

Structured Finance Swaps - Rating Agency Criteria

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Rating Agency Criteria

- S&P: May 2007; updated in October 2008
(general framework)
- Moody's: May 2007 (rules-based)
- Fitch: August 2007 (general framework)
- Credit rating of the swap counterparties considered in ratings analysis
- Criteria sets out requirements for swap documentation and credit ratings of swap counterparties

Rating Agency Criteria Requirements

- Bankruptcy remote
- Tax
- Swap Bank Ratings Downgrade
- Close-out valuations

Events of Default

ISDA EVENT OF DEFAULT	SWAP BANK	ISSUER
Failure to Pay or Deliver (s. 5(a)(i))	Apply	Optional
Breach of Agreement (s. 5(a)(ii))	Apply	Disapply
Credit Support Default (s. 5(a)(iii))	Apply	May apply only to return of excess collateral
Misrepresentation (s. 5(a)(iv))	Apply	Disapply (with exceptions)
Default under Specified Transaction (s. 5(a)(v))	Apply if more than one ISDA with Issuer	Disapply
Cross Default (s. 5(a)(vi))	Optional	Disapply
Bankruptcy (s. 5(a)(vii))	Apply	Optional
Merger without Assumption (s. 5(a)(viii))	Apply	Optional

Events of Default (2)

Swap Bank

- Credit Support Default
 - Downgrade ATE not default

Issuer

- Credit Support Default
 - Excess collateral
- Misrepresentation
 - Status, capacity, security
 - Moody's require a legal opinion if included
- Bankruptcy
 - Disapply certain sub-sections

Express requirements for Moody's and Fitch, implicit S&P

Issuer Bankruptcy

- Disapply 5(a)(vii)(2)
 - becomes insolvent or is unable to pay its debts or fails or admits in writing its inability generally to pay its debts as they become due
- Exclude transaction security from 5(a)(vii)(3)
 - Makes a general assignment, arrangement or composition with or for the benefit of its creditors
- Exclude actions by Swap Bank from 5(a)(vii)(4)
 - Bankruptcy petition / proceedings
- Delete “seeks or” from 5(a)(vii)(6) and exclude Trustee
 - Seeks or becomes subject to the appointment of an administrator, provisional liquidator, conservator, receiver, trustee, custodian or other similar official for it or for all or substantially all its assets
- Disapply 5(a)(vii)(7)
 - Enforcement by a secured party
- Disapply 5(a)(vii)(8) and (9) when relate to above
 - Analogous events in other jurisdictions
 - Any action in furtherance of, or indicating consent to foregoing

Termination Events

TERMINATION EVENT	SWAP BANK	ISSUER
Illegality (1992 s. 5(b)(i))	Optional	Optional
Tax Event (1992 s. 5(b)(ii))	Optional (with legal opinion)	Optional
Tax Event Upon Merger (1992 s. 5(b)(iii))	Optional	Optional
Credit Event Upon Merger (1992 s. 5(b)(iv))	Optional	Optional
Additional Termination Events (1992 s. 5(b)(v))	Ratings Downgrade Events (as detailed below)	<ul style="list-style-type: none"> • Full or partial redemption of Notes • Acceleration of Notes • Materially adverse change to transaction documents without Swap Bank consent

- Rating Agency Requirements
 - Bankruptcy remote
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Tax

- Withholding tax on payments by Swap Bank mean Issuer will receive less than the full amount
- If Issuer required to gross up (and a withholding tax applies) Issuer would likely divert funds from rated debt
- BUT is it a rating agency issue?
 - Moody's say "substantial amounts" and "material" to a cashflow transaction

Moody's Tax Requirements

- No gross up by Issuer; full gross up by Swap Bank
 - Amend ISDA s. 2(d)(i)(4) or "Indemnifiable Tax"
 - Tax Event; Tax Event upon Merger
 - Also Gross up for any withholding by guarantor
- OR a legal opinion confirming that, under current law, no withholding applies to payments
 - at closing and on Trade Date (if later)
 - including termination payments
 - Including guarantor's obligations
 - Also any Issuer Tax Representations
- A transaction party (other than Swap Bank) must agree to assist Issuer with tax forms
 - and determine whether they are "reasonably requested"

- Rating Agency Requirements
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S&P Swap Bank Requirements

- S&P published an updated Criteria on 22/10/08 replacing the previous two-tier downgrade criteria with a single-tier Rating requirement. S&P have indicated that they will publish a revised Criteria in the coming months
- Required ratings
 - Short-Term Rating of A-1
 - or
 - Long-Term Rating of at least A+ (if no Short-Term Rating)
- S&P Rating Event
 - Downgrade to below A-1 (or A+)

