

RatingsDirect®

General Criteria:

Use Of CreditWatch And Outlooks

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General Criteria:

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(Editor's Note: We originally published this criteria article on Sept. 14, 2009. We're republishing this article following our periodic review completed on June 19, 2013. This article updates and supersedes "Credit Policy Update: Criteria On Use Of CreditWatch And Outlooks Clarified," published Sept. 30, 2005, and supersedes "Acquisition Risk And Its Effect On Ratings," published Sept. 11, 2006.)

Background

Standard & Poor's Ratings Services uses CreditWatch and ratings outlooks to indicate its view regarding the degree of likelihood of a rating change and, in most cases, the probable direction of that change. CreditWatch highlights the potential direction of a short- or long-term rating. It focuses on identifiable events and short-term trends that may cause ratings to be placed under special surveillance by Standard & Poor's. These may include mergers, recapitalizations, voter referendums, regulatory action, performance deterioration of securitized assets, or anticipated operating developments.

Ratings may be placed on CreditWatch when such an event or a deviation from an expected trend occurs and we believe that additional information is necessary to evaluate the current rating or when there is, in our opinion, a material change in the performance of securitized assets and the magnitude of the rating impact has not been fully determined. A CreditWatch listing, however, does not mean a rating change is inevitable, and when appropriate, a range of potential alternative ratings that we believe could result will be shown. CreditWatch is not intended to include all ratings under review, and rating changes may occur without the ratings having first appeared on CreditWatch. The "positive" CreditWatch designation means that a rating may be raised; "negative" CreditWatch means a rating may be lowered; and "developing" CreditWatch means that a rating may be raised, lowered, or affirmed. (See Ratings Definitions)

A Standard & Poor's rating outlook indicates our view regarding the potential direction of a long-term credit rating over the intermediate term (typically six months to two years). In determining a rating outlook, consideration is given to any changes we see in the economic and/or fundamental business/financial conditions. An outlook is not necessarily a precursor of a rating change or future CreditWatch action.

- Positive means that a rating may be raised.
- Negative means that a rating may be lowered.
- Stable means that a rating is not likely to change.
- Developing means a rating may be raised or lowered.
- N.M. means not meaningful.

Rating outlooks (other than stable) and CreditWatch are used in a changing credit situation when, in our view, a rating change is not certain. Although many rating changes are preceded by a non-stable outlook or a CreditWatch placement, changes can and should occur even when the outlook is stable or the rating is not on CreditWatch but when an abrupt change in the creditworthiness can be assessed immediately. Standard & Poor's priority is always to

get the rating appropriate as quickly as possible, even if a rating change is not signaled in advance because of unanticipated circumstances.

Standard & Poor's credit ratings express forward-looking opinions about the creditworthiness of issuers and obligations. More specifically, Standard & Poor's credit ratings express a relative ranking of creditworthiness. The primary factor in Standard & Poor's analysis of creditworthiness is likelihood of default, although payment priority, potential recovery following default, and credit stability are factors that can also play a role in Standard & Poor's assessment of credit risk. Credit ratings incorporate an assessment of future events to the extent they can be anticipated. However, Standard & Poor's also recognizes the potential for future performance to differ from initial expectations. Outlooks and CreditWatch listings address this possibility by focusing on the scenarios that, in our opinion, could result in a rating change.

CreditWatch

Ratings may be placed on CreditWatch under three sets of circumstances: 1) When, in our view, an event or deviation from an expected trend has occurred or is expected and when additional information is necessary to take a rating action. 2) When we believe there has been a material change in the performance of an issue or issuer, but the magnitude of the rating impact has not been fully determined, and Standard & Poor's believes that a rating change is likely in the short term. 3) A change in criteria has been adopted that necessitates a review of an entire sector or multiple transactions and Standard & Poor's believes that rating changes are likely in the short term. For example, under Circumstance 1, an issuer typically is placed under such surveillance as the result of a merger, recapitalization, or unanticipated operating development. Such rating reviews are completed as soon as Standard & Poor's has received the necessary information and completed its analysis—normally within 90 days—unless the outcome of a specific event is pending. Under Circumstance 2, a group of transactions may be placed under such surveillance as the result of identified performance deterioration until we complete our analysis of the magnitude of the rating impact, normally within 90 days. In Circumstance 3, a group of transactions may be placed under such surveillance as the result of being affected by a change in criteria. In situations where ratings remain on CreditWatch for more than 90 days (e.g., for mergers and acquisitions) or when material events or deviations from trends occur, Standard & Poor's will generally publish interim updates to identify its most current assessment of the situation. In situations where ratings are placed on CreditWatch due to performance deterioration of securitized assets or due to a change in criteria, and the analysis of the ratings impact is expected to exceed 90 days, Standard & Poor's will generally publish an expected timeframe to complete its assessment of the situation.

