

June 26, 2007

**Criteria | Corporates | General:**  
**Principles Of Corporate And  
Government Ratings**

**Primary Credit Analyst:**

Gail I Hessol, New York (1) 212-438-6606; gail\_hessol@standardandpoors.com

**Secondary Credit Analysts:**

Scott Bugie, Paris (33) 1-4420-6680; scott\_bugie@standardandpoors.com

Marie Cavanaugh, New York (1) 212-438-7343; marie\_cavanaugh@standardandpoors.com

Solomon B Samson, New York (1) 212-438-7653; sol\_samson@standardandpoors.com

**Table Of Contents**

---

Issuer Credit Ratings

Rating Specific Instruments

# Principles Of Corporate And Government Ratings

Standard & Poor's Ratings Services corporate, government, financial institution, and insurer (C&G) credit ratings may be broadly split between those assigned to obligors (debt issuers) and obligations (issues). The Issuer Credit Rating (ICR) is a current opinion on an issuer's overall capacity and willingness to pay its financial obligations on a timely basis. It primarily indicates the likelihood of default.

Standard & Poor's Ratings Services also assigns credit ratings to specific issues. Issue credit ratings may reflect a blend of default risk and recovery prospects in the event of default. The issue credit rating takes into consideration the creditworthiness of guarantors, insurers, or other forms of credit enhancement on the obligation and takes into account the currency in which the obligation is denominated. The opinion evaluates the obligor's capacity and willingness to meet its financial commitments as they come due and may assess terms that could affect ultimate payment in the event of default, such as collateral security and subordination.

## Issuer Credit Ratings

For C&G ratings, Standard & Poor's Ratings Services employs fundamental credit analysis, supplemented by quantitative models, as appropriate, in accordance with its methodology and criteria. The analysis follows a systematic framework, called the Rating Methodology Profile (RAMP) tailored to the type of obligor. Business risk and financial risk are the main elements of corporate and financial institution analysis. Credit ratings are often identified with financial analysis, especially ratios. But it is critical to realize that ratings analysis starts with the assessment of the business and competitive profile of the company or the economic and political profile of the government.

### Business risk

When assessing business risk, the analysis commonly includes country risk, industry characteristics, competitive position, cost efficiency, and profitability relative to peers. Industry characteristics typically encompass growth prospects, volatility, and technological change, as well as the degree and nature of competition.

The economic environment is especially important for bank credit quality. Regulatory structure affects utilities, insurance companies, banks, and other sectors. A company's product/service diversity, especially any risk concentration of a financial institution, is considered.

While any particular profile category can be the overriding rating consideration, the industry risk assessment can be a key factor in determining the credit rating to which any participant in the industry can aspire. Broadly speaking, the lower the industry risk, the higher the potential credit rating on companies in that sector will be.

An organization's strategy, operational effectiveness, and financial risk tolerance will shape its competitiveness in the marketplace and the strength of its financial profile. Risk management is an increasingly important analytical factor in the financial services sector. Credit, market, and trading risks are assessed. Standard & Poor's Ratings Services attaches great importance to management's philosophies and policies concerning financial risk.

## **Financial risk**

Financial analysis begins with an evaluation of the firm's accounting principles employed, particularly any unusual practices or underlying assumption. Key financial indicators generally fall into the following categories: profitability, leverage, cash flow adequacy, liquidity, and financial flexibility. For financial institutions and insurers, critical factors are asset quality, reserves for losses, asset/liability management, and capital adequacy. The specific ratios analyzed vary by industry and may include profit margins, return on investment, debt/capital, debt/cash flow, and debt service coverage. Cash flow analysis and liquidity assume heightened significance for firms with speculative-grade ratings ('BB+' and lower). Trends over time and peer comparisons are evaluated.

Off-balance sheet items, such as leases and pension liabilities, are considered. Where appropriate, Standard & Poor's Ratings Services may adjust reported financial statements to arrive at a more faithful representation of credit measures and to improve comparability. Standard & Poor's Ratings Services makes extensive use of risk-adjusted asset quality indicators and risk-adjusted capital analysis to compare financial institutions in different countries.

Standard & Poor's Ratings Services employs proprietary quantitative models to measure the capital adequacy of insurance companies, including firms that insure U.S. municipal bonds and other obligations. An earnings adequacy model also may be applied to insurance companies. At its core, it is a risk-adjusted analysis of a company's earnings stream, reflecting the insurer's underwriting risks and investment income. Analysis of liquidity and reserve adequacy are also modeled.

'Pi' ratings assigned to insurance companies may be substantially determined by quantitative models that evaluate publicly available financial data.

