General Criteria:

Rating Implications Of Exchange Offers And Similar Restructurings, Update

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PRIMARY CONTACTS

Marta Castelli
Buenos Aires
(54) 114-891-2128
marta.castelli
@spglobal.com

Nik Khakee
New York
(1) 212-438-2473
nik.khakee
@spglobal.com

*(**Editor's Note:** This article is no longer effective after Aug. 7, 2020, except in Uruguay. Its contents were moved in their entirety into "S&P Global Ratings Definitions" (see "Distressed Debt Restructuring And Issue Credit Ratings" in "Appendix") without any change in substance. These contents are primarily definitional in nature and characterized as either fundamental attributes of our rating products, clarifications of the meanings of our ratings, or specific applications of our rating definitions.)*

This criteria has associated guidance, "Guidance: Rating Implications Of Exchange Offers And Similar Restructurings, Update," published June 4, 2020.

Entities in distress often restructure their obligations, offering less than the original promise. The alternative of a potential conventional default, in which the investor or counterparty stands to fare even worse, motivates (at least partially) their acceptance of such an offer. S&P Global Ratings treats such offers and buybacks analytically as de facto restructuring--and, accordingly, as equivalent to a default on the part of the issuer.

To consider an exchange offer as tantamount to default, we look for two conditions to be met:

- The offer, in our view, implies the investor will receive less value than the promise of the original securities; and
- The offer, in our view, is distressed, rather than purely opportunistic.

Upon completion of an exchange we view to be distressed, we lower our ratings on the affected issues to 'D', and the issuer credit rating is reduced to 'SD' (selective default), assuming the issuer continues to honor its other obligations. This is the case even though the investors, technically, may accept the offer voluntarily and no legal default occurs. Subsequently, we raise the rating to again focus on conventional default risk. This applies even in the case of an extended de facto restructuring--such as a proposed series of auctions to buy back distressed debt.

Our approach to such transactions pertains equally to the restructuring of any financial obligation of the entity--debt security, loan, or derivatives contract.

The criteria discussed in this article reflect our principle-based methodology, as discussed in "Principles Of Credit Ratings," published Feb. 16, 2011.

Frequently Asked Questions

1. How do you determine whether an offer is distressed or opportunistic?

We distinguish between distressed offers and those that are merely opportunistic. In a distressed exchange, holders accept less than the original promise because of the risk that the issuer won't fulfill its original obligations. By way of contrast, an entity that is a strong credit may offer to exchange bonds for below par where changes in market interest rates, other technicalities, or market developments have caused its bonds to trade at a discount. Such an offer is opportunistic, and would have no rating implications (other than the resulting beneficial impact on future financial profile.)

For an exchange offer to be viewed as distressed, we must decide that, apart from the offer, there is a realistic possibility of a conventional default (i.e., the company could file for bankruptcy, become insolvent, or fall into payment default) on the instrument subject to the exchange, over the near to medium term. Alternatively, exchange offers for which we believe the issuer does not face insolvency or bankruptcy in the near to medium term if the offer is not accepted are viewed as opportunistic exchanges, not distressed exchanges.

The extant issuer credit ratings, as well as rating outlooks or CreditWatch listings, can often serve as proxies for that assessment.

For example, we consider the following guidelines, in addition to other information:

- If the issuer credit rating is 'B-' or lower, the exchange would ordinarily be viewed as distressed and, hence, as a de facto restructuring.
- If the issuer credit rating is 'BB-' or higher, the exchange would ordinarily not be characterized as a de facto restructuring.
- If the issuer credit rating is 'B+' or 'B', market prices or other cues would be used to make the call.

Trading prices of the securities under offer and/or the offering prices can also provide some insight about the characterization of the exchange offer and other buyback activity. Investors, or counterparties--whatever their trading strategies--would be assessing the likelihood of receiving the originally promised amount and comparing the offer to what they expect to receive if a conventional default occurs.