Standard & Poor's uses CreditWatch when it believes that the likelihood of rating action within the next 90 days is substantial. Standard & Poor's will place a rating on CreditWatch if we determine that there is at least a one-in-two likelihood of a rating change within 90 days. From time to time, there may be events or issues that present such significant uncertainty to the creditworthiness of an issue or issuer that a rating is placed on CreditWatch without the need to assess this threshold of potential change.

CreditWatch designations may be positive, which indicates a rating may be raised, or negative, which indicates a rating may be lowered. (A developing designation is used for unusual situations in which future events are so unclear that the

rating could be raised or lowered, such as when a company discloses it is in merger discussions with multiple suitors.) It bears emphasizing that a CreditWatch listing does not imply that any potential change would be only one notch; it could be one notch, several notches or more, depending on the situation.

A CreditWatch listing also does not mean a rating change is inevitable. Our CreditWatch commentary typically will provide our view regarding the potential magnitude of any rating change, which could be more than one notch. When, in our opinion, a rating change is certain but the magnitude of change is not, the rating will be moved to what Standard & Poor's considers the level that represents the then-current opinion, based on the information available, and placed on CreditWatch for further surveillance. When appropriate, the range of potential alternative ratings that we believe could result is included in the CreditWatch announcement and any interim publications.

It is important to reiterate that rating changes can occur without the ratings being placed on CreditWatch beforehand. When appropriate, Standard & Poor's may communicate with an issuer in advance of making a decision to place a rating on CreditWatch. However, once a decision has been made, an issuer cannot appeal a CreditWatch listing.

Outlooks

Similar to CreditWatch, an outlook indicates our view regarding the potential for a rating change and its direction. In contrast to CreditWatch, an outlook generally is assigned as an ongoing component of long-term ratings, where appropriate, to corporate and government entities (except when the rating is on CreditWatch) and some structured finance ratings. Outlooks have a longer time horizon than CreditWatch listings and incorporate trends or risks that we believe have less-certain implications for credit quality. The time frame for an outlook generally is up to two years for investment grade and generally up to one year for speculative grade. The shorter time frame for speculative-grade outlooks reflects the very nature of speculative-grade credits: They are more volatile and more susceptible to nearer-term refinancing risks, liquidity issues, and covenant triggers.

In rare cases, where the outlook may refer to a longer time frame, Standard & Poor's will explicitly state so in its published analyses. Although Standard & Poor's ratings are based on an opinion of the most likely scenario for an issuer's future performance, the outlook addresses what direction we believe the rating may take if our most likely scenario does not hold. A separate section of Standard & Poor's full analyses and summary analyses—titled "Outlook"—outlines the potential for these scenarios.

A positive outlook indicates a rating may be raised, and a negative outlook indicates a rating may be lowered. A stable outlook is assigned when we believe that ratings are not likely to be changed. Outlooks should not be confused with expected stability of the issuer's financial or economic performance. Even though Standard & Poor's assigns positive or negative outlooks to issuer ratings when we believe that an event or trend has less-certain implications for rating change than CreditWatch, the potential for change must be realistic and not remote. Standard & Poor's assigns positive or negative outlooks to issuer ratings when we believe that an event or trend has at least a one-in-three likelihood of resulting in a rating action over the intermediate term for investment-grade credits (generally up to two years) and over the shorter term for speculative-grade credits (generally up to one year). For example, a company with rapidly improving earnings and cash flow might still have a stable outlook if Standard & Poor's doubts the sustainability of the

trend and thus views an eventual upgrade as unlikely. Occasionally, Standard & Poor's may assign a developing outlook to an issuer when it believes that a rating may be raised or lowered. An example of the application of a developing outlook may be where a subsidiary is flagged for sale, or a government enterprise is identified for privatization, and the time period for such an action is more within the outlook period (six months to two years) than the 90-day CreditWatch period.

A positive or negative outlook is not necessarily a precursor of a rating change or a CreditWatch listing. Conversely, rating changes can occur when the issuer has a stable outlook. Unanticipated events occur, and ratings can be reassessed at any time. If warranted, the rating itself would be changed to reflect the most current opinion of credit quality, and Standard & Poor's would not delay such a change by first revising the outlook or placing ratings on CreditWatch merely to signal a potential change.

Communications Policy For CreditWatch And Outlook Listings

When publishing a CreditWatch or outlook commentary, Standard & Poor's intent is to communicate clearly the nature of the potential change, its timing, and our view regarding the likelihood of change, including the potential for no change to an existing rating. Often, this can be accomplished through the use of a bi-directional statement. For issuers or issues assigned a positive, negative, or developing outlook, where appropriate, Standard & Poor's discusses its view regarding what events are likely to change a rating, the timeframe for any rating change, and its likelihood. Standard & Poor's also discusses the conditions under which the current rating would be assigned a stable outlook. For issuers or issues assigned a stable outlook, Standard & Poor's discusses the expectations underlying the current rating. Where appropriate, Standard & Poor's may discuss the conditions that could cause positive or negative rating actions, particularly in more volatile sectors. If we believe it is highly unlikely that a rating would be raised or lowered over the intermediate term, Standard & Poor's includes those views in the outlook.

