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WHO USES CREDIT RATINGS?

- Local and global investors
- Corporate bond and financial debenture issuers
- Investment market intermediaries
- Businesses and financial institutions

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WHO USES CREDIT RATINGS?

Investors. Investors most often use credit ratings to help assess credit risk and to compare different issuers and debt issues when making investment decisions and managing their portfolios. Individual investors, for example, may use credit ratings in evaluating the purchase of a municipal or corporate bond from a risk tolerance perspective.

Institutional investors, including mutual funds, pension funds, banks, and insurance companies, often use credit ratings to supplement their own credit analysis of specific debt issues. In addition, institutional investors may use credit ratings to establish thresholds for credit risk and investment guidelines.

A rating may be used as an indication of credit quality, but investors should consider a variety of factors, including their own analysis.

Intermediaries. Investment bankers help to facilitate the flow of capital from investors to issuers. They may use credit ratings to benchmark the relative credit risk of different debt issues, as well as to set the initial pricing for individual debt issues they structure and to help determine the interest rate these issues will pay. Investment bankers may look to a rating agency's criteria when seeking to understand that rating agency's approach toward rating different debt issues or different tiers of debt.

Investment bankers may also serve as arrangers of debt issues. In this capacity, they may establish special purpose entities that package assets, such as retail mortgages and student loans, into securities or structured finance instruments, which they then market to investors.

Issuers. Issuers, including corporations, financial institutions, national governments, cities and municipalities, use credit ratings to provide independent views of their creditworthiness and the credit quality of their debt issues. Issuers may also use credit ratings to help communicate the relative credit quality of debt issues, thereby expanding the universe of investors. In addition, credit ratings may help them anticipate the interest rate to be offered on their new debt issues.

As a general rule, the more creditworthy an issuer or an issue is, the lower the interest rate the issuer would typically have to pay to attract investors. The reverse is also true: an issuer with lower creditworthiness will typically pay a higher interest rate to offset the greater credit risk assumed by investors.

Businesses and financial institutions. Businesses and financial institutions, especially those involved in credit-sensitive transactions, may use credit ratings to assess counterparty risk, which is the potential risk that a party to an agreement may not fulfill its financial obligations.

For example, in deciding whether to lend money to a particular organization or in selecting a company that will guarantee the repayment of a debt issue in the event of default, a business may wish to consider the counterparty risk.

A credit rating agency's opinion of counterparty risk can therefore help businesses analyze their credit exposure to financial firms that have agreed to assume certain financial obligations and to evaluate the viability of potential partnerships and other business relationships.

[Editor's note: The contents of this article are based on the publication "GUIDE TO CREDIT RATING ESSENTIALS," published on **www.standardandpoors.com**, Copyright © 2014 by Standard & Poor's Financial Services LLC.]