General Criteria:

Guarantee Criteria

October 21, 2016

*(**Editor's Note:** On Aug. 7, 2020, we republished this criteria article to make nonmaterial changes. See the "Revisions And Updates" section for details.)*

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1. This article presents S&P Global Ratings' global criteria for assessing guarantees of rated transactions, issues, and issuers. We have expanded the scope of these criteria to include corporate and government issues and issuers, in addition to structured finance transactions.
2. We intend for these criteria to help market participants better understand our approach to reviewing legal risks in our ratings from a global perspective.
3. These criteria fully supersede:
   - "Guarantee Criteria--Structured Finance," published on May 7, 2013;
   - "Methodology: The Interaction Of Bond Insurance And Credit Ratings," Aug. 24, 2009; and
   - "General Criteria: Rating Sovereign--Guaranteed Debt," April 6, 2009.
4. This paragraph has been deleted.
5. This paragraph has been deleted.

Scope

6. The scope of these criteria encompasses guarantees of rated securities issued by structured finance issuers, as well as corporate and government issues and issuers ("obligation" or "obligations"). These criteria also apply, and are supplemented with S&P Global Ratings' jurisdiction-specific, sector-specific, or asset-specific criteria, to assess guarantees of rated obligations or issuers. In such cases, both this article and the jurisdiction-specific criteria are applicable.

Summary

7. This article discusses the elements that S&P Global Ratings typically considers in assessing whether a guarantee (or equivalent, such as a bond insurance policy) is a form of credit enhancement. Guarantees that are credit enhancements shift the evaluation of creditworthiness from the primary obligor (the guaranteed entity) to that of the guarantor (which can also be a bond insurer).
8. These criteria do not represent a departure from our existing approach. We are setting out a general methodology for assessing guarantees of rated obligations. The criteria in this article are

not intended to be read as being prescriptive but rather as providing a general methodology that guides S&P Global Ratings in considering legal issues we view as relevant to the use of guarantees in the credit analysis of rated obligations.

9. This paragraph has been deleted.

10. This paragraph has been deleted.

Methodology

11. Credit support is typically provided to a securitization structure, issue, or issuer through a guarantee or other similar irrevocable and unconditional payment obligation. The guarantee criteria assess whether a guarantee shifts the evaluation of creditworthiness of the obligation from the primary obligor to that of the guarantor (a "rating substitution").

12. We determine the short- or long-term rating of an obligation or issuer based on the creditworthiness of a guarantor, when we believe that the guarantee documentation supports rating substitution, encompassing all of the primary obligor's relevant liabilities, and demonstrates the guarantor's willingness to fulfill the terms of the obligation.

13. In assessing whether a guarantee qualifies for a rating substitution as a form of credit enhancement, S&P Global Ratings typically considers the extent to which the guarantee meets the following features:

- The guarantee is one of payment and not of collection. In other words, the guarantee should be a promise by the guarantor to pay the guaranteed obligation rather than a promise to pay any deficiency remaining after the beneficiary has exhausted all remedies against the collateral and the primary obligors.
- The guarantor agrees to pay the guaranteed obligations on the date due (as applicable) and waives demand, notice, marshaling of assets, etc.
- The guarantor's right to terminate or amend the guarantee is appropriately restricted.
- The guarantee is unconditional, irrespective of value, genuineness, validity, or enforceability of the guaranteed obligations. The guarantor waives all other circumstances or conditions that would normally release a guarantor from its obligations. The guarantor also waives its rights of set-off, counterclaim, etc.
- In connection with lease transactions, the guarantee also provides that--in the event of a rejection (or similar concept, such as repudiation or rescission) of a lease in a bankruptcy or insolvency proceeding--the guarantor will pay the lease payment, notwithstanding the rejection and as though the rejection had not occurred.
- The guarantee provides that it reinstates if any guaranteed payment made by the primary obligor is recaptured as a result of the primary obligor's bankruptcy or insolvency.
- The holders of the rated notes or other obligations are beneficiaries of the guarantee.

14. For transactions where the guarantor's obligations under the guarantee are to a party in another jurisdiction, S&P Global Ratings may also ask how the risk of any potential withholding tax with respect to cross-border payments by the guarantor is addressed.

15. Once we have determined that a guarantee is eligible for a rating substitution, we consider the guarantee's characteristics, such as payment priority and subordination. Where the obligations under the guarantee rank pari passu with the guarantor's senior unsecured obligations, the rating assigned to the primary obligor or obligation (the subject of the guarantee) will correspond to

either the rating on the guarantor or rating on an equivalent senior obligation of the guarantor. The rating assigned to an obligation that benefits from a subordinated guarantee will correspond to the rating of an equivalent subordinated obligation of the guarantor.

