STANDARD & POOR'S
RATINGS SERVICES

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Criteria | Governments | General:

Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology

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Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology

1. Standard & Poor's Ratings Services is updating its methodology for rating multilateral lending institutions (MLIs) and other nonbank supranational institutions. Supranational institutions are institutions owned or established by governments of two or more countries. They are usually established by international treaties to pursue specified policy objectives and are generally not subject to commercial law. This update follows our request for comment (RFC), "Request For Comment: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology," published July 5, 2012. (Watch the related CreditMatters TV segment titled "Standard & Poor's Takes A New Look At Multilateral Lending Institutions," dated Nov. 26, 2012.)

2. These criteria aim to enhance the clarity of our methodology. Where relevant, we have also aligned the criteria for MLIs and other supranational institutions with the criteria for other sectors, particularly banks, in light of our updated bank methodology, "Banks: Rating Methodology And Assumptions," published Nov. 9, 2011.

3. We base the criteria on the article "Principles Of Credit Ratings," which we published on Feb. 16, 2011. The criteria supersede "Criteria For Multilateral Lending Institutions," published Oct. 19, 2007, "Criteria For Rating Multilateral Aid Agencies," published July 6, 2009, and "Accounting For Capital In Multilateral Institutions," published May 16, 2006. (We note that we use "criteria" and "methodology" interchangeably here.)

I. SCOPE OF THE CRITERIA

4. The methodology applies to all MLIs and other nonbank supranational institutions. MLIs usually are established to promote economic development of their less-developed or regional member countries, regional integration, or expansion of cross-border trade. Other rated supranational institutions include multilateral insurance companies, monetary funds, regional public policy institutions, and vehicles that provide budgetary financing or that pool overseas direct assistance. Corporations that provide similar services, but are listed on an exchange, are not included in the scope of MLIs and other supranational institutions as we define them.

Acronyms Used In This Article	
ACE	Adjusted common equity
EAD	Exposure at default
FSR	Financial strength rating
GDP	Gross domestic product
GRE	Government-related entity
ICR	Issuer credit rating
IMF	International Monetary Fund
LGD	Loss given default
MLI	Multilateral lending institution
PCT	Preferred creditor treatment

Acronyms Used In This Article (cont.)	
PD	Probability of default
RAC	Risk-adjusted capital
RACF	Risk-adjusted capital framework
RWA	Risk-weighted assets
SACP	Stand-alone credit profile

II. SUMMARY OF CRITERIA UPDATE

A. Methodology For Rating MLIs

5. The methodology for rating MLIs consists of two key steps (see chart 1):

- Determining the MLI's stand-alone credit profile (SACP) (see "Stand-Alone Credit Profiles: One Component Of A Rating," published Oct. 1, 2010) and
- Assessing the impact of extraordinary shareholder support on the MLI's creditworthiness to determine the issuer credit rating (ICR).

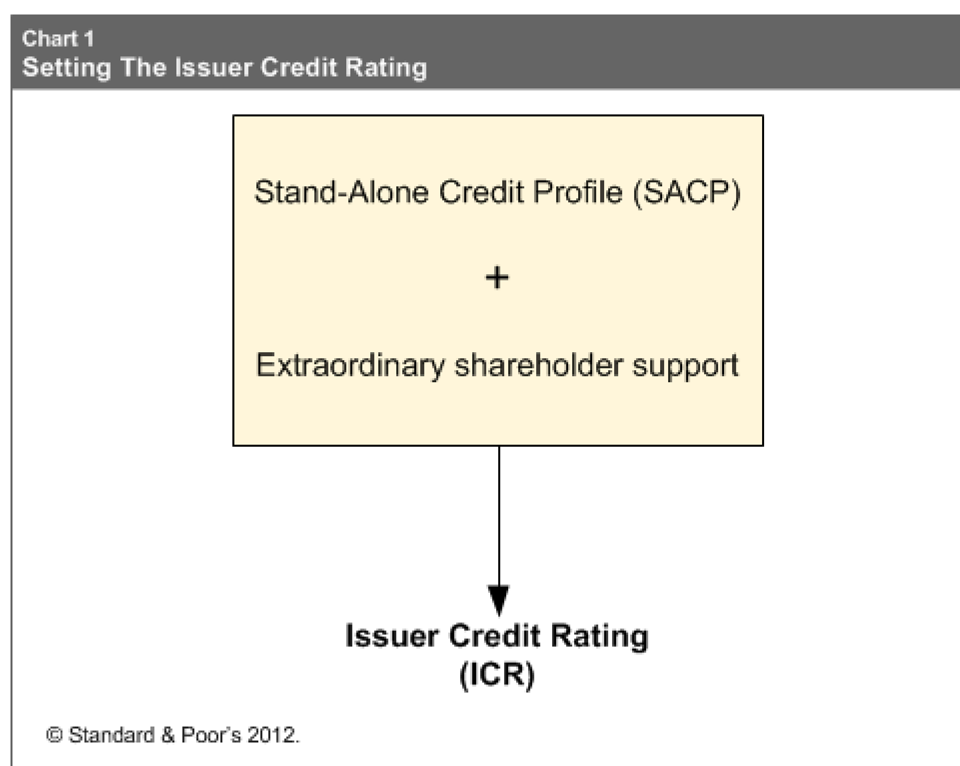
6. The methodology for assessing an MLI's SACP uses, when applicable, the quantitative and qualitative factors explained in Standard & Poor's bank criteria ("Banks: Rating Methodology And Assumptions"), but with some material differences necessary to reflect MLI-specific factors. MLIs tend to be specialized institutions established by several sovereign governments and mandated to support the public policy intent of their owners. This results in several unique characteristics for MLIs compared with banks, including:

- Their special status is governed by international treaties and the institution's bylaws. (MLIs are usually not subject to national banking regulation or commercial law.)
- Preferred creditor treatment (PCT) (see paragraph 25) on the exposures to sovereigns is a cornerstone of the MLI sector that historically has enabled it to operate with low losses.
- MLIs generally have simpler and narrower business profiles than commercial banks. Most MLIs' activities consist primarily of lending to or guaranteeing obligations of sovereign governments. They usually do not entail trading or underwriting.
- MLIs have a higher reliance on market funding (no or very limited deposits and generally no access to central bank funding), which is mitigated, in most cases, by high levels of capital and liquid assets.
- The MLIs' public policy mandate means that their goal is not to maximize operating profits. Also, MLIs' internal organization usually does not engender the potentially misaligned incentives that can be found in compensation plans or in profit-maximizing institutions' emphasis on quarterly profits. Although returns on equity may be lower than those of profit-maximizing institutions, historically MLIs' ability to generate capital internally has benefited from their exemption from paying corporate income tax. A positive feature of MLIs is higher earnings retention, thanks to low, if any, distribution of dividends or similar payments made at the board's discretion, resulting in adequate internal capital generation.

7. After assessing the SACP, we analyze the extraordinary support that an MLI may receive from its shareholders when it is in distress. The assessment of this extraordinary support (described in greater detail in section V.B.) mostly relies on the weight given to the callable capital, although some MLIs may benefit from other forms of support, such as

guarantees. We consider other types of support ongoing and factor these into the SACP. Callable capital is a common, albeit not universal, characteristic of MLIs' capital structures. It refers to the portion of the MLI's capital subscriptions that is not "paid-in" but is committed by each shareholder generally only in the event it is required to prevent a default on an MLI's debt or under its guarantee. The use of callable capital is generally restricted to preventing a default on an MLI's obligation. An MLI can use regular capital increases to support the expansion of its activities. To our knowledge, no rated MLI has ever made a call on its callable capital. Standard & Poor's views callable capital as a form of extraordinary support if we assess the shareholders' ability and willingness to pay in such capital as sufficiently strong, as indicated by the institution's policy importance.

8. After assessing the likelihood of extraordinary support, the criteria then establish the ICR on the MLI based on the combination of its SACP and extraordinary support (see chart 1).



B. Methodology For Rating Other Nonbank Supranational Institutions

9. Other rated supranational institutions comprise a variety of disparate entities, such as multilateral insurance institutions and various types of public policy institutions.

10. Whenever possible, the methodology applies a similar two-step approach involving the assessment of the entity's SACP under the applicable criteria, and then the assessment of the likelihood of extraordinary shareholder support. The support assessment uses the framework outlined in section V.B. whenever this extraordinary support is in the form of callable capital and, less often, guarantees. However, in some cases, the nature of the institution and the

presence of various forms of support mechanisms could lead Standard & Poor's to take a different approach, drawing on criteria such as "Group Rating Methodology And Assumptions," published Nov. 9, 2011, "Rating Government-Related Entities: Methodology And Assumptions," published Dec. 9, 2010, and relevant guarantee criteria. Section V.C. covers these approaches.

III. SUMMARY OF CRITERIA CHANGES COMPARED WITH RFC

11. Standard & Poor's published its "Request For Comment: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology," on July 5, 2012. Market participants who responded were generally positive about the increased transparency and clarity of the criteria. Some of them provided specific comments about certain metrics and weighting of analytical factors. These comments and further analysis led to the following main changes from the proposal in the RFC:

- We have included the preferential treatment (see paragraph 26) in addition to PCT in our analysis of the policy importance since we believe that it enhances the policy role of MLIs that specialize in private-sector lending (albeit to a lesser degree than PCT for MLIs lending to the public sector). The preferential treatment includes instances when the sovereign excludes private-sector obligations to MLIs from restrictions on access to foreign exchange needed for debt service.
- We have presented "governance and management expertise" as a separate analytical factor, rather than an adjustment to the "policy importance" assessment. We have expanded and renamed the "governance and management expertise" assessment to "strong," "satisfactory," "fair," and "weak" to be consistent with the nomenclature in "Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers," published Nov. 13, 2012.
- We have directly incorporated the adjustment for quality of capital and earnings in table 6 through our qualitative forward-looking view of the unadjusted risk-adjusted capital (RAC) ratio. This simplified presentation allowed us to streamline the criteria.
- We have removed the concentration and diversification adjustment from the RAC ratio (in table 6) and have combined the concentration risk, PCT, and other adjustments in the risk position assessment (in table 7). This realignment achieved two goals. First, the new MLI's "unadjusted" RAC ratio can now be transparently compared with commercial banks' RAC ratios. At the same time, the "adjusted" RAC now establishes a symmetrical framework, incorporating both the main benefit (PCT) and risk (concentration) of the MLI business model.
- We have expanded the risk position assessment to include "very positive" and "extremely negative" categories (see table 7) to accommodate for the current and projected distribution of the adjusted RAC ratios.
- We have presented "funding and liquidity" as a separate analytical factor to more clearly articulate its importance in the financial profile.

