---

## S&P: Top 10 Investor Questions On Our Ratings Process

S&P Global Ratings strives to provide the financial markets with timely, transparent, and forward-looking credit ratings. Through this unprecedented time, we continue to engage with borrowers, investors, and other market participants to better understand the credit effects of the coronavirus-related economic shock. Financial markets function best when participants have as much up-to-date information as possible. Through our surveillance, we continue to update our forward-looking credit ratings to incorporate new information relating to the COVID-19 outbreak. We have also been publishing and making freely available our research commenting on the effects of the pandemic on credit to help market participants better understand our thoughts and views.

Here, S&P Global Ratings answers the top 10 investor questions we've received regarding the analytical decision-making process.

**Does S&P Global Ratings rate through the cycle?**
"Rating through the cycle" can be a misleading phrase that means different things to different people. If it's meant to suggest that S&P Global Ratings will wait for a change in conditions to play out before we adjust our credit views and change ratings, that's not what we do. Any time our fundamental forward-looking view of credit quality changes–regardless of where we are in an economic or credit cycle–we want our ratings to reflect that. We think markets function best when participants have as much up-to-date information as possible, and that includes credit opinions that evolve to reflect changes to market-related or issuer-specific credit factors. We note that regulations also require credit rating agencies to adjust ratings when their assessment of credit risk changes, in line with their published methodologies.

Our credit ratings have performed well historically as effective measures of relative creditworthiness. Our ratings default and transition studies covering the last 40 years have shown that, across cyclical economic downturns, higher ratings have generally shown lower default rates, and vice-versa. Higher-rated corporate issuers tend to have some combination of more-resilient business models, lower leverage, greater financial flexibility, and more ample sources of liquidity.

**Is there a "right" time to change ratings?**
As required by regulation, we change ratings if and when our view of credit risk changes, based on our analysis of relevant information and in line with our published methodologies. Sometimes these changes are the result of inherently unpredictable events and developments or significant shifts in the market conditions or issuer-specific credit factors.

Given the movement in economic and credit cycles, we expect credit ratings to change over time, as the creditworthiness of rated issuers and obligations rises and falls. That said, the same economic cycle, or period of stress, may have very different effects on the ratings of different issuers, depending on our view of how the cycle affects the creditworthiness of each. While all issuers and issues we rate are exposed to default and downgrade risk, those with comparatively lower ratings generally experience higher levels of downgrades, and in some cases defaults, than higher-rated entities, during periods of economic or financial stress.

In addition to a rating change, our analysts may also use, when appropriate, an outlook change or CreditWatch placement to identify the potential direction of a credit rating–providing markets with another indicator to better understand the evolution and credit context of a specific entity.

**Does S&P Global Ratings need to change its ratings methodology to address this unprecedented situation?**

We calibrate our criteria with the aim that it supports the issuance and surveillance of forward-looking credit ratings that are effective measures of relative creditworthiness across a variety of economic situations. For more information on how we look at stress scenarios in the context of our ratings criteria, please see "Understanding S&P Global Ratings' Rating Definitions," published June 3, 2009.

This doesn't mean that our view of an industry or sector, for example, won't change. Given the movement in economic and credit cycles, we expect ratings of issuers and obligations to change as their creditworthiness rises and falls. And as economies recover from the current crisis, we anticipate that many sectors may face new challenges, and our ratings (adjusted or otherwise) will continue to seek to incorporate our forward-looking opinion of those challenges and their potential effects on creditworthiness.

**Before the current crisis, were ratings too high?**

Credit ratings aren't point-in-time assessments of creditworthiness, and aren't designed to be static. As forward-looking opinions on, and relative rankings of, creditworthiness, ratings are designed to be dynamic and evolve to reflect changes to market conditions or issuer-specific credit factors. Our ability to have our ratings reflect on an ongoing basis more current information helps to make our credit ratings relevant to the markets.

It's also important to note that among nonfinancial corporate borrowers globally, the median of new issuer ratings had declined two notches, from 'BB-' at the onset of the Global Financial Crisis in 2008, to 'B' by the beginning of this year. While downgrades did occur in the intervening decade-plus, nearly 85% of new nonfinancial corporate ratings have originated at speculative-grade since 2017. As a result, one-third of corporate issuers in the U.S. and one-quarter in Europe are rated 'B' or below, indicating greater vulnerability to changes in economic and financial cycles (see "Historically Low Ratings In The Run-Up To 2020 Increase Vulnerability To The COVID-19 Crisis," published May 28, 2020).

When economic conditions change, we may change our assessment of creditworthiness for the issuers most affected. The economic effects of the pandemic, along with depressed oil prices, have driven recent changes to our ratings as part of our ongoing surveillance. The effects have varied across sectors, reflecting the fact that some are more exposed to the effects of these conditions.

Changes in ratings throughout an economic cycle–either upward or downward–are an indication that ratings are doing what they are designed to do. S&P Global Ratings has been publishing and making freely available our research on the credit effects of the pandemic to help market participants better understand our thoughts and views.

**How do analytical teams develop their views on individual ratings within the scope of S&P Global's overall macroeconomic forecasts?**

Our economists set our high-level global and regional base-case macroeconomic forecasts–that is, what we see as the most likely macroeconomic outcomes given the information available at the time–with input from the ratings analysts. Our economists typically update these forecasts at least each quarter. In turn, ratings analysts consider these forecasts as inputs for their sector base-case forecasts.