An exchange offer conducted several quarters in advance of maturities, where investors are asked to extend the tenor, with compensation in the form of amendment fees or increased interest rates, would be considered proactive treasury management, rather than a de facto restructuring.

2. Aren't such offers and similar restructuring positive for the company's credit quality?

Indeed, upon completion of a distressed offer, the entity ordinarily will benefit financially, helping it to avoid a conventional insolvency and reduce risk going forward. This may ultimately lead to higher ratings than before the offer was announced.

However, this positive change would be the result of restructuring the obligation (i.e., not meeting its financial obligations in accordance with its terms). In our view, it is analogous to a bankruptcy--a process that also benefits an entity by relieving it of the financial burdens that it undertook previously. Accordingly, our ratings take into account this failure to pay in accordance with the terms of the obligation, and any subsequent benefit would be reflected only afterwards.

3. Exchange offers are sometimes referred to as "coercive." Is this the same as a "distressed offer"?

No. An offer may be deemed coercive, if, for example, the entity employs tactics that pit holders of one series against holders of another series, or imperils holdouts with the threat of stripping covenants once 51% of the bonds are bought in. But from a credit perspective, the coercive aspect of an offer is largely irrelevant. While it may reflect on management style and financial policy, incorporating coercive tactics into an offer would not cause us to view that offer as a de facto restructuring, just as the absence of such tactics would not prevent an offer from being characterized as a distressed offer.

Whether coercive tactics are involved or not, exchange offers are entirely voluntary: Investors can elect not to participate. However, the voluntary acceptance of an offer at a distressed value implies a perception of a significant risk the original obligation may not be fulfilled. The entity's offer acknowledges this reality.

Holders may be very pleased with an offer that is above market prices, especially if they account for the investment on a mark-to-market basis. Moreover, holders that bought their securities at distressed prices may be elated to turn a quick profit. In fact, holders often are the ones to initiate such transactions. But such considerations do not detract from the credit perspective: The obligation is not being fulfilled as originally promised.

4. What constitutes "less than the original promise"?

Investors may receive less value than the promise of the original securities, if one or more of the following happens without adequate offsetting compensation:

- The combination of any cash amount and principal amount of new securities offered is less than the original par amount;
- The interest rate is lower than the original yield;
- The new securities' maturities extend beyond the original;
- The timing of payments is slowed (e.g., zero-coupon from quarterly paying, or bullet from amortizing); or
- The ranking is altered to more junior.

Even a small discrepancy between the offer and the original promise may be deemed a de facto restructuring. However, if an offer is so close to the original promise that it is hard to discern any shortfall, we would not characterize that as a default.

It does not matter if the entity is offering cash, securities, or common equity, as long as the market value of the offer can reasonably be shown to equate to the accreted value of the original securities (par and any accrued interest).

5. What specific rating actions do you take in the case of a distressed transaction?

The consummation of a distressed exchange offer or analogous transaction is viewed as a de facto restructuring with respect to the security involved, resulting in a 'D' rating on that security, even if only a portion of it is subject to the exchange. The issuer credit rating is downgraded to 'SD' (selective default) to reflect the de facto restructuring on some of its obligations. We lower the issuer rating to 'SD' rather than 'D' if the entity continues to honor all its other obligations, and there is no conventional default or broad de facto restructuring, as there would be in the case of a bankruptcy.

For sovereigns, once the distressed exchange offer has been confirmed (albeit with a future effective date), we also lower the issuer rating to 'SD' and the affected issue rating to 'D'.

Once a distressed offer is announced or otherwise anticipated, we lower the issuer and issue ratings to reflect the risk of the expected de facto restructuring. The issuer credit rating is generally lowered to 'CC' and ordinarily carries a negative rating outlook. The issue that is subject to the exchange offer is cut to 'CC'. Recovery ratings--and related notching implications--do not focus on the selective default transaction; rather, they continue to focus on post-conventional default recovery.