IV. IMPACT ON OUTSTANDING RATINGS AND EFFECTIVE DATE

12. We do not expect many changes to existing MLI or other supranational institution ratings as a result of the implementation of the criteria. We expect that we could raise or lower the ratings on a few MLIs, reflecting the greater weight given to the MLIs' public policy role, capitalization level, and loan portfolio concentration.

13. These criteria are effective immediately and apply to all new and outstanding ratings within scope. We intend to

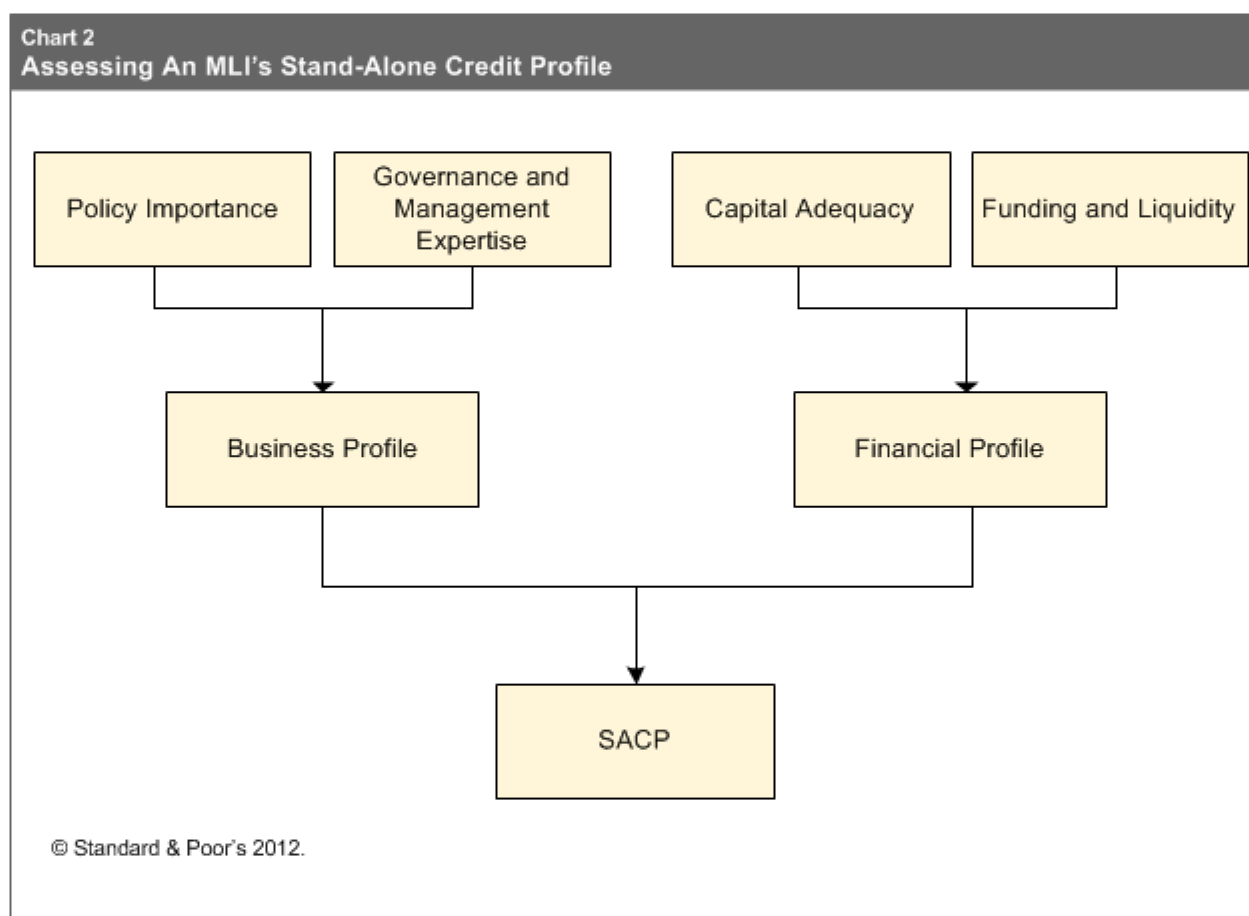
complete our review of issuers affected within the next six months.

V. METHODOLOGY

A. Assessing An MLI's Stand-Alone Credit Profile

14. The methodology determines an MLI's stand-alone credit profile by assessing two main factors (see chart 2):

- The business profile, which reflects the assessment of the MLI's policy importance and its governance and management expertise, and
- The financial profile, which reflects the assessment of the MLI's capital adequacy and its funding and liquidity.



15. Standard & Poor's then combines the business and financial profiles through the matrix presented in table 1 to determine the MLI's SACP.

Table 1

Determining An MLI's SACP

	--Financial profile--						
--Business profile--	**Extremely strong**	**Very strong**	**Strong**	**Adequate**	**Moderate**	**Weak**	**Very weak**
Extremely strong	aaa	aaa/aa+	aa+/aa	aa/aa-	a+/a	a-/bbb+	bbb/bbb-
Very strong	aaa/aa+	aa+/aa	aa/aa-	a+/a	a/a-	bbb+/bbb	bb+/bb
Strong	aa+/aa	aa/aa-	a+/a	a/a-	bbb+/bbb	bbb/bbb-	bb/bb-
Adequate	aa/aa-	a+/a	a/a-	bbb+/bbb	bbb/bbb-	bb+/bb	b+/b
Moderate	a+/a	a/a-	bbb+/bbb	bbb/bbb-	bb+/bb	bb-/b+	b/b-
Weak	a-/bbb+	bbb+/bbb	bbb/bbb-	bb+/bb	bb/bb-	b+/b/b-	ccc+/ccc/ccc-
Very weak	bbb+/bbb	bbb/bbb-	bb+/bb	bb/bb-	b+/b/b-	ccc+/ccc/ccc-	cc

16. In cases when the matrix presents a range of ratings, the choice between the two or three ratings is based on:

- The transition we expect in some of the subfactors composing the business and financial profiles that is likely to strengthen or weaken the MLI's creditworthiness over time, and
- Our view of the MLI's credit standing relative to other MLIs with the same business and financial profiles, if the assessments of the subfactors do not fully capture certain comparative factors. Peers are primarily defined based on the type and risk profile of their exposures.

17. Furthermore, if the MLI has a "weak" liquidity profile, we cap the SACP at 'bb', and when it has a "very weak" liquidity profile, the SACP is capped at 'ccc'.

18. The calibration of MLIs' SACPs is based on our analysis of the historical impact of various financial and economic crises on MLIs' creditworthiness, as well as our view of the MLI sector's credit strengths compared with global issuers in other sectors--particularly banks. More specifically, the calibration of an MLI's SACP (see table 1) is anchored on our RAC ratio and the degree of stress that an issuer should be able to withstand at each rating category while still meeting its financial obligations without extraordinary shareholder support. The calibration also reflects Standard & Poor's general framework for the expected behavior of its credit ratings over time through economic cycles. We outline our framework in three articles: "Understanding Standard & Poor's Rating Definitions," published June 3, 2009; "Credit Stability Criteria," published May 3, 2010; and "The Time Dimension Of Standard & Poor's Credit Ratings," published Sept. 22, 2010.

1. Business profile

19. The first factor, business profile, measures the strength of an MLI's business operations in relation to the rest of the MLI sector globally. To assess an MLI's business profile, we evaluate its policy importance and its governance and management expertise (see table 2).

- We have five descriptors for the policy importance assessment, ranging from "very strong" to "weak" (see table 3).
- The governance and management expertise descriptors (see table 4) are "strong," "satisfactory," "fair," and "weak."

Table 2

Business Profile

	--Policy importance--				
--Governance/management expertise--	**Very strong**	**Strong**	**Adequate**	**Moderate**	**Weak**
Strong	Extremely strong	Very strong	Strong	Adequate	Moderate
Satisfactory	Very strong	Strong	Adequate	Moderate	Weak
Fair	Strong	Adequate	Moderate	Weak	Very weak
Weak	Adequate	Moderate	Weak	Very weak	Very weak

a) Policy importance

20. The policy importance analysis reflects our assessment of the importance of an MLI's mandate and of its public policy role for the institution's shareholders and members. The core activities for most MLIs consist of lending to public-sector entities (sovereigns, local and regional governments, and public enterprises--to the latter two often under a sovereign guarantee). Some also lend to the private sector and, in some cases, take equity participations. In addition, some provide services, such as loan syndication, advisory services, and administration of grants from nonborrowers.

21. We identified several characteristics that inform our view of an MLI's policy importance. We look at four main factors that drive the policy importance (see table 3):

- The role,
- The public policy mandate,
- The strength and stability of the relationship with the shareholders and an MLI's status, and
- The PCT and preferential treatment.

22. We start by analyzing an MLI's role and the extent to which this role can be or is performed by other institutions. Further, we analyze the MLI's track record of implementing its public policy mandate throughout the credit cycle.

23. We also look at an MLI's status. We view the institutions established by treaty more favorably than those established by less formal intergovernmental agreements. We assess strength and stability of the relationship between the institution and its shareholders by looking at the membership support. We would view expanding membership due to entrance of strong shareholders positively, while the exit of shareholders would be viewed as a sign of weakening policy importance.

24. We recognize that MLIs can achieve capital accumulation in different manners, though we view regular capital increases when needed by an MLI and timely payment of new capital subscriptions as another sign of shareholder support. Finally, we evaluate the track record of the PCT and preferential treatment (see paragraphs 25 and 26) as a sign of shareholders' support for the MLI to fulfill its public policy mandate.