During relatively benign periods of an economic cycle, our macroeconomic base cases may change incrementally as new information becomes available. These adjustments typically don't have much of an effect on ratings. During such times, entity-specific changes (e.g., acquisitions, divestitures, debt-financed share buybacks), or collateral performance (e.g., a material increase in defaulted loans, significant changes in delinquency rates, or reductions in net cash flows) tend to have a larger influence on ratings.

When economic cycles enter periods of stress, such as those that have been triggered by the coronavirus pandemic, changes to our base case macroeconomic assumptions can become relatively larger drivers in our assessment of creditworthiness. The effects of these changing assumptions are rarely even across industries or sectors–and so our ratings analysts consider how these changes will affect credit in their sectors broadly, and among the issuers in those sectors specifically.

When our macroeconomic base-case forecasts shift in a meaningful way, this can be a driver of ratings changes, especially those at the lower end of the ratings scale. We publish our macroeconomic forecasts regularly, so that markets can understand what high-level assumptions factor into our ratings. We also typically publish sector base cases–such as our forecasts for oil prices, auto sales, or for revenue per available room for the hotel sector–as well as our financial forecasts for individual companies.

**At present, are you able to get sufficient information from company managements without meeting in-person to continue your surveillance of credit ratings?**
We have more than 1,500 analysts around the world who conduct surveillance on industries and issuers daily. In doing so, during the course of a year they typically meet with managements, investors, and regulators, attend industry conferences, and research developments in their sectors. All of this provides them a unique ability to offer a differentiated view of credit risk.

While our analysts haven't been able to meet with managements in-person due to the pandemic, we've been able to rely on technology to maintain contact with managements. In addition, through our continuing ratings surveillance, our analysts receive ongoing financial information from issuers and various industry sources to formulate and support our forward-looking credit opinions.

**How do you ensure that your view on each asset class is informed by behavior of other related asset classes–e.g., the link between corporates and CLOs or banks and structured finance?**
S&P Global Ratings established regional Credit Conditions Committees (CCCs) just after the Global Financial Crisis. These committees meet quarterly and on an ad hoc basis to review macroeconomic conditions in each of four regions–North America, Europe, Asia-Pacific, and Emerging Markets ex-Asia. The committees are made up of our economists, research teams, and ratings analysts from across all our ratings practices (e.g., corporates, structured finance, sovereigns) with discussions centering on identifying credit risks and their potential ratings effects in various asset classes, as well as financing conditions for businesses and consumers.

Through the current crisis, the CCCs have been meeting more frequently to monitor the effects of the pandemic on economies and markets. We routinely cascade the outcome of deliberations to ratings staff, as well as to the marketplace, through publications, slide decks, and webcasts.

**What in S&P Global Ratings' view constitutes a default?**
Generally, we can split "default" into two broad camps: 'D' (default) and 'SD' (selective default). We assign a 'D' rating when we believe an issuer will fail to pay all or substantially all of its debts as they come due. We assign an 'SD' rating when we believe the entity has missed payment on a specific issue or class of debt but will continue to make timely payment on other issues. We typically

don't consider an issuer to have defaulted if we believe payment will be made within five business days, or, in cases of a grace period longer than that, if we believe payment will be made within the stated grace period or 30 days–whichever is earlier.

Sometimes, entities in distress look to restructure their debts, offering lenders less than originally promised. The prospect that lenders could fare even worse in a conventional default may motivate them to accept such offers. S&P Global Ratings treats these as defaults, assuming that two conditions are met: that the offer implies lenders will receive less than originally promised, and that the offer, in our view, is distressed, rather than purely opportunistic.

**What about a government's call for debt moratoria, letting issuers defer payments of bank loan interest or principal?**

In cases of government-initiated payment moratoria for corporate and government borrowers, we will consider whether lenders and investors benefit from systemic intervention designed to support and stabilize the financial system–for example, when it provides lenders relief from provisioning, capital guidelines, or liquidity guidelines. We may view the benefits of such intervention as providing lenders adequate offsetting compensation for payment deferrals on bank loans.

If a country's banking and financial system tangibly benefit from such measures as part of a government's support, we would view it as adequate offsetting compensation for lenders–and, thus, wouldn't typically regard an entity's deferred payment as a default.

This would hold true for bilateral bank loans or club transactions (credit lines or loans where a bank or a group of banks is/are the holder) within a single jurisdiction. However, we would likely take a different view if the deferral applied to payments on capital-market instruments because, unlike banks, capital market investors typically don't benefit directly from systemic intervention to the same extent as banks do. Nor would this apply when payments are waived or have been forgiven, meaning they are no longer payable, which we would generally view as default (see "Rating Implications Of Exchange Offers And Similar Restructurings, Update," published June 4, 2020).

**Don't downgrades just exacerbate the pressures (on liquidity, etc.) that issuers face?**

Ratings are just one of many inputs that investors and other market participants can consider as part of their decision-making process. Our credit ratings are forward-looking opinions about credit risk, based on quantitative and qualitative analysis of available information, in accordance with our published criteria. As such, our ratings take into account, on a continuing basis, relevant changes in the economic cycle as well as other events that could affect credit risk, in accordance with our published criteria.

As discussed, regulation requires credit rating agencies to change their ratings when their assessment of credit risk changes. We can't ignore changes that weigh on an entity's creditworthiness because of the potential effects a downgrade may have. In fact, the International Organization of Securities Commissions Code of Conduct for ratings agencies states that rating agencies should not delay or refrain from taking a rating action based on its potential effect on an issuer or other market participants.