A Glossary of Emerging Market Rating Terminology

ISSUER, CORPORATE, OR COUNTERPARTY CREDIT RATING back to top
A current opinion of an obligor's capacity to pay its financial obligations. It is an opinion of the entity's overall creditworthiness, and is distinct from a specific issue credit rating. In contrast to the latter, an issuer credit rating does not take into consideration the nature and provisions of a specific obligation, its standing in bankruptcy, guarantors, insurance, and other attributes specific to that instrument. Issuer credit ratings may be provided on either a global or national scale basis, and in the form of either local or foreign currency credit opinions.

LOCAL CURRENCY CREDIT RATING back to top
A current opinion of an obligor's overall capacity to generate sufficient local currency resources to meet its financial obligations (both foreign and local currency), absent the risk of direct sovereign intervention that may constrain payment of foreign currency debt. Local currency credit ratings are provided on Standard & Poor's global scale or on separate national scales, and they may take the form of either issuer or specific issue credit ratings. A local currency credit opinion on Standard & Poor's global scale is based on the obligor's individual credit characteristics, including indirect sovereign or economic risks (i.e., country risks) that may influence the obligor's capacity to generate sufficient local currency resources to meet both local and foreign currency obligations. Country or economic risk considerations pertain to the impact of government policies on the obligor's business and financial environment, including factors such as the exchange rate, interest rates, inflation, labor market conditions, taxation, regulation, and infrastructure. However, the opinion does not address transfer and other risks related to direct sovereign intervention to prevent the timely servicing of cross-border obligations. In the case of national scale credit ratings, local currency credit opinions only address sovereign risk in a local context relative to the creditworthiness of other domestic obligors, thus excluding certain direct and indirect sovereign risk factors incorporated in Standard & Poor's global scale ratings. Regardless of the scale, local currency issue credit ratings are assigned to specific obligations and may differ from issuer credit ratings depending on the terms of the obligation with respect to such matters as collateral pledges, credit enhancements, or subordination clauses.

FOREIGN CURRENCY CREDIT RATING back to top
A current opinion of an obligor's overall capacity to meet its foreign currency denominated financial obligations. It may take the form of either an issuer or issue credit rating. Foreign currency credit ratings are typically only provided on Standard & Poor's global scale, but are also provided on a national scale basis in highly dollarized economies. As in the case of local currency credit ratings, a foreign currency credit opinion on Standard & Poor's global scale is based on the obligor's individual credit characteristics, including the influence of country or economic risk factors. However, unlike local currency ratings, a foreign currency credit rating includes transfer and other risks related to sovereign actions that may directly affect access to the foreign exchange needed for timely servicing of the rated obligation. Transfer and other direct sovereign risks addressed in such ratings include the likelihood of foreign exchange controls and the imposition of other restrictions on the repayment of foreign debt. In the case of national scale ratings, foreign currency credit opinions are only provided in highly dollarized economies and, in such cases, the foreign currency credit opinions are identical to local currency ratings, reflecting the national scale's exclusion of transfer and other direct sovereign risks that might impede timely servicing of foreign currency obligations. Regardless of scale, foreign currency issue credit ratings are assigned to specific obligations and may differ from foreign currency issuer or counterparty credit ratings depending on the terms of the obligation with respect to such matters as

collateral pledges, credit enhancements or subordination clauses.

INSURER FINANCIAL STRENGTH RATING back to top
A current opinion of the financial security characteristics of an insurance organization with respect to its ability to pay under its insurance policies and contracts in accordance with their terms. The opinion is not specific to any particular policy or contract, and does not address the suitability of a particular policy or contract for a specific purpose or purchaser. For organizations with cross-border or multinational operations, including those conducted by subsidiaries or branch offices, insurer financial strength ratings do not take into account potential that may exist for foreign exchange restrictions to prevent financial obligations from being met. Insurer Financial Strength ratings are provided on either a global or national scale basis. National scale ratings assess an insurer's financial security relative to that of other insurers in its home market. Insurer Financial Strength ratings do not refer to an organization's ability to meet non-policy (i.e., debt) obligations.