25. One distinguishing factor of MLI lending to sovereigns is commonly referred to as PCT. Historically, MLIs have had lower default rates and higher recovery rates in sovereign lending than commercial lenders have had. The reason for this is that MLIs have been exempt from participating in sovereign debt rescheduling coordinated by the Paris Club of bilateral creditors, whereas commercial lenders often have not (under the principle of "comparability of treatment"). Similarly, in a distress scenario, sovereigns often will service debt owed to MLIs, even while defaulting on commercial

debt, because sovereigns expect MLIs will offer additional financing throughout the period of distress even when commercial markets have closed. When sovereigns do default to MLIs, these defaults are usually cured before commercial debt arrears because such clearance is usually a condition of resumed access to funding from the International Monetary Fund (IMF). The PCT is not applicable to MLIs on a contractual basis, but rather it's a function of the importance of their policy role and depends, in practice, on the decision of the individual defaulting sovereign.

26. For MLIs whose exposure is mostly to the private sector, the PCT does not apply by definition. Nevertheless, historically we have observed that the loan loss track record of private-sector borrowers to these MLIs is often superior to what commercial financial institutions experience. This may be the case when the private-sector lending is conducted from the same institution that makes public-sector loans or is part of a broader group, one part of which makes public-sector loans, and the government of the debtor can provide some relief in order to maintain good relations with the public-sector MLI lender. One example would be waiving any transfer and convertibility (T&C) restrictions that impede debt service for the MLI's debtors but not others. Another example would be a government enabling an expedited restructuring of the troubled borrower when the MLI is the lender. Although we do not believe this preferential treatment of private sector MLI lending has as much impact as PCT has for MLI public sector lending, we believe that it nonetheless enhances the policy role of MLIs specialized in private sector lending.

27. Table 3 contains the characteristics that we would generally expect to see at different levels for the policy importance factor, although the institution might exhibit most but not all of them.

Table 3

Policy Importance Assessment					
	Very strong	**Strong**	**Adequate**	**Moderate**	**Weak**
Role	Role is not or cannot be readily fulfilled by another private or domestic public institution, and we expect this role to be maintained.	Role is or can be partially fulfilled by a private or another domestic public institution, or strong role is diminishing.	Diminishing role that is or can be partially fulfilled by another private or domestic public institution.	An increasing part of the MLI's activity is fulfilled by private entities.	A large part of the MLI's activity is fulfilled by private entities.
Public policy mandate	The MLI has a track record of more than two decades of fulfilling its public policy mandate throughout credit cycles, and we expect this to continue. Track record of increases and timely payments of capital subscriptions by shareholders when needed to support its public policy mandate, and we expect this to continue.	Shorter track record of fulfilling its public policy mandate. Its policy mandate is less important, for instance because of the limited geographical scope of its activities. Track record of increases and timely payments of capital subscriptions by shareholders when needed to support its public policy mandate, and we expect this to continue.	Shorter track record of fulfilling its public policy mandate. Its policy mandate is less important than peers in the "strong" category. The payment of significant scheduled capital subscriptions has not been made on schedule (within 90 days) by shareholders.	Weakening ability to fulfill its public policy mandate.	The MLI is expected not to be able in the future to fulfill its public policy mandate through the credit cycle.
Strength and stability of the relationship with shareholders	The MLI was established by treaty. No major shareholder has withdrawn from the MLI in the recent past or is expected to do so in the medium term. The MLI's earnings are exempt from corporate income tax.	The MLI was established by treaty. No major shareholder has withdrawn from the MLI in the recent past or is expected to do so in the medium term. The MLI's earnings are exempt from corporate income tax.	Shareholders' support is weakening (e.g., a major shareholder recently withdrew from the MLI). The MLI's earnings are exempt from corporate income tax.	The MLI was not established by treaty. Shareholders' support is uneven.	The MLI was not established by treaty. Shareholders' support is weak and uncertain. The MLI's earnings are not exempt from corporate income tax.
PCT and preferential treatment	The MLI has historically benefited from PCT for its government lending, and we expect this to remain so in the future.	The MLI has historically benefited from PCT for its government lending, and we expect this to remain so in the future.	The MLI has historically benefited from PCT for its government lending and (where relevant) benefited from preferential treatment.	Less certainty or short track record in borrowers' affording an MLI PCT and (where relevant) preferential treatment.	The PCT and (where relevant) preferential treatment is uncertain.

b) Governance and management expertise

28. Governance and management expertise is the second factor in the business profile analysis. Similar to a policy importance assessment, this analysis is mostly qualitative. We believe that the institution's bylaws, its internal governance rules, its strategy, and its risk management policies are important, especially given that most MLIs are neither regulated nationally or internationally nor governed by a national law. An MLI's governance and strategy are analyzed in the context of its public mission, typically that of fostering economic development and integration.

29. With regard to governance, we evaluate the breadth of the MLI's ownership, the structure of its audit and control, and its dividend policy. More specifically, we assess governance as "fair" in cases where a few member country shareholders, particularly borrowing member countries, control or have significant influence over decision-making. We are also of the opinion that the participation of private shareholders in an MLI's capital structure may dilute its public policy role and affect its governance because the goals of private and public shareholders may conflict, particularly in periods of stress.

30. In addition, our opinion of an MLI's governance standards is informed by shareholders' ranking in the World Bank's Governance Indicators for Government Effectiveness, control of corruption and regulatory quality, as well as the sovereign political score as defined in "Sovereign Government Rating Methodology And Assumptions," published June 30, 2011, among other factors. Recognizing the specificities of each information source, we use these sources as a reference point and when deemed appropriate.

31. With regard to risk management expertise and its impact on business profile, we focus on management's experience and track record in operating all of its major lines of business, as well as its ability to implement strategic plans and achieve financial and operational goals. Risk management, as it relates to the specific risk management framework, is also part of the risk position subfactor in the financial profile.

32. We classify MLIs' governance and management expertise in four categories: "strong," "satisfactory," "fair," and "weak" (see table 4).

Table 4

Governance And Management Expertise Assessment

	Strong	Satisfactory	Fair or weak*
Factors generally seen in each category	--Transparent, prudent, and independent governance and management, generally characterized by:	--MLIs other than "strong," fair," and "weak."	--The MLI is predominantly controlled by one or two shareholders.
	--Diverse and balanced composition of government shareholders (with usually five or more shareholders with more than token stakes).		--Borrowing member countries have control and a significant influence over decision-making.
	--Well-established governance standards with a clear mandate.		--The strategic planning process is limited or plans are superficial.
	--No material private-sector shareholding.		--Management is often unable to convert strategic decisions into constructive action or often fails to achieve its financial and operational goals.
	--Ability to implement strategic plans and achieve financial and operational goals in fulfilling its public policy role.		--The MLI relies on one or a small number of managers. The loss of key personnel would seriously affect the organization's operations, or management lacks the expertise and experience, and the MLI often deviates significantly from its plan.
	--Management has considerable expertise, experience, and a track record of success in operating all of its major lines of business.		--Risks to governance standards stemming from low governance ranking (see paragraph 30).
	--Ability to withstand loss of key personnel without significant disruption to operations in each of its significant business units.		--The institution employs inferior financial and risk management policies relative to its operations.
	--High ranking in governance (see paragraph 30) is reflective of strong MLI management's governance standards.		--Earning distributions (grants, transfers) lead to capital base erosion.
	--The institution employs superior financial and risk management policies in relation to its business activities.		
	--Shareholders allow most of the MLI's earnings to be consistently retained to provide for a solid growth.		

*Selection of "fair" versus "weak" depends on magnitude of risks defined in this category and its prevalence for the given institution.

2. Financial profile

33. The financial profile reflects our view of an MLI's capital adequacy, relative to the rest of the MLI sector and the broader banking industry globally, as well as its funding and liquidity profile.

34. For each MLI, we determine the strength of its financial profile by:

- First assessing the MLI's capital adequacy, using one of seven descriptors ranging from "extremely strong" to "very weak" (see tables 6 and 7).
- Second assessing the MLI's funding and liquidity profile, using one of six descriptors, ranging from "very strong" to "very weak"(see table 8).
- The combination of capital adequacy and funding and liquidity assessments determines the financial profile (see table 5).

Table 5

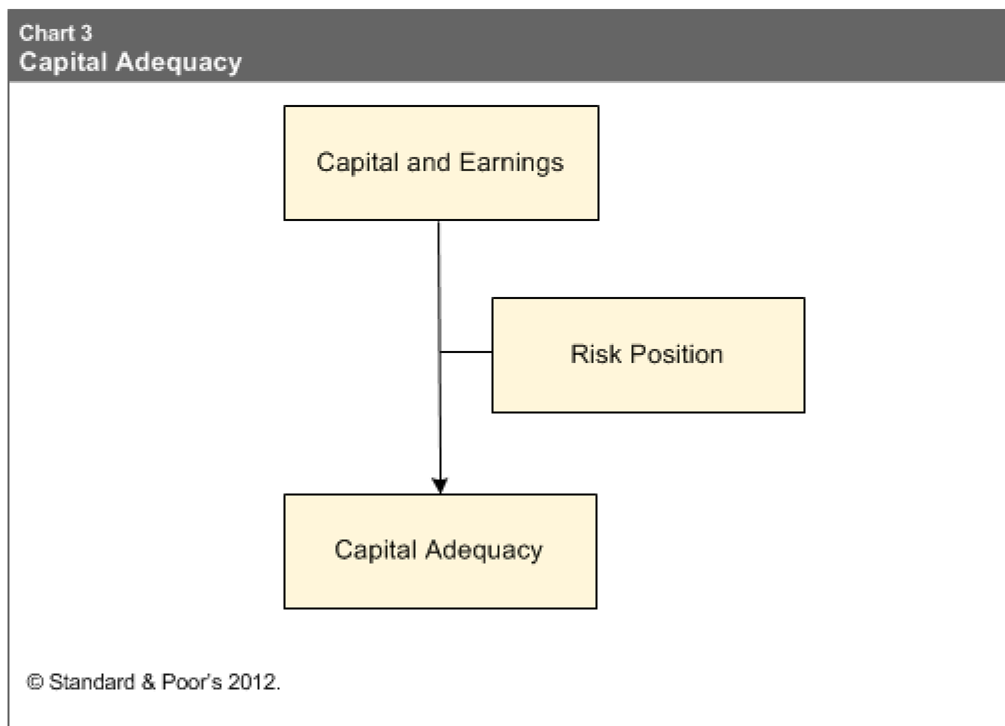
Financial Profile

	--Capital adequacy--						
--Funding and liquidity--	**Extremely strong**	**Very strong**	**Strong**	**Adequate**	**Moderate**	**Weak**	**Very weak**
Very strong	Extremely strong	Extremely strong	Very strong	Strong	Adequate	Moderate	Weak
Strong	Extremely strong	Very strong	Strong	Adequate	Moderate	Weak	Very weak
Adequate	Very strong	Strong	Adequate	Moderate	Weak	Very weak	Very weak
Moderate	Strong	Adequate	Moderate	Weak	Very weak	Very weak	Very weak
Weak	Moderate	Moderate	Weak	Very weak	Very weak	Very weak	Very weak
Very weak	Weak	Weak	Very weak	Very weak	Very weak	Very weak	Very weak

a) Capital adequacy

35. Capital adequacy is determined in two steps (see chart 3):

- The first step assesses an MLI's capital and earnings based on Standard & Poor's measure of capital, the RAC ratio (see table 6). The RAC ratio is based on a standard RAC framework used for commercial banks. The assessment is based on the most recent data and is influenced by our qualitative projections over a rating horizon of three to five years.
- In the second step, the risk position assessment refines our view of an institution's actual and specific risks beyond the standard assumptions in the capital and earnings analysis. The capital and earnings assessment is adjusted to reflect the specificities of MLIs, namely PCT and diversification and concentration. The risk adjustment can improve the capital and earnings assessment (by up to two categories) or lower it (by up to six categories) (see table 7).



