TRIS RATING
A Strategic Partner of S&P Global

Partially Guaranteed Debt Rating Methodology

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The criteria describe the methodology TRIS Rating uses to rate a debt issue that benefits from a partial guarantee provided by a third party with a higher credit rating. Under a partial-guarantee structure, the guarantor will be liable for the payment up to a certain proportion of the principal and interest payable (in any case less than 100% of principal and interest due), in case of payment default.

The criteria do not cover debt issues that benefit from other forms of credit enhancement, for instance, debt issues that are backed by a pool of assets such as mortgage-backed securities (MBS), asset-backed securities (ABS), and collateralized debt obligations (CDO).

Unlike a full-guarantee structure where an issue rating reflects the credit risk of the guarantor, a partially guaranteed debt rating reflects mainly the credit risk of the issuer, with the added benefit of improved recovery prospects for the portion guaranteed by an entity with higher creditworthiness. The probabilities that both the issuer and the guarantor default at the same time and the investors receive zero payment when interest or principal becomes due are much lower than the default probability of the issuer alone. Partially guaranteed debt benefits from a higher recovery in the event of payment default relative to an unsecured debt instrument issued by the same issuer without any third-party guarantee, and hence justifies a higher issue rating.

In assigning an issue rating that reflects the benefit from a partial guarantee, we limit the rating enhancement at three notches above the rating on the senior unsecured debt of the same issuer. This is because the default risk of the partially guaranteed debt is still tied to the issuer's default probabilities, despite the superior debt recovery relative to the issuer's senior unsecured debt. The issuer default would still result in a non-timely payment of the full amount owed, despite the partial guarantee.

As partially guaranteed debts should not be rated as high as debts fully guaranteed by the same guarantor, the rating enhancement is subject to consideration that it will not cause the issue rating on the partially guaranteed debt to be higher than one notch below the rating on the senior unsecured debt of the entity providing the partial guarantee.

RATING FRAMEWORK OF PARTIALLY GUARANTEED DEBT

Required information

The key components used to determine the rating on a partially guaranteed debt issue include:

1) The company rating on the issuer
2) The company rating on the guarantor
3) The percentage of guarantee provided by the guarantor
4) Term and payment frequency of the debt issue
5) Terms and conditions of the guarantee, including the payment mechanism pursuant to a claim under the guarantee

Rating process

1) We assign the company ratings on the issuer and the guarantor, and determine the senior unsecured debt rating of each entity.

2) Based on the remaining term and payment frequency of the partially guaranteed debt issue, we identify all possible cash flow loss scenarios should the issuer and/or the guarantor defaults, based on the percentage of guarantee provided by the guarantor.

3) We compute the joint default probability of each cash flow loss scenario, taking into consideration the estimated correlation between the issuer and the guarantor. Then, we multiply the joint default probability with the loss of each cash flow scenario to arrive at the expected loss of that scenario. TRIS Rating uses the hypothetical default probabilities deriving from our internal historical database and default statistics of international credit rating agencies.

4) We sum the expected loss of all cash flow scenarios to arrive at the expected loss of the partially guaranteed debt issue.

5) We establish benchmarks of the expected loss of senior unsecured debt issued by a hypothetical issuer at various rating levels. The senior unsecured debt is assumed to have the same term and payment mechanism as that of the partially guaranteed debt issue.

6) We compare the expected loss of the partially guaranteed debt issue with that of the benchmarked debts. The rating assigned to the partially guaranteed debt issue will be based on the rating on the benchmarked debts with expected loss closest to, but higher than, that of the partially guaranteed debt.

7) The maximum rating uplift assigned to the partially guaranteed debt issue is limited at three notches above the senior unsecured debt rating of the same issuer, and capped at one notch below the senior unsecured debt rating of the entity providing the partial guarantee.

MONITORING PROCESS

The rating on the partially guaranteed debt issue could be changed should the issuer's and/or the guarantor's rating changes. We will continue to monitor outstanding issues to ensure that the ratings remain in line with our criteria. In the case that the senior unsecured debt rating of the guarantor drops to the same level as that of the issuer or below, the rating on the partially guaranteed debt will reflect only the senior unsecured debt rating of the issuer.

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