

General Criteria:

## Use Of CreditWatch And Outlooks

September 14, 2009

*(Editor's Note: On April 15, 2020, we republished this criteria article to make nonmaterial changes. See the "Revisions And Updates" section for details.)*

### Background

1. S&P Global Ratings uses CreditWatch and ratings outlooks to indicate its view regarding the degree of likelihood of a rating change and, in most cases, the probable direction of that change. CreditWatch highlights the potential direction of a short- or long-term rating. It focuses on identifiable events and short-term trends that may cause ratings to be placed under special surveillance by S&P Global Ratings. These may include mergers, recapitalizations, voter referendums, regulatory action, performance deterioration of securitized assets, or unanticipated operating or financial developments.
2. Ratings may be placed on CreditWatch when such an event or a deviation from an expected trend occurs and we believe that additional information is necessary to evaluate the current rating or when there is, in our opinion, a material change in the performance of securitized assets and the magnitude of the rating impact has not been fully determined. A CreditWatch listing, however, does not mean a rating change is inevitable, and when appropriate, a range of potential alternative ratings that we believe could result will be shown. CreditWatch is not intended to include all ratings under review, and rating changes may occur without the ratings having first appeared on CreditWatch. The "positive" CreditWatch designation means that a rating may be raised; "negative" CreditWatch means a rating may be lowered; and "developing" CreditWatch means that a rating may be raised, lowered, or affirmed. (See Ratings Definitions)
3. A S&P Global Ratings' rating outlook indicates our view regarding the potential direction of a long-term credit rating over the intermediate term (typically six months to two years). In determining a rating outlook, consideration is given to any changes we see in the economic and/or fundamental business/financial conditions. An outlook is not necessarily a precursor of a rating change or future CreditWatch action.
  - Positive means that a rating may be raised.
  - Negative means that a rating may be lowered.
  - Stable means that a rating is not likely to change.
  - Developing means a rating may be raised or lowered or remain the same.
  - N.M. means not meaningful.
- 4.

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## General Criteria: Use Of CreditWatch And Outlooks

Rating outlooks (other than stable) and CreditWatch are used in a changing credit situation when, in our view, a rating change is not certain. Although many rating changes are preceded by a non-stable outlook or a CreditWatch placement, changes can and should occur even when the outlook is stable or the rating is not on CreditWatch but when an abrupt change in the creditworthiness can be assessed immediately. S&P Global Ratings' priority is always to get the rating appropriate as quickly as possible, even if a rating change is not signaled in advance because of unanticipated circumstances.

5. S&P Global Ratings' credit ratings express forward-looking opinions about the creditworthiness of issuers and obligations. More specifically, S&P Global Ratings' credit ratings express a relative ranking of creditworthiness. The primary factor in S&P Global Ratings' analysis of creditworthiness is likelihood of default, although payment priority, potential recovery following default, and credit stability are factors that can also play a role in S&P Global Ratings' assessment of credit risk. Credit ratings incorporate an assessment of future events to the extent they can be anticipated. However, S&P Global Ratings' also recognizes the potential for future performance to differ from initial expectations. Outlooks and CreditWatch listings address this possibility by focusing on the scenarios that, in our opinion, could result in a rating change.