i) Capital and earnings

36. The RAC ratio is the cornerstone of the capital and earnings analysis and an element of comparability with the bank criteria. It takes into account the degree to which, in our view, an MLI's capital and earnings would cover losses that could arise following an 'A' level stress in an MLI's borrowing member countries (including those an MLI has equity investments in). By incorporating earnings based on their capacity to absorb losses and build capital, the criteria make earnings a component of the capital analysis rather than a separate rating factor.

37. MLIs are not subject to national regulation and, thus, do not have to meet any minimum regulatory capital requirements. MLI shareholders historically have been supportive of strong capital positions to minimize MLIs' funding costs and to ensure market access even during times of financial stress, which reduced the need to call on extraordinary support. MLIs' generally robust capital levels also reflect that they usually do not distribute dividends to shareholders or pay corporate income tax. The quality of their capital is also typically high because most MLIs usually do not have different classes of shares, do not issue hybrid or subordinated debt, and do not carry intangibles such as goodwill or receivables such as deferred tax assets.

38. The starting point of the capital adequacy analysis is the RAC ratio, which compares an MLI's capital to its risk-weighted assets (RWAs). Specifically, the criteria use a globally consistent measure of capital, adjusted common equity (ACE) (see "Bank Capital Methodology And Assumptions," published Dec. 6, 2010, for a full explanation). The RAC ratio assessment is based on the most recently available data. However, when the RAC ratio is borderline between two categories (i.e., less than 10% different from a threshold in relative terms) and the qualitative forecast points to a change in the RAC ratio during the rating timeframe, we will adjust the assessment to account for this. For example, we would consider a RAC ratio of 4.8% borderline between "weak" and "moderate." A positive trend in the

capital ratio can raise this borderline assessment to the next category ("moderate" in this example). Conversely, a borderline RAC ratio of 5.2% can be assessed as "weak" in case of an anticipated negative trend.

39. For instance, MLIs in a start-up phase that are quickly developing their activities are likely to record lower RACs going forward, while MLIs facing periods of economic recovery, in which official credit growth is flat, are likely to see rising RAC ratios. Because an MLI's major source of new capital is its earnings, the projected RAC ratio should be consistent with the MLI's ability to internally generate capital. Capital projections also include the planned disbursements of paid-in capital and the planned disbursement of loans. Overall, our forward-looking analysis focuses on earnings growth, the pace of expansion, potential changes in the institution's strategy and risk appetite, and estimated credit losses. Failure to grow capital via retained earnings at the same pace as the business growth indicates to us that capital ratios will deteriorate unless the MLI has access to external sources to make up for the deficiency.

RAC ratio = ACE / RWAs
RAC – Risk-adjusted capital
ACE – Adjusted common equity, with special adjustments for MLIs
RWA – Risk-weighted assets, Standard & Poor's calculation of RWAs

40. To determine an MLI's RWAs, specified risk weights are applied to its various exposures. The methodology used to determine RWAs before diversification and concentration adjustments is identical to the one used for banks to ensure the comparability of these entities' RAC ratios. We use the sovereign ratings for the risk weights of loans and other exposures to sovereigns, and we use the Banking Industry Country Risk Assessment economic risk scores of the countries to calculate the risk weights of lending to the private sector in those countries (see "Banking Industry Country Risk Assessment Methodology And Assumptions," Nov. 9, 2011). Equities receive a risk weight based on the volatility of the markets in which they are invested, consistent with Standard & Poor's insurance and financial institutions capital frameworks.

41. To calculate the ACE, some adjustments are necessary because of MLI-specific factors. For example, periodic general capital subscriptions are typically scheduled to be paid in over a number of years. When this happens, we include in ACE only the portion received in cash and credited to paid-in capital or capital reserves. Therefore, we exclude the paid-in capital subscribed and not yet received, callable capital, receivables on past-due paid-in capital, and receivables on account of maintenance of value payments. We also deduct from ACE the restricted currency holdings.

Shareholders' equity (as reported by the institution)
(-) Payments committed (subscribed) but not yet due
(-) Payments due but not yet received
(-) Members Promissory Notes
(-) Maintenance of Value Payment Receivables due on capital subscriptions
(-) Capital subscriptions in restricted currencies
(-) Other adjustments (e.g., unrecognized pension deficit)
= Adjusted Common Equity (ACE)

42. The RAC ratio (see table 6) is computed according to the "Bank Capital Methodology And Assumptions." It excludes

all MLI-specific adjustments, such as single-name sovereign concentration and PCT. It also does not include a concentration and diversification adjustment. The risk position assessment (see paragraphs 44-52) considers all of these factors.

43. We calibrated the RAC risk charges to our view of a 'A' stress scenario, as described in "Understanding Standard & Poor's Rating Definitions," published June 3, 2009. Specifically, an 8% RAC ratio indicates a level of capital able to withstand a 'A' level of stress and corresponds to our "adequate" assessment of an MLI's capital and earnings. To account for the generally high capitalization levels in the MLI sector, we are introducing a new category, "extremely strong," which the bank criteria do not have.

Table 6

Assessing An MLI's Financial Profile: Capital And Earnings

Assessment	The RAC ratio is:*
Extremely strong	Above 23%
Very strong	Above 15% and up to 23%
Strong	Above 10% and up to 15%
Adequate	Above 7% and up to 10%
Moderate	Above 5% and up to 7%
Weak	Above 3% and up to 5%
Very Weak	Lower than 3%

*If within 10% of threshold, incorporates qualitative forecast (see paragraphs 38-39).

ii) Risk position adjustment

44. The main drivers of risk position are the RAC ratio after adjustments, loss experience and risk management, and other risks not captured in the RAC capital measure. The adjusted RAC is the primary factor. Loss experience and risk management can improve the risk position (see table 7) by one category, leave it unchanged, or worsen it by one category. In addition, if an MLI is exposed to material risks not covered in the risk-adjusted capital framework (RACF) (see paragraphs 51-52), the assessment will be lowered by one category or more, depending on the magnitude of such risks. For example, a "very negative" risk position assessment can be the result of the combination of 1) a RAC after adjustment scored by table 6 falling in the same category as the unadjusted RAC, 2) a negative loss experience and risk management assessment, as well as 3) some material risks not covered by the RACF.

1) Adjusted RAC

45. The quantitative part of the risk position analysis is based on our calculation of the RAC after diversification and PCT. To reflect the PCT (and, subsequently, a lower default probability and higher recovery expectations on the MLI's sovereign exposures), we adjust the risk weights in the RAC formula. The adjustment is not automatic or binary, but rather reflects our view of the strength of the PCT as discussed in the business profile (see paragraphs 90 and 95 for more details).

46. To adjust for concentration and diversification, we follow the "Bank Capital Methodology And Assumptions," except for the following three adjustments: We add single-name concentration penalization for the sovereign exposures; we remove penalization (to avoid double counting) for geographic concentration; and we do not adjust for business line concentration and diversification, which is not relevant for MLIs (see paragraphs 92-96).

47. After having calculated the "adjusted" RAC, we score it by table 6. The difference between the "new," indicative capital and earnings assessment based on "adjusted" RAC and the regular assessment, using the "unadjusted" RAC, is one of the factors that determines the risk position assessment (see the right-hand column in table 7). For instance, if the "adjusted" RAC ratio is 6% and the "unadjusted" RAC ratio is 13%, the ratio after adjustment (according to the scoring in table 6) falls two categories below the unadjusted RAC, which corresponds to a "very negative" risk position assessment. This would lower the capital and earnings assessment (based on table 6 with an adjusted RAC ratio) by two categories (middle column of table 7) if no further adjustment is necessary because of additional factors in paragraphs 49-52.

48. Further, additional qualitative factors (see paragraphs 49-52) are combined with quantitative results discussed in paragraphs 45-46. Depending on the characteristics described in table 7, the risk position is assessed as "very positive" to "extremely negative." Correspondingly, the risk position assessment adjustment can raise the capital and earnings assessment by up to two categories, leave it unchanged, or lower the capital and earnings assessment by up to six categories (see middle column in table 7).

