Article Title: ARCHIVE | General Criteria: Standard & Poor's To Explicitly Recognize Credit Stability As An Important Rating Factor Data: (EDITOR'S NOTE: —This article, published Oct. 15, 2008, has been superseded by the article titled "Methodology: Credit Stability Criteria," published May 3, 2010.) 1. Standard & Poor's Ratings Services is incorporating credit stability as an important factor in our rating opinions, as previously proposed (see "Request for Comment: Should S&P; Explicitly Recognize Credit Stability As An Important Rating Factor?" published July 16, 2008, on RatingsDirect). When assigning and monitoring ratings, we will consider whether we believe an issuer or security has a high likelihood of experiencing unusually large adverse changes in credit quality under conditions of moderate stress (for example, recessions of moderate severity, such as the U.S. recessions of 1960 and 1991 and the European recession of 1991 or appropriate sector-specific stress scenarios). In such cases, we would assign the issuer or security a lower rating than we would have otherwise. 2. We intend to implement the new approach over a period of about six months. It will apply to ratings on all types of issuers and securities and to both new and existing ratings. 3. We would like to thank those who responded to our request for comment (RFC). Defining An Unusually Large Decline In Credit Quality 4. The table shows the maximum projected deterioration under moderate stress conditions that we would associate with each rating level for time horizons of one year and three years. For example, we would not assign a rating of 'AA' where we believe the rating would likely fall below 'A' within one year under moderate stress conditions. The change is an extension of our previously announced initiative to include a what-if scenario analysis in rating reports. Maximum Projected Deterioration Associated With Rating Levels For One-Year And Three-Year Horizons Under Moderate Stress Conditions AAA AA A BBB BB B One year AA A BB B CCC D Three years BBB BB B CCC D D 5. These credit-quality transitions do not reflect our view of the expected degree of deterioration that rated issuers or securities could experience over the specified time horizons. Nor do they reflect the typical historical levels of deterioration among rated issuers and securities. In fact, instances of credit deterioration of this magnitude and speed have been relatively uncommon. The proposal does not imply that we believe that issuers or securities should become—or are likely to become—less stable. 6. Rather, the values in the table express a theoretical outer bound for the projected credit deterioration of any given issuer or security under specific, hypothetical stress scenarios. Actual experience likely will vary from the hypothetical scenarios, so the universe of rated issuers and securities (as well as sub-populations of the full universe) likely will display actual degrees of deterioration greater than or less than those indicated in the table. For example, we would naturally expect relatively little credit deterioration during benign market conditions or during conditions of only mild or modest stress. Conversely, issuers and securities could suffer greater degrees of credit deterioration during periods of severe or extreme stress. In addition, specific business segments—such as housing, energy, retail, and transportation—could experience different degrees of stress over any given period. 7. The global credit markets generally and certain sectors of the economy are now experiencing extreme stress and exceptional volatility. The current environment has led to and could continue to result in some sharp rating adjustments. 8. We do not intend for the new approach to result in upgrades in sectors that have historically displayed above-average credit stability. Instead, we intend for the new framework to function as a limiting factor on the ratings assigned to credits that we believe are vulnerable to exceptionally high instability. 9. The primary focus of the stability consideration is intended to be ordinary business risk rather than special types of risk, such as changes in laws, fraud, or corporate acquisitions. 10. The change is asymmetric in that it focuses solely on credit deterioration rather than on credit improvement. There are two reasons for this approach. First, investors and creditors have expressed greater concern about deterioration than improvement. Second is the essential downside/upside asymmetry of the basic credit proposition. Why Is Standard & Poor's Adopting This Approach? 11. We are incorporating credit stability in our ratings in light of the high degree of credit volatility displayed by certain derivative securities during the past 18 months. By explicitly recognizing stability as a factor in our ratings, we intend to align their meanings more closely with our perception of investors' desires and expectations. 12. Responses to the RFC reinforce our belief that investors generally prefer high ratings to be more stable than low ratings. High ratings should connote high stability. The Possible Effects 13. We expect the change will have very little, if any, effect on our ratings in the corporate and government segments of the capital markets. Investment-grade corporate and government issuers generally are expected to weather moderate stress with at most modest rating adjustments. Although speculative-grade credits are expected to exhibit some volatility, moderate stress is not likely to result in rating movements beyond the parameters shown in the table. 14. The new approach could affect a few specialized corporate issuers or issues, possibly including deferrable hybrid capital instruments (mainly preferred stock) of companies that are rated in the 'BBB' and 'BB' categories and some catastrophe bonds. 15. We anticipate that the proposed change would have a more pronounced impact in certain areas of the structured finance segment, particularly on our ratings of derivative securities or those where credit risk is primarily a function of market values, such as: Collateralized debt obligations of asset-backed securities (ABS CDOs), especially CDOs backed by mezzanine tranches of other transactions. Constant-proportion debt obligations (CPDOs). Leveraged super-senior (LSS) structures. Collateralized commodity obligations (CCOs) and collateralized foreign exchange obligations (CFXOs). 16. Transactions and structures that create more significant credit cliff risks would likely experience the largest impact. The change could result in downgrades to significant numbers of the securities listed above when we first implement the new approach. The change could require modifications to the specific or detailed rating criteria for certain types of issuers or securities. 17. We will focus on structures or asset types that have experienced or which we believe could experience substantial credit instability. Our current estimate is that adoption of this approach will lead to few, if any, rating changes for securities directly backed by home mortgages, credit card obligations, auto loans, and student loans. 18. We will continue to strive for general comparability of ratings across the universe of ratings at each point in time, but the change may somewhat affect comparability of ratings before and after the change. 19. As a general matter, our ratings express our opinion of the creditworthiness of issuers and specific securities. However, the notion of creditworthiness has sometimes been interpreted differently in various market segments. In particular, certain areas of the structured finance segment have favored a narrow interpretation, essentially meaning "likelihood of default" without regard to other factors. We plan to move beyond the narrow interpretation in favor of one that we believe is more practical and useful for market participants. As a result, although our view on likelihood of default would remain a focus of our ratings, it would not be our only consideration. Coordination With Other Proposed Initiatives 20. We previously announced that we would seek market comments on ways to highlight nondefault risk factors, such as volatility, and we have informally discussed a potential volatility indicator with some investors and other market participants. We are still exploring development of a separate volatility indicator that would complement our traditional credit ratings. However, such a volatility indicator would not be a substitute for explicitly incorporating the stability considerations outlined above into our ratings. 21. On May 29, we published "Request For Comment: Should An Identifier Be Added To Standard & Poor’s Structured Finance Ratings?" on RatingsDirect. We proposed adding an "s" identifier to ratings on securities issued from securitization transactions. The purpose of the identifier would be to provide greater transparency and insight to market participants by distinguishing ratings on structured finance instruments from ratings on corporate and government entities and obligations. We have not yet decided whether to implement the "s" identifier, but it would not supplant the incorporation of credit stability in our ratings. Related Articles "Standard & Poor's Reaffirms Its Commitment To The Goal Of Comparable Ratings Across Sectors And Outlines Related Actions," published on May 6, 2008. "Detailed Descriptions of S&P;'s New Actions Aimed at Strengthening the Ratings Process," published on Feb. 7, 2008.