## CreditWatch

6. Ratings may be placed on CreditWatch under three sets of circumstances: 1) When, in our view, an event or deviation from an expected trend has occurred or is expected and when additional information is necessary to take a rating action. 2) When we believe there has been a material change in the performance of an issue or issuer, but the magnitude of the rating impact has not been fully determined, and S&P Global Ratings' believes that a rating change is likely in the short term. 3) A change in criteria has been adopted and S&P Global Ratings believes that the combined effect of changes in criteria is likely to affect a credit rating. For example, under Circumstance 1, an issuer typically is placed under such surveillance as the result of a merger, recapitalization, or unanticipated operating development. Such rating reviews are completed as soon as S&P Global Ratings' has received the necessary information and completed its analysis—normally within 90 days—unless the outcome of a specific event is pending. Under Circumstance 2, a group of transactions may be placed under such surveillance as the result of identified performance deterioration until we complete our analysis of the magnitude of the rating impact, normally within 90 days. In Circumstance 3, when the combined effect of changes in criteria is likely to affect a credit rating, S&P Global Ratings will convene a rating committee to evaluate the changes and, as applicable, affirm or change that credit rating. Pending evaluation, S&P Global Ratings will, if appropriate, place the potentially affected credit ratings on CreditWatch. In situations where ratings remain on CreditWatch for more than 90 days (e.g., for mergers and acquisitions) or when material events or deviations from trends occur, S&P Global Ratings' will generally publish interim updates to identify its most current assessment of the situation. In situations where ratings are placed on CreditWatch due to performance deterioration of securitized assets or due to a change in criteria, and the analysis of the ratings impact is expected to exceed 90 days, S&P Global Ratings' will generally publish an expected timeframe to complete its assessment of the situation.
7. S&P Global Ratings' uses CreditWatch when it believes that the likelihood of rating action within the next 90 days is substantial. S&P Global Ratings' will place a rating on CreditWatch if we determine that there is at least a one-in-two likelihood of a rating change or rating suspension or withdrawal (with the latter generally linked to the lack of information as noted in Circumstance 1 of paragraph 6) within 90 days. From time to time, there may be events or issues that present such significant uncertainty to the creditworthiness of an issue or issuer that a rating is placed on CreditWatch without the need to assess this threshold of potential change.

## General Criteria: Use Of CreditWatch And Outlooks

8. CreditWatch designations may be positive, which indicates a rating may be raised, or negative, which indicates a rating may be lowered. (A developing designation is used for unusual situations in which future events are so unclear that the rating could be raised or lowered, such as when a company discloses it is in merger discussions with multiple suitors.) It bears emphasizing that a CreditWatch listing does not imply that any potential change would be only one notch; it could be one notch, several notches or more, depending on the situation.
9. A CreditWatch listing also does not mean a rating change is inevitable. Our CreditWatch commentary typically will provide our view regarding the potential magnitude of any rating change, which could be more than one notch. When, in our opinion, a rating change is certain but the magnitude of change is not, the rating will be moved to what S&P Global Ratings' considers the level that represents the then-current opinion, based on the information available, and placed on CreditWatch for further surveillance. When appropriate, the range of potential alternative ratings that we believe could result is included in the CreditWatch announcement and any interim publications.
10. It is important to reiterate that rating changes as well as rating suspensions and withdrawals can occur without the ratings being placed on CreditWatch beforehand.

## Outlooks

11. Similar to CreditWatch, an outlook indicates our view regarding the potential for a rating change and its direction. In contrast to CreditWatch, an outlook generally is assigned as an ongoing component of long-term ratings, where appropriate, to corporate and government entities (except when the rating is on CreditWatch) and some structured finance ratings. Outlooks have a longer time horizon than CreditWatch listings and incorporate trends or risks that we believe have less-certain implications for credit quality. The time frame for an outlook generally is up to two years for investment grade and generally up to one year for speculative grade. The shorter time frame for speculative-grade outlooks reflects the very nature of speculative-grade credits: They are more volatile and more susceptible to nearer-term refinancing risks, liquidity issues, and covenant triggers.
12. In rare cases, where the outlook may refer to a longer time frame, S&P Global Ratings' will explicitly state so in its published analyses. Although S&P Global Ratings' ratings are based on an opinion of the most likely scenario for an issuer's future performance, the outlook addresses what direction we believe the rating may take if our most likely scenario does not hold.
13. A positive outlook indicates a rating may be raised, and a negative outlook indicates a rating may be lowered. A stable outlook is assigned when we believe that ratings are not likely to be changed. Outlooks should not be confused with expected stability of the issuer's financial or economic performance. Even though S&P Global Ratings' assigns positive or negative outlooks to issuer ratings when we believe that an event or trend has less-certain implications for rating change than CreditWatch, the potential for change must be realistic and not remote. S&P Global Ratings' assigns positive or negative outlooks to issuer ratings when we believe that an event or trend has at least a one-in-three likelihood of resulting in a rating action over the intermediate term for investment-grade credits (generally up to two years) and over the shorter term for speculative-grade credits (generally up to one year). For example, a company with rapidly improving earnings and cash flow might still have a stable outlook if S&P Global Ratings' doubts the sustainability of the trend and thus views an eventual upgrade as unlikely. Occasionally, S&P Global Ratings' may assign a developing outlook to an issuer when it believes that a rating may be raised or lowered. An example of the application of a developing outlook may be where a subsidiary is flagged for sale, or a government enterprise is identified for privatization, and the time period for such an action is more within the outlook period (six months to two years) than the

## **General Criteria: Use Of CreditWatch And Outlooks**

90-day CreditWatch period.