Table 7

Assessing An MLI’s Financial Profile: Risk Position

Assessment	Effect on the MLI's capital adequacy	RAC after adjustment
Very positive	Improves the capital and earnings assessment in table 6 by two categories (e.g., "strong" becomes "extremely strong")	RAC after adjustment scored by table 6 falls two categories or more above the unadjusted RAC
Positive	Improves the capital and earnings assessment in table 6 by one category (e.g., "strong" becomes "very strong")	RAC after adjustment scored by table 6 falls one category above the unadjusted RAC
Neutral	No effect on the capital and earnings assessment in table 6	RAC after adjustment scored by table 6 falls in the same category as the unadjusted RAC
Negative	Lowers the capital and earnings assessment in table 6 by one category (e.g., "strong" becomes "adequate")	RAC after adjustment scored by table 6 falls one category below the unadjusted RAC
Very negative	Lowers the capital and earnings assessment in table 6 by two categories (e.g., "strong" becomes "moderate")	RAC after adjustment scored by table 6 falls two categories below the unadjusted RAC
Extremely negative	Lowers the capital and earnings assessment in table 6 by three categories or more	RAC after adjustment scored by table 6 falls three categories or more below the unadjusted RAC
	--Adjustments--	
	Positive adjustments	**Negative adjustments**
	--Positive loan performance, loss experience, and risk management compared with the MLI sector (see paragraphs 49-50) can improve the risk position by one category.	--Negative loan performance, loss experience, and risk management compared with the MLI sector (see paragraphs 49-50) can worsen the risk position by one category.
		-- Material risks not covered by the RACF (see paragraphs 51-52) can worsen the risk position by one or more categories.

2) Loss experience and risk management

49. Loan performance, loss experience, and risk management are qualitative factors assessed in determining the risk position. Although the track record of sovereign and sovereign-guaranteed loans written off by MLIs has been historically very low, they can nonetheless suffer arrears on payments. While we consider that an MLI's loss experience is generally supported by its historical and expected PCT and preferential access to foreign exchange, we differentiate among MLIs based on their loss experience. Our analysis focuses on the current stock of past due and impaired exposures (loan performance), as well as on the resolution outcome of exposures previously in arrears, both

in terms of timing and recovery of principal and interest. In evaluating loan performance, we take into account past due loans to a soft loan window of an affiliate or debt forgiveness effected off balance sheet (as was the case in the Highly Indebted Poor Country Initiative). Similarly, we take into account net principal flows between the MLI and its borrowers, as debt servicing is easier when net flows are constantly positive and rising. On the other hand, we will view positively an MLI that can mitigate its credit risk losses using third-party guarantees or physical collateral, provided that this collateral is of high quality, liquid, and enforceable, in our opinion.

50. Further, the criteria evaluate risk and financial management. Standard & Poor's assesses as "positive" risk management that articulates and maintains conservative risk tolerances, maintains its underwriting standards during periods of growth or change in exposure (notably while fulfilling its countercyclical lending role), and stays focused on its core activities or prudently approaches new business. Conversely, risk management is "negative" when an MLI is displaying one or more of the following characteristics: the MLI's management maintains aggressive risk tolerance policies; it requires weaker loan conditionality relative to peers'; it shows more aggressive recent organic growth and more significant prospects for future growth than in the past when compared with other MLIs in similar regions; or it moves materially into new countries or product lines outside of its traditional area of expertise.

3) Risks the RACF does not cover

51. The risk position analysis also seeks to adjust for the risks not covered in the RACF, such as the interest rate risk and currency risk in the MLI's operations, the yearly variation of pension funding, the market risk of derivatives positions, and single-name concentration to private-sector exposures. In particular, an analysis of interest rate risk and currency includes a review of relevant stress scenarios the MLI performs, as well as its hedging policy, including basis and partial hedging risks.

52. Unfunded benefit scheme liabilities, including pension deficits, are deducted from ACE when an MLI's financial statements have not fully recognized them. However, the MLI may face additional risk for defined benefit pensions from potential movements in the values of the scheme's assets and liabilities, and the RACF does not otherwise include this risk. Therefore, this additional risk is accounted for in this category. The risk depends on the size of the scheme's liabilities; key actuarial assumptions, including the discount factor, life expectancy, or future salary increases; and other variables such as the investment policy and amount of reinsurance used.

b) Funding and liquidity

53. Funding and liquidity are combined to form the second main factor we use to assess an MLI's financial profile. How an MLI funds its business and the confidence-sensitive nature of its debts directly affect its ability to maintain lending volumes and to meet obligations. The combination of funding and liquidity results in the assessment that ranges from "very strong" to "very weak" (see table 8).

Table 8

Assessing An MLI’s Financial Profile: Funding And Liquidity

	--Liquidity--					
--Funding--	**Very strong**	**Strong**	**Adequate**	**Moderate**	**Weak***	**Very weak§**
Positive	Very strong	Strong	Adequate	Adequate	Weak	Very weak
Neutral	Strong	Strong	Adequate	Moderate	Weak	Very weak
Negative	Strong	Adequate	Moderate	Weak	Very weak	Very weak

*When liquidity is “weak,” the institution SACP is capped at ‘bb’. §When liquidity is “very weak,” the institution SACP is capped at ‘ccc’.

i) Funding

54. We assess the strength and potential volatility of an MLI's funding by reviewing its funding mix and funding profile, using qualitative and quantitative measures. Unlike commercial banks, MLIs usually do not take deposits and generally have no access to central bank funding and liquidity mechanisms. They fund themselves primarily through unsecured borrowings in the capital markets, although some smaller institutions have loans from other MLIs, bilateral development banks, or commercial banks.

55. The assessment of an MLI's funding mix is mostly based on the diversification of its funding sources and its access to capital markets. In assessing an MLI's access to capital markets, indicators such as the tenor and composition of the MLI's yield curve and marginal net interest revenue inform our view. We also observe credit spreads on MLI's bonds to the extent they are indicative of a shift in MLI's credit fundamentals. Although we recognize that most MLIs have mechanisms to adjust pricing to reflect changing funding conditions, materially adverse trends (such as significant widening of spreads) or factors that could lead to a material deterioration in the MLI's funding conditions (such as a significant lowering of a shareholder rating or a questioning of the institution's policy role) weigh on the assessment.

56. We also analyze the structural match between the duration of an MLI's assets and liabilities, looking at the schedule of its assets and liabilities over the current and next five years.

57. Table 9 summarizes the characteristics that Standard & Poor's uses to classify MLIs in terms of funding.

Table 9

Assessing An MLI's Financial Profile: Funding

Funding assessment	Characteristics
Positive	The MLI has established and substantial market access that significantly exceeds its liquidity needs, as informed by factors such as:
	--An MLI is a regular benchmark issuer as needed to fund its activities;
	--No overreliance on a single market;
	--No expected material deterioration in the MLI’s funding conditions, which could result from factors such as a significant lowering of its shareholders’ ratings or a questioning of its policy role; and
	--The MLI has a conservative funding profile, with cumulative assets exceeding consistently cumulative debt for maturities up to one year and no significant gap for five years.
Neutral	Other MLIs
Negative	The MLI meets at least one of the three factors below:
	1) Expected material deterioration in the MLI’s funding conditions.
	2) Limited access to external sources of liquidity or inadequate available market access relative to current or future funding needs as reflected by any of the following factors:

Table 9

Assessing An MLI's Financial Profile: Funding (cont.)	
	--The MLI is an infrequent issuer,
	--Its issues are of limited size, or
	--It relies predominantly on bank funding.
	or
	3) A vulnerable funding profile, as reflected by any of the following factors:
	--Significant reliance on short-term liabilities,
	--Large funding gap, or
	--A marginal cost of funds in excess of marginal yield on earning assets.

ii) Liquidity

58. Our liquidity analysis centers on an MLI's ability to manage its liquidity needs in adverse market and economic conditions and its likelihood of normal functioning over an extended period in such conditions. It is primarily based on the analysis of sources and uses of liquidity. The analysis seeks to find the balance between an MLI's expected and contingent uses for liquidity and its sources of reliable liquidity during adverse market and economic conditions. It considers different survivability periods--e.g., one, three, six, and 12 months--because market disruptions or economic downturns may persist for extended periods. Where relevant, the analysis examines the potential for local or foreign currency mismatches. An implicit part of this assessment is the strength of an MLI's liquidity risk management framework and controls, taking into account the type of business it undertakes and the markets in which it operates.

59. The potential uses of cash are assessed to determine an MLI's contractual and contingent short-term obligations, including the following:

- The maturity profile of liabilities, assuming no access to the markets;
- Disbursements of undrawn loan commitments;
- Requirements to post collateral on derivatives payables;
- Potential calls under guarantees; and
- Support payments to affiliates (through earnings distributions).

60. The potential sources of cash include the following:

- Repayment of purpose-related exposures;
- Drawdown of unrestricted cash and short-term inter-bank placements;
- Drawdown of committed credit facilities, subject to conditionality and headline considerations;
- The repayment, repo, or sale of unencumbered high-quality liquid securities in the open market; and
- Disbursement of paid-in capital in line with scheduled general capital increases.

61. This analysis of the potential "liquidity gap" between sources and uses of cash is done on a forward-looking basis over the next one, three, six, and 12 months. This liquidity analysis is then stressed for adverse market and economic conditions.

62. Thus, we adjust liquid and maturing assets by applying the risk haircuts to assets depending on the asset class, the rating, and the maturity (see paragraph 97).

63. Table 10 summarizes the characteristics that Standard & Poor's uses to classify MLIs in terms of liquidity. This liquidity

assessment takes into consideration the confidence-sensitivity of an MLI's funding profile and the generally high rating level of this asset class. We also analyze the eligibility of the liquid assets to repo with a central bank either directly (should the bank have direct access) or indirectly via commercial banks.

