

### General Criteria:

## Methodology: Credit Stability Criteria

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## General Criteria:

# Methodology: Credit Stability Criteria

*(Editor's Note: This article supersedes "Standard & Poor's To Explicitly Recognize Credit Stability As An Important Rating Factor," published Oct. 15, 2008.)*

1. Standard & Poor's Ratings Services is clarifying its criteria for recognizing credit stability as an important rating factor. We are publishing this article to help market participants better understand how credit stability is incorporated in our ratings. This article is related to "Principles Of Corporate And Government Ratings," which we published on June 26, 2007, and "Principles-Based Rating Methodology For Global Structured Finance Securities," which we published on May 29, 2007.

## SCOPE OF THE CRITERIA

2. These criteria apply to credit ratings on all types of issuers and issues.

## SUMMARY OF CRITERIA UPDATE

3. Standard & Poor's incorporates credit stability as an important factor in our rating opinions. When assigning and monitoring ratings, we consider whether we believe an issuer or security has a high likelihood of experiencing unusually large adverse changes in credit quality under conditions of moderate stress. In such cases, we would assign the issuer or security a lower rating than we would have otherwise.
4. This update clarifies the meaning of "moderate stress," as used in these criteria, and supersedes "Standard & Poor's To Explicitly Recognize Credit Stability As An Important Rating Factor," published Oct. 15, 2008.

## EFFECTIVE DATE AND TRANSITION

5. These criteria are effective immediately for all new and outstanding ratings.

## METHODOLOGY

6. When assigning and monitoring ratings, we consider whether we believe an issuer or security has a high likelihood of experiencing unusually large adverse changes in credit quality under conditions of moderate stress (for example, recessions of moderate severity, such as the U.S. recession of 1982 and the U.K. recession in the early 1990s or appropriate sector-specific stress scenarios). To promote rating comparability, we use hypothetical stress scenarios as benchmarks for calibrating our criteria across different sectors and over time (see "Understanding Standard & Poor's Rating Definitions," published June 3, 2009). Each scenario broadly corresponds to one of the rating categories 'AAA' through 'B'. The scenario for a particular category reflects the level of stress that issuers or obligations rated in that category should, in our view, be able to withstand without defaulting. The 'BBB' stress scenario connotes moderate stress.

## Defining An Unusually Large Decline In Credit Quality

7. The table shows the maximum projected deterioration under moderate stress conditions that we would associate with each rating level for time horizons of one year and three years. For example, we would not assign a rating of 'AA' where we believe the rating would likely fall below 'A' within one year under moderate stress conditions.

Maximum Projected Deterioration Associated With Rating Levels For One-Year And Three-Year Horizons Under Moderate Stress Conditions						
	AAA	AA	A	BBB	BB	B
One year	AA	A	BB	B	CCC	D
Three years	BBB	BB	B	CCC	D	D

8. These credit-quality transitions do not reflect our view of the expected degree of deterioration that rated issuers or securities could experience over the specified time horizons. Nor do they reflect the typical historical levels of deterioration among rated issuers and securities. In fact, instances of credit deterioration of this magnitude and speed have been relatively uncommon. These criteria do not imply that we believe that issuers or securities should become--or are likely to become--less stable.
9. Rather, the values in the table express a theoretical outer bound for the projected credit deterioration of any given issuer or security under specific, hypothetical stress scenarios. Actual experience likely will vary from the hypothetical scenarios, so the universe of rated issuers and securities (as well as sub-populations of the full universe) likely will display actual degrees of deterioration greater than or less than those indicated in the table. For example, we would naturally expect relatively little credit deterioration during benign market conditions or during conditions of only mild or modest stress, which we view as the 'B' and 'BB' stress scenario, respectively. Conversely, issuers and securities could suffer greater degrees of credit deterioration during periods of severe (AA scenario) or extreme (AAA scenario) stress. In addition, specific business segments--such as housing, energy, retail, and transportation--could experience different degrees of stress over any given period.
10. We do not intend this approach to result in rating upgrades in sectors that have historically displayed above-average credit stability. Instead, we intend the framework to function as a limiting factor on the ratings assigned to credits that we believe are vulnerable to exceptionally high instability.
11. The primary focus of the stability consideration is intended to be ordinary business risk rather than special types of risk, such as changes in laws, fraud, or corporate acquisitions.
12. The methodology is asymmetric in that it focuses solely on credit deterioration rather than on credit improvement. There are two reasons for this approach. First, investors and creditors have expressed greater concern about deterioration than improvement. Second is the essential downside/upside asymmetry of the basic credit proposition.

## Why Did Standard & Poor's Adopt This Approach?

13. We incorporate credit stability in our ratings in light of the high degree of credit volatility displayed by certain derivative securities in recent years. By explicitly recognizing stability as a factor in our ratings, we intend to align their meanings more closely with our perception of investors' desires and expectations.
14. Responses to our July 16, 2008, Request For Comment on this subject reinforce our belief that investors generally

prefer high ratings to be more stable than low ratings. High ratings should connote high stability.

15. As a general matter, our ratings express our opinion of the creditworthiness of issuers and specific securities. However, the notion of creditworthiness has sometimes been interpreted differently in various market segments. In particular, certain areas of the structured finance segment have favored a narrow interpretation, essentially meaning "likelihood of default" without regard to other factors. We have moved beyond the narrow interpretation in favor of one that we believe is more practical and useful for market participants. As a result, although our view on likelihood of default remains a focus of our ratings, it is not our only consideration (see "Understanding Standard & Poor's Rating Definitions," published June 3, 2009).

## **RELATED CRITERIA AND RESEARCH**

- Big Changes in Standard & Poor's Rating Criteria, Nov. 3, 2009
- Understanding Standard & Poor's Rating Definitions, June 3, 2009
- Standard & Poor's Reaffirms Its Commitment To The Goal Of Comparable Ratings Across Sectors And Outlines Related Actions, May 6, 2008

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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