14. A positive or negative outlook is not necessarily a precursor of a rating change or a CreditWatch listing. Conversely, rating changes can occur when the issuer has a stable outlook. Unanticipated events occur, and ratings can be reassessed at any time. If warranted, the rating itself would be changed to reflect the most current opinion of credit quality, and S&P Global Ratings' would not delay such a change by first revising the outlook or placing ratings on CreditWatch merely to signal a potential change.

## **Frequently Asked Questions**

### **What is the difference between an outlook and CreditWatch?**

15. Ratings may be placed on CreditWatch when an unanticipated event or deviation from an expected trend has, in our view, occurred and we believe we need additional information prior to making a rating change, if any. CreditWatch status generally lasts for up to 90 days, though it can last longer when an event is still pending or more information is still required. An issuer placed on CreditWatch does not carry an outlook during the CreditWatch review period.
16. In contrast long-term corporate and government issuer credit ratings and some structured finance ratings carry outlooks (unless the ratings are on CreditWatch). Furthermore, outlooks cover a longer time period—generally up to two years for investment grade and one year for speculative grade—and can incorporate trends or developments that, in our view, have less-certain implications for credit quality than CreditWatch. They present S&P Global Ratings' opinion of possible changes to a company's credit quality over this longer time period, not specific near-term events.

### **Does a negative outlook mean that an issuer has unfavorable credit characteristics?**

17. No. A negative outlook refers to the long-term rating the issuer currently is assigned. It indicates S&P Global Ratings' view that the rating could be downgraded if the scenario upon which the rating is based does not transpire. A very highly rated issuer may have a negative outlook associated with the assigned rating, while an issuer with a rating deep in the speculative-grade category may have a positive outlook.

### **Do companies within a given industry peer group generally have the same rating outlooks?**

18. Not necessarily. An outlook pertains to the rating on a specific issuer. Occasionally, however, most or all companies in a peer group may share the same outlook or CreditWatch status because of a possible change in business conditions that would affect that entire peer group.

### **Do entities within a given country generally have the same rating outlooks?**

19. No, a rating outlook reflects our view regarding the trends and risks affecting the long-term rating prospects of a specific issuer. However, in instances in which nonsovereign ratings are constrained by the probability of the sovereign restricting access to foreign exchange needed for debt service, nonsovereign rating outlooks (in some cases like the ratings themselves) are more

## **General Criteria: Use Of CreditWatch And Outlooks**

likely to be the same as the sovereign outlook. Also, if we believe an entity is dependent on a sovereign for intergovernmental transfers, for subsidies, for a monopoly position, or for any other factors affecting operating and financial performance, outlooks may be linked, particularly if the nonsovereign and sovereign ratings are the same.

### **Does S&P Global Ratings' always place ratings on CreditWatch prior to a rating change?**

20. No. Provided S&P Global Ratings' believes it is in full possession of all necessary information, we may make a rating change without having placed the rating on CreditWatch. Indeed, S&P Global Ratings' believes it would be doing a disservice to the investment community if it delayed a rating change by needlessly placing ratings on CreditWatch.

### **Is an upgrade or downgrade always preceded by a positive or negative outlook?**

21. No. Outlooks speak to the potential directional change of the rating, and in practice, rating changes commonly occur in the direction indicated by the outlook. However, this would not necessarily occur if the rating change was due to an unanticipated event.

### **Under what circumstances does S&P Global Ratings' change a rating and place the revised rating on CreditWatch pending a further review?**

22. S&P Global Ratings' does this when it believes that an event or situation may result in a further change in the rating over the very short term but S&P Global Ratings' still needs more information to make that determination. Similarly, a rating may be lowered and assigned a negative outlook rather than a stable one, or it may be raised and assigned a positive outlook. On the other hand, it is extremely rare for a rating to be lowered and assigned a positive outlook, or raised and assigned a negative outlook, though it may occur.