Table 10

Assessing An MLI's Financial Profile: Liquidity

Assessment	Characteristics
Very strong	All the characteristics below apply:
	--The MLI can consistently maintain its scheduled loan disbursements to its borrowing members without access to market funding in the next 12 months, under stressed market and economic conditions and without withdrawing principal resources from borrowing members.
	--There are no unusual or large liquidity needs in the next 12-24 months, resulting, for instance, from a significant ramp-up expected in the disbursement of committed loans or from material or easily identified contingent liabilities.
	--There are no financial ratio covenants or rating triggers on material facilities that would result in liquidity strain.
Strong	--The same characteristics as for "very strong" apply, except that the MLI would likely need to reduce moderately the scheduled loan disbursements to its borrowing members under such circumstances.
Adequate	All the conditions below apply:
	--The MLI can consistently maintain its scheduled loan disbursements to its borrowing members without access to market funding in the next six months, under stressed market and economic conditions, and without withdrawing principal resources from borrowing members. However, under such circumstances, it may have to reduce significantly the scheduled loan disbursements in the following six months in order to ensure full coverage of its liabilities.
	--There are no unusual or large liquidity needs in the next 12-24 months, resulting for instance from a significant ramp-up expected in the disbursement of committed loans or from material or easily identified contingent liabilities.
	--There are no financial-ratio covenants, or rating triggers, on material facilities that would result in liquidity strain.
Moderate	Any of the conditions below apply:
	--The MLI can consistently survive no access to market funding in the next three months, under stressed market and economic conditions, and without withdrawing principal resources from borrowing members, but it may have to reduce significantly its scheduled loan disbursements under such circumstances.
	--An expected increase in liquidity needs in the next 12-24 months due, for instance, to a significant ramp-up expected in the disbursement of committed loans or to the materialization of important contingent liabilities.
	--Covenants or triggers are present that, if violated, could result in liquidity strain or cancellation of existing facilities, thereby limiting the MLI's ability to meet the conditions for a higher liquidity score.
Weak	Any of the conditions below apply:
	--The MLI can survive no access to market funding in the next month, but it may have to reduce significantly its scheduled loan disbursements under such circumstances.
	--Covenants or triggers are present that, if violated, could result in liquidity strain or cancellation of existing facilities, thereby limiting the MLI's ability to meet the conditions for a higher liquidity score.
Very weak	The MLI's access to market funding is under significant pressure.
	--The MLI may not be able to meet its next month's financial obligations.
	--Covenants or triggers are present that, if violated, could result in liquidity strain or cancellation of existing facilities, thereby limiting the MLI's ability to meet the conditions for a higher liquidity score.

B. Assessing The Likelihood Of Extraordinary Shareholder Support

64. Once the assessment of an MLI's SACP is complete, the methodology evaluates the likelihood that an institution would receive extraordinary shareholder support to service its debt obligations if needed. In the case of MLIs, extraordinary shareholder support usually comes in the form of an injection of callable capital and less often in the form of guarantees or other type of support.

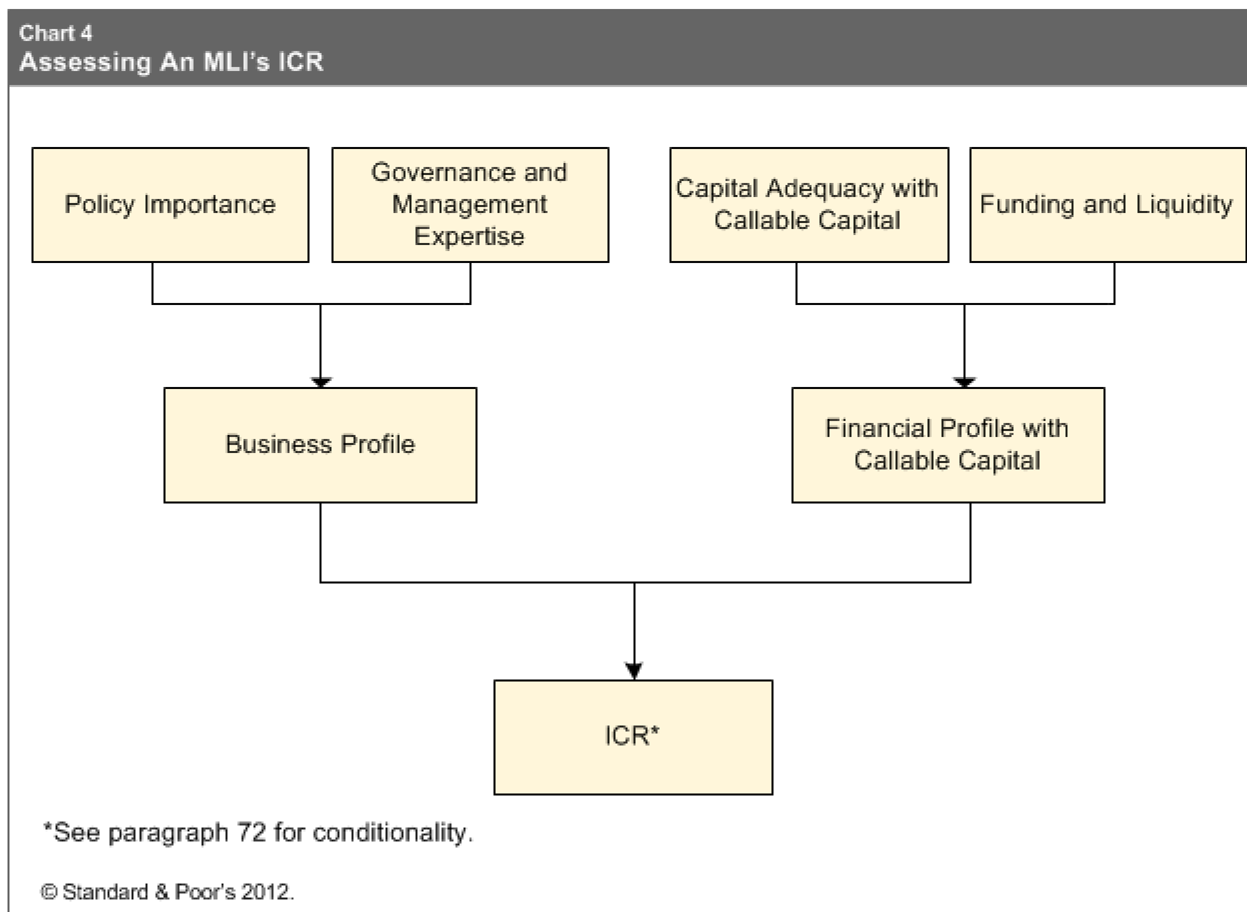
65. Callable capital is a characteristic of most MLIs. It corresponds to a commitment by each shareholder to make additional capital available, but generally only when necessary to avoid an MLI's default on a borrowing or a call of a guarantee. The size of capital subscriptions generally varies among members, in proportion to their ownership shares. However, the ratio of paid-in to callable capital is generally the same for each shareholder. An MLI's callable capital is typically a multiple of its paid-in capital and often exceeds not only paid-in capital, but also shareholders' equity. If a capital call is made, each shareholder is responsible for providing the same percentage of the callable capital to which it has subscribed. Moreover, each shareholder is typically responsible for meeting a call on capital, up the amount to which it has subscribed, even if other shareholders do not.

66. To our knowledge, there is no precedent for a call being made on callable capital of a rated MLI to avoid a default on a borrowing or on a call of a guarantee. The mechanism explaining when and how callable capital would be called for payment is usually described in general terms in the MLI's article of agreement and can vary by institution. In most cases, it is the responsibility of the MLI's board of governors or board of directors to call for the amount of the unpaid subscription necessary to meet the payment of debt or guarantees. We assign value to the callable capital because we believe these commitments are credible and constitute a strong incentive for the shareholders to support an MLI in times of stress. At the same time, given the absence of a track record on the use of callable capital and given that the directors who vote to make the call are appointed by the governments to which the call is made, it is difficult to assess with certainty under what level of stress a board would make a capital call, how long the approval process would take for the member governments, and what demonstration effect nonpayment of a capital call by one member government would have on others.

67. In some cases, a joint shareholder guarantee on nonperforming outstanding loans may exist. Exercising this guarantee may be subject to certain defined conditions. Analytically, we treat these guarantees like callable capital because we would expect the process and the financial impact on calling on the guarantee to be broadly comparable to that of calling callable capital.

68. We reflect the positive impact of the callable capital on the MLI's creditworthiness by assessing how callable capital would affect the RAC ratios. More specifically, we add to the numerator of the RAC ratios the callable capital from all shareholders that have foreign currency ratings equal to or higher than the issuer credit rating on the MLI. The denominators of the RAC ratios are unchanged. The RAC ratios before and after adjustments enhanced by this additional capital form the basis of our updated assessment of the capital adequacy.

69. An improvement in the capital adequacy after the callable capital is factored in will improve the financial profile, assuming no change in the liquidity or funding profiles. We then determine the issuer credit rating on the MLI (see chart 4) as the combination of the "enhanced" financial profile (including the benefit of the callable capital) and the business profile as per table 1. In cases where the matrix presents a range of ratings, we apply the same bound (lower, upper, or middle point--if the cell gives the choice between the three ratings) for the ICR as we did when choosing the SACP. For instance, if the SACP fell in the cell 'a+'/'a' and if the peer comparison and/or trend in business and financial profiles led us to select a lower bound 'a', then if the ICR fell in the cell 'AA+'/'AA', we would select the lower bound as well (i.e., 'AA').



70. We only include the callable capital from the shareholders rated at or above the issuer credit rating on the MLI. We make this distinction in the level of support, since we note that the market conditions that would lead to an MLI being on the verge of default and, thus, resorting to a capital call could entail its own shareholders being under similar stress with diminishing capacity to provide support. Such a diminishment of capacity would likely be reflected in the ratings on the shareholders.

71. At the same time, we view the callable capital from all shareholders as a potential stabilizing factor for an MLI's capital and earnings assessment. Specifically, if an MLI's creditworthiness deteriorates, the resilience of shareholder ratings can stabilize an MLI's worsening financial profile. This could be the case when the issuer credit rating on an MLI falls to or below the level of some previously excluded shareholders providing callable capital. We also take into account callable capital from shareholders rated below the MLI indirectly in the business profile of the SACP, when evaluating the general shareholders' support.

72. We limit the maximum support provided by the callable capital to three notches from the SACP. This is due to the uncertainties regarding the capital call process. Our view on the maximum uplift can vary from zero to three notches, depending on the RAC calculation before considering callable capital and on the shareholders' willingness and ability to make a payment on callable capital, as informed by the following considerations:

- The adequacy of the legal and administrative process in place to ensure that a capital call will be made if management believes that a call is necessary to avoid a default.
- The shareholders' ability to make the payment of capital when called. This view is informed by the legal and administrative processes required for the shareholders to make such payment shortly after the capital call.
- The shareholders' willingness to make the payment of capital when called. This view is informed by the shareholders' record in increasing the MLI's capital when needed to support its public policy role or its growing activity, and their record of paying on schedule the paid-in capital for general capital increases. This assessment is not limited to the specific MLI, but could extend to shareholders' record of promptly paying capital subscriptions to other MLIs for which they are members. In cases of shareholders' failure to make their payments of capital subscriptions, or repeated arrears on capital subscriptions, we could consider their willingness to make payment on callable capital as low. Conversely, recent increases in paid-in capital by shareholders would affect positively our assessment of shareholder's willingness to support the MLI.
- An MLI's policy importance score (see table 3). If policy importance is scored "very strong" or "strong," the uplift due to callable capital is capped at three notches; if scored "adequate," the uplift is capped at one notch. MLIs with "moderate" or "weak" policy importance cannot receive any uplift for callable capital.