S&P Rating Event Provisions

Swap Bank must:

- Post collateral within **10 Business Days**
(NB. Criteria states 10 calendar days but S&P have agreed to 10 Business Days in a recent deal)
- And transfer to a replacement counterparty within 60 calendar days
 - Rated at or above the Required Ratings (or lower with RAC)
 - No adverse tax consequences
- Or obtain a guarantee from a guarantor within 60 calendar days
 - Rated at or above the Required Ratings
 - No adverse tax consequences
 - Must also have RAC from S&P
- Or any other action with Rating Agency Confirmation (RAC)
 - No adverse tax consequences

S&P Rating Event Remedies

- Failure to comply an Additional Termination Event
 - Swap Bank as sole Affected Party
- Deemed to occur (automatic)
 - 11th BD following Event if no collateral posted
 - 61st calendar day if no transfer/guarantor
 - regardless of whether commercially reasonable efforts made

Fitch Swap Bank Requirements

- Required ratings
 - Long-Term Rating of A and Short-Term Rating of F-1
 - or
 - Long-Term Rating of A (if no Short-Term Rating)
- Initial Fitch Rating Event
 - Downgrade to below F-1 (or A)
- Subsequent Fitch Rating Event
 - Downgrade to below F-2 or (BBB+)

Initial Fitch Rating Event Provisions

Swap Bank must within **30 calendar** days:

- Transfer to a replacement counterparty
 - **Rated at or above the Required Ratings**
- Or obtain a guarantee from a guarantor
 - **Rated at or above the Required Ratings**
- Or post collateral

Subsequent Fitch Rating Event Provisions

Swap Bank must within **30 calendar** days:

- Transfer to a replacement counterparty
 - **Rated at or above the Required Ratings**
- Or obtain a guarantee from a guarantor
 - **Rated at or above the Required Ratings**
- Or post (additional) collateral
 - **Not recommended**
 - **Independent verification of MTM**
 - **Independent verification of timely postings**

Fitch Rating Event Remedies

- Failure to comply an Additional Termination Event
 - Swap Bank as sole Affected Party
- Deemed to occur (automatic)
 - 31st calendar day

Moody's Swap Bank Requirement

- Required ratings
 - Long-Term Rating of A2 and Short-Term Rating of P-1
 - or
 - Long-Term Rating of A1 (if no Short-Term Rating)
- First Trigger
 - Downgrade to below A2/P-1 (or A1)
- Second Trigger
 - Downgrade to below A3/P-2 (or A3)

Moody's First Trigger Provisions

Swap Bank must:

- Post collateral within **30 Business Days**
- Or transfer to a replacement counterparty
 - **Rated above the Second Trigger**
 - **If rated at or below the First Trigger must immediately post First Trigger Collateral Amount**
- Or obtain a guarantee from a guarantor
 - **Rated above the First Trigger**

Failure to comply, an Additional Termination Event with Swap Bank as sole Affected Party

Moody's Second Trigger Provisions

Swap Bank must:

- Post (additional) collateral within **30 Business Days**

And

- Transfer to a replacement counterparty
 - **Rated above the Second Trigger**
- Or obtain a guarantee from a guarantor
 - **Rated above the Second Trigger**

Moody's Second Trigger Provisions (2)

- Ongoing obligation on Swap Bank to seek guarantee or replacement
 - as soon as reasonably practicable
 - using "commercially reasonable efforts"
- Swap Bank must still post First Trigger Collateral Amounts
 - during Second Trigger grace period
 - if replacement / guarantor at or below First Trigger

Moody's Second Trigger Remedies

- Failure to comply an Event of Default
- Second Trigger also an Additional Termination Event
 - 30 BDs following downgrade
 - Swap Bank sole Affected Party
- Amended ISDA termination payment measure
 - modified Market Quotation
 - ONLY WHERE at least one "live bid"

- Rating Agency Requirements
 - Bankruptcy remote
 - Tax
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Moody's Amended Market Quotation

- Applies if Swap Bank is Defaulting Party or Sole Affected Party (unless an Illegality or Tax Event)
- Live bids
 - Replacement value
 - terms at least as beneficial (in all material respects) for Issuer
 - rating triggers
 - credit support
 - other components of Moody's framework
- To be determined by Issuer
 - acting in a commercially reasonable manner
- Swap Bank may obtain bids
 - Must attempt to do so if required by Issuer
 - All bids considered whether sourced by Swap Bank or Issuer

Moody's Amended Market Quotation (2)

- Issuer must enter into a replacement transaction
 - Actual replacement price used for Market Quotation if paid on or before Early Termination Date
 - Otherwise live bid most beneficial for the outgoing Swap Bank
- If no live bid on Early Termination Date, use Loss

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