16. In the case of a primary obligor that has a rating based on its unguaranteed credit risk profile, for any issuer or obligation benefiting from credit enhancement, the potential rating will be the higher of the rating on the guarantor (or the higher of the guarantors' ratings in case of joint guarantors) and the rating on the primary issue or issuer in the absence of the credit enhancement unless otherwise specified in a sector-specific or specific cross-sector criteria.

17. In cases of several guarantees (i.e., where each guarantor only guarantees a proportional amount of the obligation), we typically rate to the lowest guarantor rating to rate the obligation--though not below that of our rating on the transaction if it were unenhanced by guarantees--unless otherwise specified in a sector-specific or specific cross-sector criteria.

18. If the primary obligor does not have a stand-alone credit profile (SACP) or an S&P Underlying Rating (SPUR), we can still rate an obligation based on the guarantor's rating, subject to this criteria.

19. Under certain conditions, we may rate an obligation jointly supported by two or more supporting parties at a rating higher than that of either party, if in our view, the two supporting parties are not too highly correlated (see "Methodology And Assumptions For Rating Jointly Supported Financial Obligations," published May 23, 2016).

20. In addition to all other provisions of current criteria, we would not apply the rating on the guarantor to the obligation unless we believe the guarantee arrangement, viewed as a whole and including any collective actions, embodies features (i.e., systems and facilities) that adequately support the guarantor's practical ability to fulfill its obligations under the guarantee.

Appendix: Criteria Questions And Answers

1. What types of guarantees fall under the scope of these criteria?

The Guarantee Criteria are applicable to guarantees extended to a wide variety of structured finance transactions, as well as corporations and entities including nonfinancial corporations, banks, nonbank financial institutions, insurance companies, governments, and other public entities. These guarantees may be standard financial guarantees, or bond insurance policies, insurance policy guarantees, bank guarantees, or guarantees extended to a structured finance transaction. Such guarantees can be given to specific debt instruments or specific obligations arising from insurance policies, or they can be extended to all of the present and future obligations of a given entity. In addition, the Guarantee Criteria cover third-party guarantees, as well as downstream and upstream guarantees extended by entities belonging to the same group.

2. For a guarantee to qualify for a rating substitution as a form of credit enhancement, does it have to meet all of the features listed in paragraph 13 of the criteria?

The ultimate decision on that question is determined by our rating committees. The Guarantee Criteria are our general methodology for assessing guarantees, and are not intended to be read as being prescriptive but rather as providing guidelines in considering legal issues we view as relevant to the use of guarantees in rated obligations, for purposes of a rating substitution. S&P

Global Ratings typically considers the extent to which the guarantee meets the features detailed in paragraph 13.

3. How do the guarantee criteria relate to S&P Global Ratings' Group Rating Methodology?

The Guarantee Criteria and "Group Rating Methodology," (GRM) published July 1, 2019, are fully consistent, but a rating is usually based on either our guarantee criteria or on our GRM analysis rather than a combination of the two. While many group structures include intragroup guarantees (that is, guarantees extended by a strong member of the group to a relatively weaker member), the features of such guarantees are not always relevant or a deciding factor in rating a given obligor or obligation. For example, this holds true in the case of subsidiaries that receive a guarantee from a parent, and whose group status we have defined as "core" according to the GRM. In such cases, debt issued by a core subsidiary may carry the rating of the guarantor but may not be rated based on the guarantee. This can also hold true for some primary obligors who we define as government-related entities. In both cases described above, the guarantee can be "incidental" to the rating of the primary obligor. For further details, please see the GRM criteria and "Rating Government-Related Entities: Methodology And Assumptions," published March 25, 2015.

4. How do we consider guarantees extended to subordinate or hybrid instruments?

Guarantees provided for subordinated or hybrid debt instruments are most prevalent in the banking and insurance sectors. Provided that the guarantee qualifies for a rating substitution according to the Guarantee Criteria, the ratings on these guaranteed issues would correspond to an equivalent obligation of the guarantor, taking into account relevant provisions for coupon nonpayment and other forms of loss absorption. Our approach is consistent for all types of primary obligors, whether they are operating companies, holding entities, or special-purpose vehicles. For these instruments, we expect the guarantor to make payment if the primary obligor fails to make payment on the guaranteed hybrid in situations where the guarantor would have made payment on an equivalent directly issued obligation. We do not expect the guarantor to make payment where the hybrid is absorbing losses in line with its terms, in situations where an equivalent directly issued obligation of the guarantor would similarly be absorbing losses.

5. For insurers, how do you assess the potential rating of senior obligations based on a credit-substitution guarantee?

Where an insurer has provided an eligible guarantee of another insurer's policy obligations, the guaranteed entity's policy obligations become obligations of the guarantor. The potential financial strength rating (FSR) assigned to the primary obligor's (guaranteed entity's) policy obligations will, therefore, correspond to the FSR of the guarantor, subject to any sovereign-related considerations (see "Group Rating Methodology," published on July 1, 2019, and "Ratings Above The Sovereign," published on Nov. 19, 2013).