For issuers or issues with ratings on CreditWatch, Standard & Poor's generally will include commentary discussing what events it believes are likely to change a rating. Standard & Poor's will discuss the conditions under which it expects that the current rating would be affirmed as well. Where appropriate, Standard & Poor's may use language indicating the identifiable likelihood of rating changes for positive, negative, and developing CreditWatches.

Consistent with its previously published research, Standard & Poor's will periodically report on the performance of CreditWatch and outlook designations.

Frequently Asked Questions

What is the difference between an outlook and CreditWatch?

Ratings may be placed on CreditWatch when an unanticipated event or deviation from an expected trend has, in our view, occurred and we believe we need additional information prior to making a rating change, if any. CreditWatch status generally lasts for up to 90 days, though it can last longer when an event is still pending or more information is still required. An issuer placed on CreditWatch does not carry an outlook during the CreditWatch review period.

In contrast long-term corporate and government issuer credit ratings and some structured finance ratings carry outlooks (unless the ratings are on CreditWatch). Furthermore, outlooks cover a longer time period—generally up to two years for investment grade and one year for speculative grade—and can incorporate trends or developments that, in our view, have less-certain implications for credit quality than CreditWatch. They present Standard & Poor's opinion of possible changes to a company's credit quality over this longer time period, not specific near-term events.

Does a negative outlook mean that an issuer has unfavorable credit characteristics?

No. A negative outlook refers to the long-term rating the issuer currently is assigned. It indicates Standard & Poor's view that the rating could be downgraded if the scenario upon which the rating is based does not transpire. A very highly rated issuer may have a negative outlook associated with the assigned rating, while an issuer with a rating deep in the speculative-grade category may have a positive outlook.

Do companies within a given industry peer group generally have the same rating outlooks?

Not necessarily. An outlook pertains to the rating on a specific issuer. Occasionally, however, most or all companies in a peer group may share the same outlook or CreditWatch status because of a possible change in business conditions that would affect that entire peer group.

Do entities within a given country generally have the same rating outlooks?

No, a rating outlook reflects our view regarding the trends and risks affecting the long-term rating prospects of a specific issuer. However, in instances in which nonsovereign ratings are constrained by the probability of the sovereign restricting access to foreign exchange needed for debt service, nonsovereign rating outlooks (in some cases like the ratings themselves) are more likely to be the same as the sovereign outlook. Also, if we believe an entity is dependent on a sovereign for intergovernmental transfers, for subsidies, for a monopoly position, or for any other factors affecting operating and financial performance, outlooks may be linked, particularly if the nonsovereign and sovereign ratings are the same.

Does Standard & Poor's always place ratings on CreditWatch prior to a rating change?

No. Provided Standard & Poor's believes it is in full possession of all necessary information, we may make a rating change without having placed the rating on CreditWatch. Indeed, Standard & Poor's believes it would be doing a disservice to the investment community if it delayed a rating change by needlessly placing ratings on CreditWatch.

Is an upgrade or downgrade always preceded by a positive or negative outlook?

No. Outlooks speak to the potential directional change of the rating, and in practice, rating changes commonly occur in the direction indicated by the outlook. However, this would not necessarily occur if the rating change was due to an unanticipated event.

Under what circumstances does Standard & Poor's change a rating and place the revised rating on CreditWatch pending a further review?

Standard & Poor's does this when it believes that an event or situation may result in a further change in the rating over the very short term but Standard & Poor's still needs more information to make that determination. Similarly, a rating may be lowered and assigned a negative outlook rather than a stable one, or it may be raised and assigned a positive outlook. On the other hand, it is extremely rare for a rating to be lowered and assigned a positive outlook, or raised and assigned a negative outlook, though it may occur.

Does every surprising development with an issuer that warrants further investigation result in a CreditWatch placement?

Not every situation involving information uncertainty leads to a CreditWatch. As with most aspects of sound credit analysis, judgment is required. To the extent we identify credits where we believe there is a significant chance (at least a one-in-two likelihood) of rating action over this near-term time horizon but additional information is still needed to make a rating decision, then the rating should be put on CreditWatch.

Related Criteria And Research

- Standard & Poor's Analysis Of ABCP Ratings Following Changes To Ratings On Support Providers, Dec. 18, 2008
- CreditWatch And Rating Outlooks Provide Powerful Warning Signals, Aug. 7, 2007

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