### **Does every surprising development with an issuer that warrants further investigation result in a CreditWatch placement?**

23. Not every situation involving information uncertainty leads to a CreditWatch. As with most aspects of sound credit analysis, judgment is required. To the extent we identify credits where we believe there is a significant chance (at least a one-in-two likelihood) of rating action over this near-term time horizon but additional information is still needed to make a rating decision, then the rating should be put on CreditWatch.

### **How does S&P Global Ratings' apply its criteria for listing on CreditWatch the credit ratings of an entity that is subject to an acquisition offer by an entity that meets the two following conditions?**

**--The entity will not exist as an independent legal entity following the transfer of its assets and obligations to another rated legal entity, e.g., a merger,**

**restructuring, or consolidation.**

**--The entity is likely to have some or all existing debt repaid according to the terms of each obligation, concurrent with or before the transaction closes.**

24. Despite the expectation that an issuer would cease to exist as an independent legal entity after it transfers assets and obligations (possibly following an upcoming acquisition) to another legal entity, such as through a merger, restructuring, or consolidation (collectively, "the transaction"), the issuer credit rating (ICR) continues to reflect our "forward-looking opinion about an obligor's overall creditworthiness". The ICR needs to be thought of addressing all of the issuer's financial obligations. Therefore, we would apply CreditWatch to the ICR of the rated issuer being acquired if we expect that combined entity would have weaker or stronger creditworthiness than the rated issuer. The acquisition offer, in and of itself, will not lead us to use CreditWatch on the issuer's obligations for those instances where we are virtually certain that the obligations will be extinguished before or concurrent with the transaction's consummation. We would be virtually certain the referenced debt will not remain outstanding after the transaction closing date because, for example:
- We expect all the referenced debt will be accelerated due to a "change-of-control" clause.
  - The referenced debt is short term, expected to mature before the closing date, and will not be renewed.
  - The referenced debt has a call option that will be exercised on or before closing.
25. A change-of-control "put" is not sufficient to meet this level of certainty, unless we are virtually certain that all investors will exercise the put option. Similarly, the intent to initiate a tender offer is not sufficient, unless we were virtually certain that all investors would participate. In addition, to meet this level of certainty, we expect to see creditworthy mechanisms in place that will retire the entire par amount of the rated issues. The existence of creditor protections requiring the repayment of obligations upon such a transaction, such as change-of-control clauses in one or more of rated and unrated obligations, is not sufficient to meet this level of certainty without the mechanisms in place to ensure the retirement of these obligations. Examples of creditworthy mechanisms that are sufficient to retire the entire par amount of the rated issues include:
- The acquirer has a committed facility from a bank that is rated at least as high as the company to be acquired that is designated for this purpose.
  - The acquirer has sufficient cash on hand that is designated for this purpose.

## Revisions And Updates

This article was originally published on Sept. 14, 2009.

Changes introduced after original publication:

- We republished this article on April 10, 2015, to add a question to the "Frequently Asked Questions" section.
- We republished this article on Nov. 3, 2015, to remove noncriteria content that addressed procedural matters such as how S&P Global Ratings communicates CreditWatch and outlook placements.

## General Criteria: Use Of CreditWatch And Outlooks

- Following our periodic review completed on Oct. 20, 2016, we updated the contact information and provided an additional example (unanticipated operating or financial developments) of identifiable events and short-term trends that may cause ratings to be placed under special surveillance. We also updated criteria references and deleted outdated sections that appeared in paragraphs 9-11, which were related to the initial publication of our criteria and no longer relevant.
- Following our periodic review completed on Oct. 20, 2017, we clarified that the outcome of a developing outlook could be that the rating remains the same (paragraph 3). We also clarified in paragraph 6 when a rating may be placed on CreditWatch due to the combined effect of changes in criteria. We also updated contact information.
- On Dec. 10, 2018, we republished this criteria article to make nonmaterial changes to the contact information.
- On April 15, 2020, we republished this criteria article to make nonmaterial changes. We clarified the language relating to CreditWatch placement in paragraph 7 by including suspension and withdrawals (generally as a result of a lack of information) as other examples of possible rating actions. We also added similar clarifying language in paragraph 10.

## Related Criteria And Research

### Superseded Criteria

- Acquisition Risk And Its Effect On Ratings, Sept. 11, 2006
- Credit Policy Update: Criteria On Use Of CreditWatch And Outlooks Clarified, Sept. 30, 2005

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.

## General Criteria: Use Of CreditWatch And Outlooks

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