PUBLIC INFORMATION CREDIT RATING back to top
A local currency issuer credit rating or insurer financial strength rating identified by the "pi" subscript and based on an analysis of the obligor's or insurer's published financial information, as well as additional information in the public domain. Public Information ratings are not modified with "+" or "-" designations and are not assigned outlooks. Ratings with a "pi" subscript are reviewed annually based on a new year's financial statements, but may be reviewed on an interim basis if a major event that may affect an issuer's credit quality or insurer's financial strength occurs. At present, "pi" ratings are only provided on Standard & Poor's global scale.

MANAGED FUND RATING back to top
Standard & Poor's managed fund ratings may take the form of bond fund credit quality ratings and/or market risk ratings, money market fund ratings, and equity fund ratings. Bond fund ratings and money market fund ratings are provided on both a global and national scale basis.

Bond Fund Rating: Both credit quality ratings and market risk ratings may be assigned to fixed income mutual funds. Credit quality ratings, identified by the 'f' subscript, provide a current opinion of the level of protection against losses from credit defaults and are based on an analysis of the credit quality of the portfolio investments and the likelihood of counterparty defaults. Market risk ratings, identified by a lower-case symbology (e.g., 'aa'), provide a current assessment of a fund's rate of return variability.

Equity Fund Rating: A current assessment of a fund's investment management abilities combined with the level of risk-adjusted returns, reflecting Standard & Poor's observation that funds that adhere to disciplined processes and exhibit strong management are more likely, over time, to provide consistent, above-average returns relative to those of other funds in the same sector with comparable objectives. Equity fund ratings are based on an evaluation of quantitative and qualitative factors that contribute to long-term performance. Equity fund ratings range from 'frAAA' (very strong investment management abilities and consistent, above-average risk-adjusted returns) to 'frB' (very uncertain investment management abilities and below-average risk-adjusted returns). Equity fund ratings may also be assigned to balanced funds and pension funds.

Money Market Fund Rating: A current opinion on the safety of invested principal on money market funds or other funds with similar objectives of protecting principal value and limiting exposure to loss. Money market fund ratings, identified by the 'm' subscript, address the ability of a fund to maintain stable or consistently rising net asset value. Money market fund ratings are unique in that they encompass both credit risk and market risk. Money market fund ratings may not be applicable in markets that have historically exhibited extreme interest-rate volatility.

SOVEREIGN LOCAL CURRENCY CREDIT RATING back to top
A current opinion of a sovereign government's capacity and willingness to meet its financial obligations denominated in the legal tender of that country. The opinion emphasizes the expected stance of fiscal and monetary policies and the resulting levels and trends in budgetary balances, public debt burden, inflation and the financial health of the banking system. These fiscal and monetary indicators are evaluated in the context of the stability of the political process and the structure of the economy and income. The sovereign local currency credit rating is the primary indicator of the general economic or country risk facing obligors in that country, but the impact of such risks can vary widely between sectors and individual obligors. (See "Sovereign Credit Ratings: A Primer" in the April 16, 1997 CreditWeek for more details.)

SOVEREIGN FOREIGN CURRENCY CREDIT RATING back to top
A current opinion of a sovereign government's capacity and willingness to meet its financial obligations denominated in currencies other than its own. The opinion is based on analysis of all the same economic and political factors addressed in the sovereign local currency rating, plus an examination of the external financial factors that may further constrain the government's access to the foreign exchange needed to ensure timely servicing of foreign currency obligations. As a result, sovereign foreign currency ratings also address the country's balance of payments flexibility and its external debt and liquidity position. Typically, the sovereign foreign currency rating represents the level of transfer risk for financial obligations of other obligors domiciled in the country, with the exception of certain obligors that benefit from unrestricted access to adequate offshore resources or that are located in a highly dollarized economy.