If the offer is rejected and there is no expectation of another offer being made, the issuer and issue ratings will ordinarily be restored to their previous levels (unless credit quality has evolved in the meantime for other reasons, including the increased risk of additional distressed exchange offers).

After an exchange offer is completed, the entity is no longer in default--similar to an entity that has exited from bankruptcy. The 'SD' issuer credit rating is no longer applicable--and we change it as expeditiously as possible (that is, once we complete a forward-looking review that takes into account whatever benefits were realized from the restructuring, as well as any other interim developments). If the exchange offer applies to only part of an issue--either because the offer was limited or because some holders declined it--we could raise the rating on the portion of the original securities that remain outstanding, if the issuer continues full debt service as originally contracted. The rating could also remain at 'D' if payments are not made on time and in full on that portion. (Please see the "E. After A Distressed Debt Restructuring" section of "Post-Default Ratings Methodology: When Does Standard & Poor's Raise A Rating From 'D' Or 'SD'?" published March 23, 2015, for the methodology applicable after the offer is completed.)

6. How do you treat loan modifications?

Similar to exchange offers for bonds, if a bank loan is rescheduled such that the lender receives less value than the original value of the loan--for example, if tenor is extended without appropriate compensation (e.g., an amendment fee or increased interest rate) , or interest or principal is reduced, we may consider it a de facto restructuring. However, the extension of bank loan maturities for a bilateral bank loan (between a bank and its customer, as opposed to a syndicated loan) considered in the normal course of business (rather than an extension for a distressed issuer) would not be considered a de facto restructuring.

Sometimes it is difficult to discern the nature of the changes. Apart from the credit risk of the borrower (i.e., whether it viewed as distressed by virtue of low ratings), the context and timing of an extension may offer insights. Accordingly, whether we consider them de facto restructurings depends on the circumstances.

7. How do you treat secondary market repurchases below par?

We make an exception for open-market purchases; however, this exception applies only in a limited fashion. When the market is liquid, so that an issuer's market repurchases can be anonymous, we view that as if any other investor were buying the securities. By contrast, when a company faces its investors through direct or indirect interaction--including advertising itself as a buyer--we treat such repurchases as a debt restructuring. Typically, repurchases of significant percentages of an issue indicate that the issuer is playing at least a behind-the-scene role.

8. What if a shareholder or one of its affiliates, launches the offer, rather than the company itself?

A related party offering at clearly less than par would be seen in the same light as if the entity itself made the same offer. The fact that the loan remains outstanding--held by the affiliate--is irrelevant, because the investors participating in the transaction received less than the original promise.

(This situation is obviously distinct from restructuring a loan originally extended by the shareholders, which would be viewed as the equivalent of infusion of equity.)

9. How does a selective default affect ratings on the entity's affiliates--including parent companies and subsidiaries?

Ordinarily, ratings indicating default apply strictly to the legal entity involved. That applies to de facto restructurings as well. However, we extend that to affiliates that guarantee the issues which are subject to the restructuring.

If the obligation was guaranteed by a third party, there would be no implications for that other entity, inasmuch as the guarantee is not invoked.

10. Does the amount of debt restructured matter?

Yes and no. The amount of "par" that gets restructured does not directly matter, because even very small amounts may be deemed a default, just as if a company misses a minimal amount of payment due.

However, if the transaction involves only a trivial amount, we would not characterize that as a restructuring. Consider that in such instances any impact on the company's risk profile is de minimus (even though we do not otherwise attempt to gauge the extent to which a de facto restructuring will succeed in relieving the risk of a conventional default.)

11. What about restructurings that are not effected in a single transactions, but rather involve multiple separate transactions over several weeks or months? How do you deal with such situations?