73. Some MLIs benefit from other forms of shareholder support, such as guarantees on debt obligations or support from a parent institution or from a government. In these cases, we may apply an additional uplift above the MLI's SACP based on the approach explained in section V.C.

C. Methodology For Rating Other Nonbank Supranational Institutions

74. Other rated supranational institutions consist of a number of disparate entities ranging from multilateral insurance institutions to public policy institutions or vehicles. These entities were previously rated based on criteria "Principles Of Credit Ratings," or now superseded "Criteria For Multilateral Lending Institutions" or "Criteria For Rating Multilateral Aid Agencies."

75. Whenever possible, the methodology applies a similar two-step approach involving the assessment of the entity's SACP under the applicable criteria and then the assessment of the likelihood of extraordinary shareholder support, using the framework outlined in section V.B. However, in some cases, the nature of the supranational institution or the presence of various forms of support mechanism from its shareholders would lead to applying a different rating approach. This section presents the various forms of other supranational institutions and outlines corresponding rating approaches.

1. Rating approach for multilateral insurance institutions

76. For multilateral insurance institutions, assigning an issuer credit rating (ICR) or financial strength rating (FSR) consists of two key steps:

- Step 1: Determining the SACP. The SACP is determined in large part by using the insurance criteria (see "Interactive Ratings Methodology," published April 22, 2009, and "Request For Comment: Insurers: Rating Methodology," July 9, 2012). However, to reflect the specificity of multilateral insurance institutions' public policy role, the business risk profile score in the insurance criteria is substituted by the "business profile" assessment, as described in section V.A. MLI insurers tend to have exposure particularly to the private sector, with loss recovery for noncommercial (investment) risks from sovereign governments. The rest of the insurance rating methodology applies for

determining the SACP.

- Step 2: Assessing the impact of extraordinary shareholder support. This assessment uses the framework laid out for MLIs in section V.B.

2. Rating approach for rating multilateral aid agencies

77. The rating approach for multilateral aid agencies is based on support by multiyear sovereign commitments to fund aid activities. The analysis focuses on the nature of the commitments and the buffer between the amounts of the collective commitments and the debt that the aid agencies may incur based on these commitments. More specifically, multilateral aid agency ratings are based on the ratings on the sovereign donors, adjusted by their history of making contributions on a timely basis, and the scope for moderate payment delays provided by the buffer.

78. The approach is divided into two steps. The first step is an assessment of the value of sovereigns' commitments to pay installments of multiyear grants to aid agencies compared with their undertakings to provide paid-in capital to MLIs or their obligation to service their own debt. The second step is the assessment of the buffer provided by the excess of the present value of these commitments over the present value of the debt issued.

79. Because of the generally narrow focus of multilateral aid agencies that provide essential public purposes, we believe that the willingness of sovereigns (that have entered into legally documented obligations) to fund contributions through multiyear grants will generally rank above the sovereign's willingness to provide paid-in capital to MLIs. Depending on the aid agency in question, a sovereign's willingness to provide these grants could be equal to their willingness to service their own debt obligations. In our opinion, the perception that a charitable institution has become ineffective or that other factors have eroded political support for the institution could jeopardize this willingness. When we observe that sovereigns are late in making fund contributions or when we have other cause to believe political support for the multilateral aid agency has diminished, ratings will likely be lowered to reflect the increased risk that future inflows will be insufficient to service the multilateral aid agency's debt.

80. The difference between the present values of legally documented sovereign commitments and the debt that the aid agency issues based on these commitments is, in effect, a cushion and may be viewed as similar to capital. Accordingly, size matters, and a default by a government with a major commitment would be more serious (and have larger implications for the rating on the multilateral aid agency) than a default by a government with a smaller commitment.

81. Step 2 of the rating approach includes the analysis of the buffer against late payments. The buffer is based on the difference between the present values of legally documented commitments and the debt that is issued based on these commitments. The failure of a contributor to make a scheduled contribution reduces the size of that buffer. A protracted failure by a government on its commitment would be a negative factor for the rating. However, a protracted failure by a government with a major commitment would weigh more heavily on the rating than a default by a sovereign with a smaller commitment. The credit standing of the government is also taken into consideration; a default by the government of a highly rated sovereign would be viewed more negatively than that of a lower-rated sovereign. Finally, the timing of the default is also a factor: A default early in the life of the entity may provide the opportunity to rebuild the cushion or prompt a smaller issuance of debt.

3. Rating approach for supranational institutions established by governments to fulfill a unique policy role.

82. This category consists of institutions that have been established by governments to fulfill a unique policy role. It includes entities that operate on the world economic and political stage. This category does not include monetary funds that are rated using the MLI criteria, or supranational monetary authorities and central banks which are rated using the criteria "Monetary Authorities Rating Methodology," published Sept. 14, 2012.

83. We rate these institutions according to the GRE criteria, "Rating Government-Related Entities: Methodology and Assumptions," published Dec. 10, 2010. Standard & Poor's analyzes the role of the institution, its bylaws, and its funding. We also assess the nature of the link between the institution and each government, as well as the relationship among the different governments. Depending on this assessment, the rating approach to the supranational could be as follows:

- If, in our view, one government has a prominent link with the supranational and would appear to be the most willing to support fully the institution, even if the other governments don't, we would use the local currency rating on that one government as a reference in tables 4-8 of the GRE methodology.
- If support were to come from all member states for their respective shares (for instance, based on ownership percentages), then we would use the lowest government local currency rating upon whose resources the institution's debt service rely as a reference in tables 4-8.
- If we see a significant risk that diverging interests of shareholders or slow joint decision-making could weaken support to this class of supranational, this could bear on our assessment of the likelihood of support, bringing it down to "low," as defined in table 1 of the GRE criteria.

84. The supranational institution could be rated at the same level as its most highly rated significant member states in cases where the institution's bylaws provide for full and timely payment of debt service obligations by resources or support from these member states. In these institutions, the debt service may be assured by a combination of a debt limit, reserve mechanism, guarantees, some forms of "joint and several" support, or access to member state resources. The supranational rating is then linked to that of its most creditworthy member states upon whose resources the institution's debt service rely.

4. Rating approach for supranational institutions with a high degree of operational and financial integration with a parent institution

85. This category consists of institutions with a high degree of operational and financial integration with a parent institution, which could be an MLI or another supranational institution. In this category, the supranational is economically a division of the parent, even though it may be a legally separate entity. This would be the case for entities that are assessed as "core" or "highly strategic" under the "Group Rating Methodology and Assumptions," published Nov. 9, 2011. An entity would be assessed as "core" if it is integral to the group's current identity and future strategy and if it is likely to receive support from its parent under any foreseeable circumstances. A "core" entity can share with a parent institution the same name or the same budget or debt program, or it can share administrative functions with the group. In such cases, the rating on the supranational institution is driven by the application of the group methodology. Under this methodology, the rating on a "core" subsidiary could generally be at the level of the group credit profile, while the rating on a "highly strategic" subsidiary would be one notch below. We apply this approach to rate subsidiaries of MLIs, but also supranational institutions that are closely integrated with another

institution--for instance, through a common budget or a common debt issuance program.

5. Rating approach for supranational institutions issuing debt instruments that benefit from shareholder guarantees

86. Some supranational institutions issue debt instruments that may benefit from a form of shareholder guarantee. The guarantee's impact on the issue rating on the institution depends on the guarantee mechanism, which can take multiple different forms.

87. If an institution's debt obligations are guaranteed by a government, then the issue rating would generally be based on the guarantor's creditworthiness, provided that the terms of the guarantee meet the conditions for credit substitution in the criteria "Rating Sovereign-Guaranteed Debt," published April 6, 2009.

88. If the institution's debt obligations benefit from a several guarantee from its shareholders, in which each sovereign government bears debt-servicing responsibility for only its own portion of the proceeds, then Standard & Poor's would generally rate the bond at the level of the lowest-rated participating sovereign upon whose guarantee the full and timely repayment of the bond relies, irrespective of how large or small that sovereign's share in the bond may be (see "Methodology: Weak-Link Approach For Composite Government Issuance With Several Payment Responsibilities," published May 29, 2009). In cases where the shareholder guarantees cover more than the institution's current and expected debt program, through a form of overcollateralization, then Standard & Poor's would determine the subset of the highest-rated shareholders, whose cumulative overcollateralization will cover 100% of the institution's debt program. The bond will be rated at the level of the lowest-rated participating sovereign from this subset.

89. If an institution's debt obligations benefit from a partial or a nontimely guarantee from its shareholders, the issue rating may receive uplift from the rating on the primary obligor based on the expected post-default recovery prospects. This uplift is based on our expectation of the expected recovery and can reach up to three notches if the rating on the institution is 'BB+' or lower, up to two notches if the rating is in the 'BBB' category, and up to one notch if the rating is in the 'A' category. Ratings in the 'AA' category will receive no uplift (for more details, see "Methodology: Partially Guaranteed Sovereign Debt May Benefit From Notching Based On Recovery Considerations," published Nov. 9, 2009, and "Rating Sovereign-Guaranteed Debt," published April 6, 2009).

VI. APPENDIX

A. Adjustment To RAC Calculation And Liquidity Haircuts

1. Risk weights

90. To take into account the expected PCT of sovereign and sovereign guaranteed loans and historically greater recovery rate experience, we improve the risk weights assigned to the sovereign exposures in the risk-weight calculation (see table 11). The risk weights also consider the share of multilateral debt in the total external debt of the sovereign.

Table 11

Risk Weights For Central Government Exposures (%)

	--Share of multilateral debt in the total external debt--			
Sovereign long-term foreign currency credit rating	**<25%**	**25%-50%**	**50%-75%**	**>75%**
AA- and above	3	3	3	3
A+	3	3	3	5
A	3	3	5	9
A-	3	5	9	15
BBB+	5	9	15	23
BBB	9	15	23	34
BBB-	15	23	34	47
BB+	23	34	47	62
BB	34	47	62	79
BB-	47	62	79	99
B+	62	79	99	122
B	79	99	122	146
B- and below	99	122	146	173

91. Whenever material, we cap the risk weight of high risk exposures (e.g., private equity) so that the capital allocated to such exposures does not exceed the exposed amount. Whenever the cap is applied, the resulting RAC ratio is the same as what we would obtain if we deduct 100% of these high-risk exposures from the ACE (i.e., assuming that the loss under our stress scenario would amount to the entire exposure).

