a guarantee, or any other third-party obligation, would constitute a default and how such a default would affect the guarantor's issuer credit rating. This article is related to our criteria article "Principles Of Credit Ratings," published on Feb. 16, 2011. SCOPE 2. This methodology applies to all guarantors and issuers of commitments to repay the obligation of a third party (including intragroup guarantees and letters of credit), both rated and not rated. It applies to any type of guarantors (governments, private or public sector institutions). SUMMARY 3. A guarantee, or any other third-party commitment, constitutes a financial obligation under S&P; Global Ratings' definition of an issuer credit rating (ICR), when: The payment obligation under the guarantee is legal, valid, binding, and unconditional; The amount of the payment due is fully determined; and The underlying obligation is a financial obligation. 4. When these conditions are met, a guarantor's failure to honor a payment under the guarantee would, in most cases, constitute a default that would lead to the lowering of the guarantor's ICR to 'SD' (selective default). The ICR would most likely be lowered to 'SD' rather than 'D' if the entity continues to honor its other direct and guaranteed financial obligations (for more information on the difference between 'SD' and 'D', see paragraph 11). 5. This paragraph has been deleted. 6. This paragraph has been deleted. METHODOLOGY 7. A guarantor's failure to honor its payment obligations according to the terms of the guarantee constitutes a default under S&P; Global Ratings' definition, if the guarantee meets the conditions listed in paragraph 8 below. This default then generally triggers a lowering of the guarantor's ICR to 'SD' or 'D.' There are two exceptions to this, which are listed in paragraph 9. 8. A guarantee, or any other third-party obligation, constitutes a financial obligation under S&P; Global Ratings' definition of an ICR when it meets the conditions listed below. First, the payment obligation is legal, valid, and binding. S&P; Global Ratings does not consider comfort letters or support letters to be legally binding obligations. In certain jurisdictions, a failure to observe material requirements regarding the issue of a guarantee may also result in making a guarantee nonvalid through a court ruling. This would be the case, for example, if the guarantor exceeded its authority in issuing the guarantee. Second, the payment obligation has become unconditional. The obligation to pay may be unconditional from the outset (for instance, in cases of payment on first demand) or may become unconditional once the conditions necessary for the payment to become due under the terms of the guarantee have been satisfied. For example, if the terms of a guarantee require a guarantor to pay the guaranteed obligation on receipt of a written demand by the trustee or bondholders, then the payment would become unconditional once this condition has been satisfied. Another example can be found in jurisdictions where government guarantees are guarantees of collection but not of payment. This means that the government is under no obligation to pay under the guarantee until a final judgment has been rendered stating that a sum is due on the underlying obligation and that this sum has not been paid. Third, the amount due under the guaranteed obligation is fully determined. The amount due under a guarantee may constitute the full amount of the underlying financial obligation or, in the case of a partial guarantee, a portion of it. The amount due may become fully determined after the closing of a liquidation procedure following a court ruling, for example in the case of sureties or statutory guarantees for which the payment obligation refers to the amount remaining due after the liquidation of the primary obligor's assets or on the dissolution of the primary obligor. Fourth, the underlying primary obligation is a financial obligation under S&P; Global Ratings' definition of an ICR. The following are not considered financial obligations for the purpose of these criteria: traditional insurance policy claims, settlements for a commercial dispute, employment benefit obligations, other labor obligations, leases, and vendor or supplier obligations. In contrast, derivatives and bond insurance policies are considered financial obligations. 9. There are two specific circumstances when nonpayment by a guarantor, or another third-party obligor, does not cause the guarantor's ICR to be lowered to 'SD': when there is a "bona fide commercial dispute," or when the failure to deliver timely payment on the guaranteed obligation does not reflect the guarantor's lack of willingness or ability to honor its financial obligation. In the case of a bona fide commercial dispute arising from the terms of a primary obligation or those of a guarantee, the ICR on the guarantor would not be lowered to 'SD' or 'D' as a result of nonpayment under the guarantee. The main reason for considering a commercial dispute as "bona fide" is not based on the validity of a legal claim or an expectation that a court would rule in favor of the guarantor. Instead, a commercial dispute would be considered as "bona fide" when the application of the terms of the guarantee or those of the underlying obligation, or their legality or validity, may be ambiguous and subject to differing interpretations. A possible example might be when a legal proceeding regarding a specific transaction has been engaged before the payment due date. The ICR on the guarantor would not be lowered to 'SD' if the failure to deliver timely payment on the guaranteed obligation does not reflect the guarantor's lack of willingness or ability to honor its financial obligation. It would be the case when all or most of the following characteristics are met: (i) the guaranteed obligation is not a capital market debt; (ii) it is part of guarantees for small amounts issued in large numbers as part of a public policy (for example, student loans or farmers loans); (iii) the payment delay is caused by administrative or operational reasons and is cured within the grace period contained in the guarantee documentation; and (iv) the obligation does not trigger the activation of cross-default clauses contained in the guarantor's other financial obligations. Related Clarifying Questions 10. Q: What are S&P; Global Ratings' criteria for rating guaranteed obligations? A: S&P; Global Ratings' guarantee criteria (listed in "Related Criteria And Research") explain the characteristics generally found in a guarantee where substitution of the guarantor's ICR is sought in place of the primary obligor's ICR. In effect, the creditworthiness of an obligation is shifted from that of the primary obligor to the guarantor. Timeliness of payment is a key component of the guarantee criteria. 