## **Combining business and financial risk**

RAMP categories may be scored, but there is no precise recipe for combining the scores to produce ratings. The analytical variables are interrelated and the weights are not fixed. A company's business-risk profile determines the level of financial risk appropriate for any rating category. A well-positioned firm can tolerate greater financial risk, for a given rating, than a poorly positioned organization. Two firms with identical financial metrics may be rated very differently to the extent their business challenges and prospects differ.

## **Government credit ratings**

For sovereign governments, the key determinants of credit quality are political and economic risk. Economic risk addresses a government's ability to repay obligations on time. Political risk addresses the sovereign's willingness to repay, a qualitative factor that distinguishes sovereigns from most other issuers. Political risk encompasses the stability and legitimacy of political institutions. At the regional and local government level, the analysis includes the supportiveness and predictability of the public sector system and the matching of revenue to service responsibilities.

The foundation of government creditworthiness is the economic base. The economic structure, demographics, wealth, and economic growth prospects play a key role in credit analysis.

Budgetary performance is a central component of financial analysis. Special attention is paid to revenue forecasting, expenditure control, long-term capital planning, debt management, and contingency plans. The debt burden relative to the economic and population base, as well as the government's debt structure and funding sources are considered.

Off-balance sheet obligations are recognized. Quantitative elements are captured in a number of ratios that can be compared to those of peers.

For sovereigns, financial analysis includes fiscal and monetary flexibility. The financial sector may be viewed as a significant contingent liability for a sovereign government. External liquidity is also analyzed.

Similar to the rating process in the private sector, analytical judgment, rather than a formulaic approach, is employed to weigh the individual RAMP categories and reach a rating decision.

## **Rating Specific Instruments**

The ICR, which indicates the obligor's default risk, is generally the starting point when rating individual C&G issues. The issue's credit rating may also take account of ultimate recovery in the event of default. For the same obligor, secured debt is often rated higher than unsecured debt, and subordinated debt is typically rated below senior debt. Debt of a holding company may be rated below debt of its operating subsidiary.

Recovery expectations dictate whether an obligation is rated above, below, or the same as the ICR. Standard & Poor's Ratings Services is in the process of expanding its recovery analysis for speculative-grade issuers, in response to the market's increased interest in post-default recovery. As a result, a growing number of issues will be rated 1-3 designations (notches) above and below the ICR.

Certain obligations, including municipal revenue bonds, are serviced from a dedicated source, such as water and sewer charges and road tolls. Analysis of these instruments is generally project-specific and focuses on revenue generation relative to debt service, facility maintenance, and other requirements, often cushioned by reserve funds.

Copyright © 2009, Standard & Poors, a division of The McGraw-Hill Companies, Inc. (S&P). S&P and/or its third party licensors have exclusive proprietary rights in the data or information provided herein. This data/information may only be used internally for business purposes and shall not be used for any unlawful or unauthorized purposes. Dissemination, distribution or reproduction of this data/information in any form is strictly prohibited except with the prior written permission of S&P. Because of the possibility of human or mechanical error by S&P, its affiliates or its third party licensors, S&P, its affiliates and its third party licensors do not guarantee the accuracy, adequacy, completeness or availability of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. S&P GIVES NO EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE. In no event shall S&P, its affiliates and its third party licensors be liable for any direct, indirect, special or consequential damages in connection with subscribers or others use of the data/information contained herein. Access to the data or information contained herein is subject to termination in the event any agreement with a third-party of information or software is terminated.

Analytic services provided by Standard & Poor's Ratings Services (Ratings Services) are the result of separate activities designed to preserve the independence and objectivity of ratings opinions. The credit ratings and observations contained herein are solely statements of opinion and not statements of fact or recommendations to purchase, hold, or sell any securities or make any other investment decisions. Accordingly, any user of the information contained herein should not rely on any credit rating or other opinion contained herein in making any investment decision. Ratings are based on information received by Ratings Services. Other divisions of Standard & Poor's may have information that is not available to Ratings Services. Standard & Poor's has established policies and procedures to maintain the confidentiality of non-public information received during the ratings process.

Ratings Services receives compensation for its ratings. Such compensation is normally paid either by the issuers of such securities or third parties participating in marketing the securities. While Standard & Poor's reserves the right to disseminate the rating, it receives no payment for doing so, except for subscriptions to its publications. Additional information about our ratings fees is available at [www.standardandpoors.com/usratingsfees](http://www.standardandpoors.com/usratingsfees).

Any Passwords/user IDs issued by S&P to users are single user-dedicated and may ONLY be used by the individual to whom they have been assigned. No sharing of passwords/user IDs and no simultaneous access via the same password/user ID is permitted. To reprint, translate, or use the data or information other than as provided herein, contact Client Services, 55 Water Street, New York, NY 10041; (1)212.438.7280 or by e-mail to: [research\\_request@standardandpoors.com](mailto:research_request@standardandpoors.com).