2. Concentration adjustment and liquidity haircuts

92. To adjust for concentrations on sovereign exposures, we use the same formula as for corporate exposures, but without the quadratic scaling, which was introduced for corporates because of the limited information available on large exposures. The rest of the assumptions are identical to the methodology for single-name concentration on corporate exposures, detailed in appendix B of the "Bank Capital Methodology And Assumptions," published Dec. 6, 2010.

93. In practice, the formula originally described and tested by Gordy and Lütkebohmert (see "Granularity adjustment for Basel II," published by the Deutsche Bundesbank as a Discussion Paper, Series 2: Banking and Financial Studies, No 01/2007 in January 2007) simplifies to the following based on sovereign exposures reported to us:

94. Sovereign Single Name Add-on = Sum over all sovereign exposures [(si*si) * Qi * Ci / (2 * K)]

95. Where:

- si = EAD(i) / Total Sovereign EAD, is the share of the sovereign total exposures corresponding to sovereign i.
- Qi= Delta * (Ki + Ri) - Ki is used for notational convenience.
- Parameter Delta equals 4.83
- Ci = [(LGD*LGD) + 25% * LGD * (1-LGD)] / LGD. Ci can be viewed as a stressed LGD using its normalized variance.
- Our LGD assumption varies from 10% to 45% depending on our expectation for PCT based on the PCT and loss experience track record as per table 3. We would usually assume 10% LGD for institutions with "very strong" PCT; 20% LGD for institutions with "strong" PCT; 30% LGD for MLIs with "adequate" PCT; 40% LGD for MLIs with

"moderate" PCT; and 45% LGD for MLIs with "weak" PCT.

- Ki is the Basel 2 Unexpected Loss for exposure i (in percent of EAD) computed using the Basel 2 Foundation IRB formula, where the Probability of Default (PDi) is set as the long-term averaged Standard & Poor's global corporate default rate for the rating class when the exposure is rated. Sovereigns rated 'AAA' to 'AA-' are assumed to have a 0% Probability of Default. If the exposure is not rated, we use a proxy or internal credit estimate. The default rates are published in in "2009 Annual Global Corporate Default Study and Rating Transitions," March 17, 2010.
- Ri = PDi * LGD, is the expected loss for exposure i (in percent of EAD).
- K is the sum of Ki for all sovereign exposures (in percent of EAD).

96. To avoid double counting, we then remove the concentration adjustment based on GDP for geographic concentration and do not apply the adjustment for business line concentration and diversification. Given that many MLIs are concentrated on a few sovereigns, the single-name concentration adjustment for sovereign exposures is material, leading to a reduction of the RAC ratio in most cases.

97. See table 12 for liquidity haircuts.

Table 12

Liquidity Haircuts (%)

		--Liquidity risk haircut**--				
Asset class	**Credit risk haircut***	**Maturing within three months**	**Maturing between three and six months**	**Maturing between six and 12 months**	**Maturing between one and five years**	**Maturing beyond five years**
Cash/demand deposits	0					
Unencumbered securities rated 'AA-' or above						
Corporate§	1	15	20	26	44	56
Sovereign	1	2	3	4	14	18
Structured	6	100	100	100	100	100
Unencumbered securities rated 'A+' to 'BBB-'						
Corporate§	6	18	24	32	54	60
Sovereign	6	12	17	22	46	56
Structured	31	100	100	100	100	100
Unencumbered securities rated 'BB+' or below or unrated						
Corporate§	31	32	42	56	82	94
Sovereign	31	32	42	56	82	94
Structured	100	100	100	100	100	100
Loans and advances rated 'BBB-' or above	6					
Loans and advances rated 'BB+' or below or unrated	31					
Deposits and placements at banks rated 'AA-' or above	1					
Deposits and placements at banks rated 'A+' to 'BBB-'	6					

Table 12

Liquidity Haircuts (%) (cont.)	
Deposits and placements at banks rated 'BB+' or below or unrated	31
Derivatives	100
Publicly listed or privately held equity shares and funds	100
Other assets	100

*This credit risk haircut is applied to all assets maturing before the end of the ratio horizon, to reflect default risk. **The liquidity risk haircut is applied to securities maturing beyond the ratio horizon, to reflect valuation risk. For example, when computing the one-year liquidity ratio, we apply credit risk haircuts to all assets maturing within one year, and we apply the respective “one to five years” or “five years and beyond” columns to longer dated securities. All assets other than unencumbered securities that are not maturing during the stress period are applied a haircut of 100%. §Corporate includes financial and supranational institutions.

B. Responses To Standard & Poor's Request For Comment And Main Changes To Proposed Criteria

98. The majority of the responses we received on the RFC were from currently rated MLIs and a few from investors and other market participants. The feedback included generally positive comments on the greater transparency of our proposed revised approach. In response to our specific questions, we received the following comments:

99. On the first question regarding the appropriateness of key factors affecting a supranationals' creditworthiness and the choice of the main metrics, most--but not all--market participants responded favorably. Some institutions disagreed with the use and suitability of the RACF model (developed and used for commercial financial institutions) for the analysis of the supranationals. Specifically, the concern was raised that basing capital adequacy considerations on the RACF model does not take into account a very different business model, portfolio profile, and loss history of the MLIs compared with those of commercial banks. We redesigned the capital adequacy section to fully reflect the aforementioned specificities of the MLI's asset class in the risk position (both quantitatively and qualitatively). We stressed that PCT remains a cornerstone of the MLI's model and hence is recognized and accounted for in multiple areas of these criteria. Further, in the business profile, we expanded the analysis of the preferential treatment afforded to MLIs beyond the PCT. Specifically, we have incorporated the preferential treatment in our analysis of the policy importance. Additionally, we changed a number of quantitative adjustments (such as single-name concentration risk, liquid assets haircuts) to reflect different business and risk profiles of MLIs compared to the commercial banks.

100. On the second question regarding the proposal to incorporate the MLI's PCT as a positive adjustment to the capital and earnings analysis and reflect it in the risk position assessment, most respondents disagreed with such PCT treatment. Their concern was based on the view that such qualitative treatment will underestimate a positive impact of the PCT on the capital adequacy position. We have revised the capital adequacy section by removing the concentration and diversification adjustment from the RAC ratio to make a more transparent comparison between "unadjusted" RAC for MLIs and the RAC ratios for the commercial banks. We then have combined the concentration risk, PCT, and other adjustments in the risk position. We quantified the PCT and concentration adjustments by calculating the adjusted (MLI-specific) RAC in the risk position table 7. We will publish both unadjusted and adjusted RAC ratios. We have expanded the risk position table to include "very positive" and "extremely negative" categories.

101. On the final question on our proposal to reflect callable capital as a form of extraordinary support permitting a rating uplift of up to three notches, we received mixed comments. Some respondents agreed with the proposals, while others believed that more flexibility should be allowed (e.g., including callable capital from lower-rated shareholders and removing a cap for a three-notch uplift). We believe that the initially proposed framework adequately balances out the uncertainty of a never-tested mechanism for this asset class with the strength of shareholders' support, based on their callable capital subscriptions. Consequently, we have not changed our proposed approach.

102. In addition, we received and analyzed a few comments on some specific aspects of our methodology. In instances where we believe that a comment was relevant for our analysis of MLIs and other supranational institutions worldwide, we have made marginal changes in our methodology. However, in other cases, we have considered that some comments were mostly relevant for a specific MLI, but not for the asset class more broadly, or we have considered that the issue was addressed in other parts of the methodology.

103. The main changes between the criteria presented in the request for comment and the final criteria are:

- We have included the preferential treatment in our analysis of the policy importance. The preferential treatment is the preferential access to foreign exchange often afforded to MLIs by excluding private sector obligations to MLIs from restrictions on access to exchange needed for debt service.
- We have presented "governance and management expertise" as a separate analytical factor, rather than an adjustment to the "policy importance" assessment. We have expanded and renamed the "governance and management expertise" assessment to "strong," "satisfactory," "fair," and "weak" to be consistent with the nomenclature in "Management And Governance Credit Factors For Corporate Entities And Insurers," published Nov. 13, 2012.
- We have directly incorporated the adjustment for quality of capital and earnings through our qualitative forward-looking view of the unadjusted RAC ratio.
- We have removed concentration and diversification adjustment from the RAC ratio to make a more transparent comparison between unadjusted RAC for MLIs and the RAC ratios for the commercial banks. We have combined the concentration risk, PCT, and other adjustments in the risk position.
- We have expanded the risk position table to include "very positive" and "extremely negative" categories to accommodate for the current and projected distribution of the adjusted RAC ratios.
- We have presented the "funding and liquidity" assessment as a separate analytical factor, rather than an adjustment to "capital adequacy."

VII. RELATED CRITERIA AND RESEARCH

- Request for Comment: Insurers: Rating Methodology, July 9, 2012
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Group Rating Methodology and Assumptions, Nov. 9, 2011
- Banking Industry County Risk Assessment Methodology and Assumptions, Nov. 9, 2011
- Supranationals Special Edition 2011, Sept. 23, 2011
- Principles Of Credit Ratings, Feb. 16, 2011
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

- The Time Dimension Of Standard & Poor's Credit Ratings, Sept. 22, 2010
- Credit Stability Criteria, May 3, 2010
- For Development Banks, Callable Capital Is No Substitute For Paid-In Capital, Dec. 31, 2009
- Methodology: Partially Guaranteed Sovereign Debt May Benefit From Notching Based On Recovery Considerations, Nov. 9, 2009
- Understanding Standard & Poor's Rating Definitions, June 3, 2009
- Methodology: Weak-Link Approach For Composite Government Issuance With Several Payment Responsibilities, May 29, 2009
- Interactive Ratings Methodology, April 22, 2009
- Rating Sovereign-Guaranteed Debt, April 6, 2009

104. 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.

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