11. Q: What is the impact of a missed payment on a guaranteed financial obligation on the guaranteed issue rating and on the ICR of the entity issuing the underlying obligation? A: In line with S&P; Global Ratings' ratings definitions, if a long-term guaranteed obligation is not paid on the due date, then the issue rating on the obligation is lowered to 'D', unless we believe that such payment will be made within five business days but not longer than the stated grace period if any. In the case of a short-term guaranteed obligation, the issue rating would be lowered to 'D' if payment is not made on the due date, unless the obligation has a grace period and we believe that payment will be made within that period (but no later than five days from the due date). At the same time, the ICR of the entity issuing the underlying obligation will be lowered to 'SD,' if S&P; Global Ratings believes that the obligor has selectively defaulted on a specific issue or class of obligations, but it will continue to meet its payment obligations on other issues or classes of obligations in a timely manner. It will be lowered to 'D' if S&P; Global Ratings believes that the default will be a general default and that the obligor will fail to pay all or substantially all of its obligations as they come due. 12. Q: What happens when the performance date of the guarantee is after the due date of the underlying obligation on which a payment is missed? A: If a guaranteed obligation meets the conditions listed in paragraph 8, the guarantor's ICR would be lowered to 'SD' only if payment is not made when it is due under the terms of the guarantee (and the guarantor continues to pay on other obligations). In other words, the timing of the lowering of the guarantor's rating to 'SD' would depend on the performance date of the guarantee, which can be after the due date of the underlying obligation (for example 30 days later or on the closure of a liquidation procedure). More precisely, if the guarantee documentation contains a grace period, then the guarantor's ICR would be lowered to 'SD' if the guarantee is not paid at the end of the grace period, in accordance with paragraph 8 (second bullet point). 13. Q: How long would the guarantor's ICR and the issue rating on a guaranteed obligation remain at 'SD' and 'D', respectively, in the event of a default of the guaranteed obligation? A: The rating on the guaranteed obligation would remain at 'D' until full payment of the obligation is made. The guarantor's ICR would remain at 'SD' until S&P; Global Ratings completes its review of the likelihood of the guarantor making full and timely payments on its other financial (unsecured and guaranteed) obligations. If the guaranteed obligation is subject to an exchange offer, S&P; Global Ratings' relevant criteria apply (see "Rating Implications Of Exchange Offers And Similar Restructurings, Update," published May 12, 2009). 14. Q: How does a guarantor's default on its payment obligation under a guarantee affect the issue ratings on the guarantor's other unsecured and guaranteed obligations? A: If a default on a guaranteed obligation leads to the lowering of the guarantor's ICR being to 'SD,' the guarantor's other obligations (other than those in default) would continue to be rated based on our forward-looking opinion of its willingness and ability to service those obligations. The level of the issue ratings on the other obligations would be based on the relevant criteria applicable to the guarantor, the nature of the obligations (senior or subordinated, for example), and, when applicable, the terms of the guarantees, for obligations guaranteed by the same guarantor. The issue rating would take into consideration the reasons that led to a default on the guaranteed obligation and their potential implications on the assessment of the guarantor's willingness and ability to timely service its other obligations. For instance, if the default on the guaranteed obligation is due to a general liquidity problem of the guarantor, or the default reflects the guarantor's weak credit culture or poor governance, then those factors would be factored into the issue ratings on the other, nondefaulted, obligations in line with S&P; Global Ratings' relevant criteria. If the default is due to an isolated reason that is unlikely to apply to any other rated obligations, then the guarantor's other obligations might be less affected or potentially even unaffected. 15. Q: Would the repudiation or the revocation of an irrevocable guarantee lead to the lowering of the guarantor's ICR to 'SD'? A: Repudiating an irrevocable guarantee on a financial obligation would result in the lowering of the guarantor's ICR to 'SD' or 'D' on the date of repudiation, unless the underlying obligation is defeased with sufficient funds so as to cover any ensuing need, or unless the compensation to the beneficiaries was clearly sufficient for the offer not to be considered as providing less value than the promise of the original obligation. The same would apply if an irrevocable guarantee is revoked and there is a realistic probability of the guarantee being called on the underlying obligation. In order to assess the probability of a guarantee being called, we apply the same guidelines as those in FAQ question 1 in the criteria article "Rating Implications Of Exchange Offers And Similar Restructurings, Update." REVISIONS AND UPDATES This article was originally published on May 11, 2012. Changes introduced after original publication: Following our periodic review completed on Jan. 27, 2017, we updated the "Related Criteria" list. Following our periodic review completed on Jan. 26, 2018, we updated the contact information. On March 6, 2019, we republished this criteria article to make nonmaterial changes to the contact information. On March 27, 2020, we republished this criteria article to make a nonmaterial change to a reference in "Related Research." RELATED CRITERIA AND RESEARCH Related Criteria Guarantee Criteria, Oct. 21, 2016 Post-Default Ratings Methodology: When Does S&P; Global Ratings Raise A Rating From 'D' Or 'SD'?, March 23, 2015 Timeliness Of Payments: Grace Periods, Guarantees, And Use Of 'D' And 'SD' Ratings, Oct. 24, 2013 Principles Of Credit Ratings, Feb. 16, 2011 Rating Implications Of Exchange Offers And Similar Restructurings, Update, May 12, 2009 Related Research S&P; Global Ratings Definitions, Sept. 18, 2019 These criteria represent the specific application of fundamental principles that define credit risk and ratings opinions. Their use is determined by issuer- or issue-specific attributes as well as Standard & Poor's Ratings Services' assessment of the credit and, if applicable, structural risks for a given issuer or issue rating. Methodology and assumptions may change from time to time as a result of market and economic conditions, issuer- or issue-specific factors, or new empirical evidence that would affect our credit judgment.