We have recently seen a number of cases, especially on bank loans, where the issuer intends to conduct periodic auctions to repurchase some of its debt over several weeks or several quarters. We downgrade to 'D'/'SD' on completion of the first repurchase. Subsequently--as early as the next business day--we would raise the corporate rating so that it reflects the risk of a conventional default--i.e., not focusing on the ongoing restructuring associated with the buyback. (In some cases, this rating will be higher than the original rating, given the debt reduction resulting from the buybacks. However, any issues subject to the buyback remain at 'D' until the termination of the restructuring that pertains to them. (This paragraph has been superseded by paragraph 26, "Multiple repurchases," of "Post-Default Ratings Methodology: When Does Standard & Poor's Raise A Rating From 'D' Or 'SD'?" published March 23, 2015.)

12. How do you treat standstill agreements?

Unless the standstill provides for appropriate compensation with respect to the obligations that will be deferred, we will typically lower the issuer's credit rating to 'D' (or 'SD' if some obligations would not be subject to the standstill). Similarly, we would lower the issue ratings to 'D' for those obligations subject to the stand-still agreement.

In particular, we do not wait until a payment is first missed on an obligation but would typically lower the issuer's credit rating to 'D'/'SD' (and affected issue ratings to 'D') upon agreement with lenders on the standstill or any like formalization of the default. The ratings in such cases will remain 'D' or 'SD' until the obligations are subsequently restructured.

13. What about the entity's other rated obligations?

A distressed exchange offer for specific securities may have no direct bearing on the entity's other securities and/or loans, so the ratings on these may not be immediately affected. (Whereas issue ratings typically are anchored by the issuer rating--i.e., they reflect a combination of the issuer's credit rating and the issue-specific recovery prospects--we make an exception in the case of selective default situations, such as de facto restructurings.)

However, as mentioned earlier, in the aftermath of an exchange offer, the entity may be in a better financial position than before--and that could potentially benefit all its rated obligations. Accordingly, these issue ratings could be placed on CreditWatch with positive (or developing) implications when an exchange offer is announced. The listing would be based on the likelihood that post-completion default risk or recovery prospects, or both, would have improved enough to warrant an upgrade on the issue. Such a CreditWatch listing would be resolved once we know the offer will be consummated as proposed and can assess its implications for ongoing credit quality. An opportunistic offer rarely affects our ratings on the issuer's other obligations.

14. How do you apply this methodology to ratings of equity hybrid instruments?

Hybrids typically incorporate features other than fixed obligations—such as deferral and/or conversion provisions. An exchange offer on an equity hybrid instrument may reflect the possibility that, absent the exchange offer taking place, the issuer would exercise the coupon deferral option--in accordance with the terms of the instrument.) In such instances, the hybrid's rating would go to 'C', rather than the 'D' rating used for nonhybrids. Since deferral on a hybrid in accordance with its terms (outside of the offer scenario) would result in a rating of 'C', a distressed exchange offer should not result in a lower rating. Similarly, the issuer rating would not be affected--just as deferral on hybrid instruments in accordance with terms does not automatically lead to a change in the issuer rating. (This paragraph has been superseded by paragraph 25, "Exchange Offers And Similar Restructurings On Hybrid Capital Instruments," of "Use Of 'C' And 'D' Issue Credit Ratings For Hybrid Capital And Payment-In-Kind Instruments," published Oct. 24, 2013.)

15. What about exchange offers for unrated obligations?

Where we determine that a rated issuer's offer in reference to unrated financial contracts constitutes a distressed exchange, the issuer credit rating will be lowered to 'SD'. Such offers in reference to unrated financial obligations may include: bank loan modifications (see question No. 6), offers in reference to the commutation of credit default swaps, or offers in reference to the restructuring of other derivatives. We review these offers using the same factors we review for rated obligations, in order to determine whether we consider such exchanges distressed, resulting in an issuer rating of 'SD'. Exchange offers for unrated obligations that are not considered financial obligations or do not provide credit enhancement for financial obligations, such as commutation offers on traditional insurance policy claims or a settlement offer for a commercial dispute, would not be considered a distressed exchange offer for the purpose of these criteria. We also do not consider modifications to pension plans, other retirement benefit plans, other labor obligations, or operating leases a default event for the purpose of these criteria.