6. Is timeliness a relevant consideration for assessing the eligibility of an insurance policy guarantee?

Our FSRs do not address timeliness of payment (see "S&P Global Ratings Definitions," updated

from time to time). Therefore, the absence of a reference to a due date in an insurance policy guarantee is not usually a relevant factor when assessing its eligibility for credit enhancement of an FSR. In contrast, timeliness is likely to be a very relevant factor for determining the eligibility of a guarantee for credit substitution, which relates to policy obligations covered by a financial enhancement rating (see "S&P Global Ratings Definitions").

7. How do you assess termination clauses for insurance policy guarantees?

We typically assess whether all obligations incurred up to the time of termination will continue to benefit from the guarantee, and whether the guarantee is binding on successors. A guarantee that does not cover all of the original obligor's policy obligations may not be eligible for credit substitution based on that guarantee.

8. Is it important that the existence of an insurance policy guarantee and its key features are public?

Yes. We assign significance to the fact that policyholders, as beneficiaries of the guarantee, are made aware of the existence of a guarantee and its key features. This strengthens the guarantee's enforceability by policyholders.

9. What about guarantees provided to corporate members of the Lloyd's insurance market?

In addition to the other factors we analyze for a policy guarantee to qualify for credit substitution, for a guarantee provided to corporate members of the Lloyd's insurance market, we look for a method through which valid claims continue to be paid to policyholders should the central Lloyd's claims payment process become inoperable for any reason, including regulatory action affecting Lloyd's. In addition, such a guarantee is typically triggered when a corporate member fails to make timely payment of any amount, once determined to be due and payable, from premium trust funds and funds at Lloyd's. There should be no reliance on payments from the Lloyd's Central Fund.

10. How does the application of S&P Global Ratings' guarantee criteria differ for sovereign guarantors versus nonsovereign guarantors?

The key difference is based on the fact that sovereign entities make and can change laws. Because of this ability, enforcing a claim against a sovereign body is not always certain. This is why S&P Global Ratings, when assessing a sovereign guarantee, may also consider, on top of the considerations included in paragraph 13, to what extent the sovereign extends a guarantee to support a public policy purpose. We believe that a sovereign usually has a strong incentive to honor all of its obligations under the guarantee when it serves a public policy purpose. When we determine that the absence of a public policy purpose raises questions about the government's strong commitment to honor its obligations as detailed in the guarantee, we could choose not to qualify the guarantee for a rating substitution.

An additional point of difference is the actual form of a sovereign guarantee. Sovereigns as well as subsovereign governmental entities often issue statutory guarantees (for example, a law, regulation, or executive order). The existence of such a guarantee may support the equalization of the rating of the guaranteed debt to that of the sovereign or subsovereign, but only if we believe

the statutory guarantee generally meets the features described in paragraph 13.

Revisions And Updates

This article was originally published on Oct. 21, 2016. These criteria became effective upon publication, except in markets that required prior notification of or registration by the local regulator. In these markets, the criteria became effective when so notified by S&P Global Ratings or registered by the regulator.

Changes introduced after original publication:

- Following our periodic review completed on Oct. 21, 2017, we deleted text that was no longer relevant, including paragraphs 5, 9, and 10. We also added the "Revisions And Updates" section.
- On Dec. 12, 2018, we republished this criteria article to make nonmaterial editorial changes. We updated the contact information.
- On Sept. 11, 2019, we republished this criteria article to make nonmaterial changes. We deleted text that was no longer relevant in paragraph 4 following the republishing of our "Group Rating Methodology" on July 1, 2019.
- On Aug. 7, 2020, we republished this article to make nonmaterial changes. We added content to it from "General Criteria: Methodology: Timeliness Of Payments: Grace Periods, Guarantees, And Use Of 'D' And 'SD' Ratings," which we initially published on Oct 24, 2013, and retired on Aug. 7, 2020. The added content appears in paragraph 20 of this article. Also, we updated the criteria references.

Related Criteria

- Methodology And Assumptions For Rating Jointly Supported Financial Obligations, May 23, 2016
- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Group Rating Methodology, July 1, 2019
- Principles Of Credit Ratings, Feb. 16, 2011

These criteria represent the specific application of fundamental principles that define credit risk and ratings opinions. Their use is determined by issuer- or issue-specific attributes as well as S&P Global Ratings assessment of the credit and, if applicable, structural risks for a given issuer or issue rating. Methodology and assumptions may change from time to time as a result of market and economic conditions, issuer- or issue-specific factors, or new empirical evidence that would affect our credit judgment.

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