

December 11, 2006

Credit FAQ:

Introduction Of Sovereign Recovery Ratings

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On Dec. 6, 2006, Standard & Poor's Ratings Services published a Request For Comment titled " Introduction Of Sovereign Recovery Ratings." In this criteria article, we invite feedback on our plan to expand global coverage of recovery ratings to speculative-grade sovereign issuers. Market participants are asked to submit comments on this plan by Jan. 22, 2006. In the meantime, to shed light on the background behind this proposal, we address some of the likely questions that may arise from investors.

Frequently Asked Questions

Why are you making this proposal now?

We began assigning recovery ratings to secured debt instruments of speculative-grade corporate issuers in 2003, and to project finance transactions in 2005. Subsequently, Standard & Poor's published a Request For Comment titled " Expanding Recovery Rating Coverage And Enhancing Issue Ratings" on Oct. 4, 2006, in which we presented our plan to extend recovery ratings to other asset classes, including sovereign debt. The latest proposal outlines the analytical approach we plan to adopt in order to assign recovery ratings to senior unsecured foreign currency debt of speculative-grade sovereign issuers.

What are recovery ratings?

Recovery ratings are Standard & Poor's current estimate of the range of recovery likely to be returned to lenders in a prospective default or debt-restructuring scenario, as highlighted in the proposed recovery scale of '1+' through '6' (where '1+' represents the highest expectation of recovery). While informed by our proprietary LossStats database showing historical average recovery experience, recovery ratings are based on a fundamental issuer- and instrument-specific, scenario-based, recovery analysis.

What will Standard & Poor's sovereign recovery ratings address?

Sovereign recovery ratings will identify the likely recovery prospects to be expected on senior unsecured, foreign-currency-denominated commercial debt. Such ratings will cover commercial debt issued by speculative-grade rated sovereigns (that is, those assigned long-term foreign currency sovereign credit ratings of 'BB+' and lower). They will not be assigned to secured debt or debt guaranteed by third parties, nor will they differentiate between different types of commercial creditors, or on the basis of other features such as different maturities.

Recovery ratings will be assigned according Standard & Poor's proposed global recovery ratings scale from '1+' to '6', and published alongside the current issuer credit ratings. Issue ratings will incorporate both default risks and recovery prospects, reflecting the "enhanced notching" approach proposed for unsecured debt ratings in our Request For Comment dated Oct. 4, 2006 (see above).

Which sovereigns will initially receive recovery ratings?

Once we have finalized our methodology, having considered market participants views, we will begin to assign and publish recovery ratings to speculative-grade sovereigns. The initial rollout in the first quarter of 2007 will include 25 noninvestment grade sovereigns that are among the most active participants in today's global capital markets. Examples include the Federative Republic of Brazil (BB/Positive/B) and the Republic of Turkey (BB-/Stable/B). Recovery ratings for less frequent issuers of sovereign foreign currency debt will be assigned later in 2007.

What are the distinctive analytical considerations for sovereign, compared with corporate, recoveries?

Essentially, there are five major considerations:

- No insolvency regime, and no foreclosure on assets;
- No objective point of default for sovereign issuers;
- More varied time periods of default;
- Payment willingness, as well as payment ability, after default; and
- Expected recovery rates expressed in net present value (NPV) rather than nominal terms, in order to provide a more meaningful calculation.

What will Standard & Poor's analytical approach consist of?

The analysis begins with the identification of likely sovereign default scenarios, which set the parameters (economic, fiscal, and political conditions) for the subsequent recovery analysis. These scenarios take into account 21 sovereign default and crisis episodes experienced since the first half of the 1990s.

What are the three pillars of your sovereign recovery analysis?

The three pillars encompass the sovereign's payment ability, its anticipated payment willingness, and the existence of subordination or enhancement features. Of these, the sovereign's willingness to pay is of paramount importance due to the absence of a sovereign insolvency framework. While a sovereign does not usually cease to exist and is therefore likely to retain links with investors, payment willingness will also depend on the importance, for both the government and the domestic economy, of access to global goods and capital markets.

Why will recovery ratings only be available on speculative-grade sovereign issuers?

For speculative-grade issuers, Standard & Poor's assesses the likely default scenario and the fiscal, economic, and political profile of the issuer in a default situation, and draws relevant and distinctive conclusions on recovery given default. We believe that analysis of the likely recovery dynamics for speculative-grade sovereigns is of particular interest to market participants, since default is a more remote prospect for investment-grade issuers.

An issuer that is currently rated investment grade would likely be downgraded to a lower rating level prior to default. Its credit profile may therefore look very different from that which exists today, and would possibly be more similar to a profile of past defaulters.

What are the next steps?

During the six-week comment period ending Jan 22, 2007, Standard & Poor's will be reviewing comments received via e-mail and from other contacts with market participants. After that time, we will publish the final methodology for assigning sovereign recovery ratings. Subsequently, during the first quarter of 2007, we plan to assign and publish recovery ratings to speculative-grade rated sovereigns.

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