16. How do you apply this methodology to structured finance ratings?

Many issuers of structured finance obligations are incorporated with a very limited purpose; thus, we refer to them as special purpose vehicles (SPVs) or special purpose corporations (SPCs). We generally do not assign issuer credit ratings to these entities, so the 'SD' treatment would not be relevant.

The most frequent request reviewed by our Structured Finance group does not typically concern a distressed exchange of notes, but rather an amendment of existing debt document terms and conditions. The most frequent type of amendment, in this context, concerns credit derivative swap amendments, such that the floating-rate payer (the protection buyer--most typically a swap broker-dealer counterparty) agrees to a higher or more remote threshold amount or attachment point in exchange for paying a far lower insurance premium or fixed-rate swap payment leg.

The impact of such an amendment is often to lower the coupon on a note issued by the trust or special purpose vehicle that has entered into the credit default swap as a seller of protection. In contrast with a distressed exchange offer, these amendments for swaps and notes typically reference vehicles that currently have 'AAA' or other investment-grade ratings. Thus, such amendment requests are not typically being made to avoid a payment default or insolvency of the SPV.

Nevertheless, the same principles will apply as described in the previous paragraphs. When we believe an amendment was not requested in order to avoid an issue payment default or an SPV insolvency or bankruptcy if the offer was not accepted, we will view the amendment as opportunistic and not distressed, and we would not lower the rating to 'D'.

Recently, we have also seen proposals for exchange offers involving traditional securitization structures, such as student loan asset-backed securities. To date, such offers have been opportunistic and, therefore, would not affect outstanding ratings. However, if we believe the issuer would face insolvency, bankruptcy, or imminent payment default if the exchange or amendment were not executed, then we would view it as commensurate with a distressed exchange and lower the issue rating to 'D' before raising it to a level that reflects the then-current credit quality.

17. Can a cash tender offer conducted below par by an entity rated in the 'CCC' category be considered proactive treasury management, and therefore opportunistic?

Typically, a tender offer below par conducted by a company rated in the 'CCC' category would be viewed as distressed. However, if such a company has significant excess cash reserves on its balance sheet, can fund the tender without incurring additional debt, the tender is conducted several quarters before the maturity of the bond, and the default scenario implicit in the 'CCC' rating is unrelated to the tender offer, the transaction could be considered treasury management and therefore opportunistic provided that the discount to par is minimal.

Revisions And Updates

This article was originally published on May 12, 2009. These criteria became effective on May 12, 2009.

This article updated and superseded:

- Distressed Exchange Offers: Tantamount To Default, published Nov. 2, 2001;
- Rating Implications Of Exchange Offers And Similar Restructurings, published Jan. 28, 2009 (in particular, questions 9-12 were added, and some of the original answers were clarified); and
- Corporate Default Risk With A Twist, published July 5, 2005.

Changes introduced after original publication:

- Following our periodic review completed on March 24, 2016, we updated the author contact information and criteria references, and we moved some paragraphs related to the initial publication of the criteria to the "Revisions And Updates" section. In addition, we added question 17 to the "Frequently Asked Questions" section.
- On May 9, 2016, we republished this article to clarify the second sentence in the response to question 1.
- On June 27, 2019, we republished this criteria article to make nonmaterial changes. Specifically, we deleted noncriteria text from the answer to question 16 in "Frequently Asked Questions."
- On June 4, 2020, we republished this article to add a reference to a related guidance article. We also made nonmaterial editorial changes to update paragraph and article references. We also added a "Related Publications" section.

Related Publications

Related guidance

Guidance: Rating Implications Of Exchange Offers And Similar Restructurings, Update, June 4, 2020