SOVEREIGN RISK back to top
The likelihood that actions by the sovereign government might directly and/or indirectly affect the ability of the obligor to meet its obligations in a timely fashion. Direct and indirect sovereign risks vary by country, by the currency denomination of the obligation, and by obligor. (See 'Understanding Sovereign Risk' in Jan. 1, 1997, CreditWeek for more details.)

Direct: Intervention by the sovereign government that directly impedes the obligor's capacity to meet its financial obligations in a timely fashion. The timely servicing of foreign currency debt is typically more vulnerable to direct sovereign risks, including the imposition of foreign exchange controls or a moratorium on repayment of foreign debt. However, direct sovereign risks may also affect local currency debt ratings when the potential for acute monetary and/or political instability creates the possibility of a government mandated restructuring of not only its own local currency obligations, but also those of the banking system.

Indirect (Country or Economic Risk): Actions by the government that may adversely affect the economic environment in which the obligor operates and, in turn, may negatively impact the obligor's capacity to meet its obligations in a timely fashion. Country or economic risks incorporate the impact of government policies that influence the financial and business environment facing the obligor, including uncertainties related to the exchange rate, interest rates, labor market conditions, taxation, regulation, and infrastructure. Indirect sovereign risk affects global scale issuer or issue credit ratings pertaining to either foreign or local currency obligations by influencing an obligor's cost of debt service, availability and cost of inputs, and the demand for its output or services.

TRANSFER RISK back to top
The likelihood that the sovereign government might impose foreign exchange controls that restrict the ability of obligors to obtain and utilize the foreign exchange necessary to meet foreign currency obligations in a timely fashion. Standard & Poor's current opinion of the transfer risk associated with a foreign currency obligation is typically equivalent to the foreign currency rating of the sovereign government of the obligor's country of domicile. In the case of certain foreign currency obligations, transfer risk may be deemed to be less than indicated by the sovereign foreign currency rating, including obligations that benefit from unrestricted access to adequate offshore sources of foreign exchange (e.g., external guarantees, offshore parental support, and legal structure that mitigate transfer risk for a specific obligation) or that are supported by an obligor's presence in a highly dollarized economy. Transfer risk is addressed in all foreign currency ratings, but is not addressed in local currency ratings.

EXCHANGE RATE RISK back to top
The likelihood that fluctuations in the value of the local currency relative to foreign currencies may impair the obligor's ability to service its financial obligations in a timely fashion. This risk may arise from either a large depreciation or appreciation of the local currency relative to foreign currencies and may arise in the absence of any change in transfer risk. Exchange rate risk is factored into all ratings, whether for local or foreign currency debt and whether on a global or national scale basis. The stress test for exchange rate risk should assess both the potential size and probability of a significant depreciation or appreciation of the local currency versus major hard currencies (e.g., the U.S. dollar, yen, and deutschemark) and the currencies of major trading partners. Exchange rate risk may affect global or national scale ratings by influencing an obligor's cost of debt service, cost of inputs, and the demand for its output or services. Credit risk ratings do not address the risk that exchange rate movements may change the value of specific obligations in terms of the local currency of the investor.

DOLLARIZATION back to top
The process in countries with a history of high inflation whereby the U.S. dollar, or another hard currency, replaces the local currency as the main vehicle for savings and investment. In highly dollarized economies, sovereign risk, especially as it pertains to transfer risk, is viewed as less of a factor affecting foreign currency ratings of obligors domiciled in that country. As a result, the foreign currency debt ratings of private sector obligors in such dollarized economies can more fully reflect the obligor's overall creditworthiness as indicated by its local currency issuer credit rating and may exceed the foreign currency rating of the sovereign government. (See "Less Credit Risk for Borrowers in 'Dollarized' Economies" in April 30, 1997, CreditWeek for more details.)