

Understanding Global Ratings

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■ Summary

International and cross-border investors increasingly look to credit ratings to compare risk worldwide, particularly in emerging markets. To satisfy these needs, Fitch IBCA issues various ratings addressing diverse concerns. Different scales are used for national and international investors, and further distinctions are made based on the currency of issuance. This report defines the ratings issued by Fitch IBCA and explains how best to use them in assessing credit risk.

■ International Scale Ratings

International credit ratings assess the capacity to meet foreign currency or local currency commitments. Both foreign and local currency ratings are internationally comparable assessments.

Most Fitch IBCA ratings are defined on an international scale. This scale, in turn, is based on an 'AAA' benchmark rating, such as U.S. Treasury bonds, that is comparable worldwide. Under this scale, a 'BB' rating for a Chinese entity is directly comparable to one in the U.S. as well as in Argentina. This scale allows investors to compare ratings across the world when considering different investment options.

Local and Foreign Currency Ratings

International scale ratings can apply to either local or foreign currency issues. The two ratings reflect different risk levels. A local currency rating is based on the issuer's ability to repay debt in its country's currency whether issued locally or abroad. Local currency and foreign currency ratings apply, in principle, only to sovereigns since only they have the capacity to meet obligations depending on the currency. Other issuers may also have different local and foreign currency ratings as a result of government actions, usually referred to as the sovereign ceiling (*see box, page 2*).

Most, but not all, countries have higher local currency than foreign currency ratings. This is due to the sovereign's capacity to tax, print money, and generally control domestic finances and the financial system. However, for private issuers, this distinction normally does not apply since all debt payments come from the same source. A Deutsche mark bond issued by a U.S. company, for example, will have the same rating as an otherwise identical U.S. dollar bond. One exception to this rule is for those companies whose stand-alone ratings may be limited by the sovereign. The stand-alone rating excludes any direct consideration of the sovereign rating or of actions that the government could take to limit access to foreign currency. It represents what the company or deal rating could be if the sovereign ceiling were not an issue. In most cases, the stand-alone rating is the same as the local currency rating. Depending on governmental support, a bank's rating may be raised above its stand-alone rating, but not above the sovereign's rating.

A private issuer whose stand-alone credit quality is higher than that of the country in which it resides often finds its foreign currency rating limited to that of the sovereign, while its local currency rating may be higher. (*For more information, please see Fitch IBCA Research on "Rating Above the Sovereign Ceiling," dated June 18, 1998, available on Fitch IBCA's web site at www.fitchibca.com.*)

■ National Scale Ratings

Fitch IBCA offers national ratings, which are an assessment of credit quality relative to the rating of the sovereign state in that country's national market. The national scale measures relative credit risk in a particular country. The process begins by assigning an 'AAA' rating to the most creditworthy entity in the country, which is usually the government. On an international scale, this rating might be only 'BBB' or 'BB' or even

Sovereign Ceiling

A sovereign's rating on its foreign currency obligations has traditionally been regarded as the ceiling on ratings for other issuers domiciled in the country. The assumption is that a sovereign default will force all domestic issuers to default. Circumstances leading to a national debt crisis, which include economic and political upheavals, balance of payments crises, trade shocks, and high inflation, directly affect the debt servicing capacity of private lenders. More important, countries facing default may impose exchange controls and other restrictive measures that impede access by issuers to the foreign currency necessary to service their obligations.

The sovereign's local currency rating, on the other hand, is usually not a ceiling on other ratings due to the government's limited interest in restricting access to its own currency. Foreign currency is a very valuable commodity in a default crisis as opposed to local currency, the value of which is usually ravaged by high inflation in those circumstances. But sovereign foreign ratings do not always act as a ceiling. Fitch IBCA has rated issuers (YPF S.A. and MetroGas S.A. in Argentina), transactions (PDVSA Ltd. Finance in Venezuela, Sino Commercial Properties Funding, Ltd. in Hong Kong), and project financing (Cerro Negro Finance, Ltd. and Fertilizantes Nitrogenados de Venezuela in Venezuela) higher than the respective country's ratings.

ratings approach. Currently, Fitch IBCA has three different ratings for this oil company. On the international scale, YPF is rated 'BBB-' for foreign currency and 'A-' for local currency. Both ratings are higher than Argentina's 'BB' foreign currency and 'BB+' local currency ratings. YPF's foreign currency rating, although not automatically limited to the government's rating, is nevertheless constrained, which is why it is lower than the local currency rating. These ratings are comparable across the world. They reflect a higher capacity to pay peso rather than dollar debt due to the possibility of exchange controls limiting YPF's access to foreign currency.

On the national scale, YPF is rated 'AAA', the highest possible rating. Fitch IBCA considers YPF one of the best credits within Argentina, and it is this scale that local investors look to when comparing opportunities within the country. The two scales complement each other and address different investor needs.

lower. While international credit ratings are comparable on a worldwide basis, national ratings refer only to issuers within their own country.

Companies within the domestic market are assigned ratings based on their credit standing in relation to the benchmark and to other issuers in the country. This rating scale provides local and foreign investors with greater rating differentiation than does the international scale because the ratings assigned are not constrained by the sovereign ceiling. The ratings are modified with the addition of country-specific symbols to distinguish them from the international scale ratings.

■ Fitch IBCA Rating Methodology

YPF S.A., Argentina's largest corporation, is one example of Fitch IBCA's

Rating Scales

International	Argentina	Brazil	Chile	South Africa
AAA	AAA (arg)	AAA (bra)	AAA (chl)	AAA (zaf)
AA	AA (arg)	AA (bra)	AA (chl)	AA (zaf)
A	A (arg)	A (bra)	A (chl)	A (zaf)
BBB	BBB (arg)	BBB (bra)	BBB (chl)	BBB (zaf)
BB	BB (arg)	BB (bra)	BB (chl)	BB (zaf)
B	B (arg)	B (bra)	B (chl)	B (zaf)

Note: Fitch IBCA has national scale ratings in four countries (Mexico will soon be added). All of them use the same letter system as in international ratings, with the addition of a country qualifier signaling that the rating is to be used only within the context of that country. All rating categories (except 'AAA' and categories below 'CCC') are further differentiated by the use of plus and minus signs.

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