



## **Dialogue With Rating Agencies**

NAST 2008 Annual Conference

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## Agenda

- 1) Analytic Enhancements
- 2) Governance
- 3) Reassessment of Municipal Ratings Framework



## Analytic Enhancements/Exposure Drafts

- 1) Revised corporate CDO methodology
- 2) Rating 'Cap' on complex market value transactions
- 3) Global roll-out of tranche-level outlooks
- 4) User-customizable non-conforming RMBS model (Europe)
- 5) Complementary rating scales for Structured Finance:
  - > LGD, stability, collateral ratings
- 6) Greater use of deterministic stress tests
- 7) Reassessment of Municipal Ratings Framework



## **Governance/Process**

- 1) Full separation of non-rating work into Fitch Solutions
- 2) Creation of Group Credit Officer position within analytic teams
- 3) Will implement all revisions to IOSCO Code including:
  - Specify criteria used for each rating
  - Reports to specify attributes and limitations of individual ratings
  - Criteria to deal with limited or non-robust data



## Reassessment of Municipal Ratings Framework

- > Goal is to denote a comparable level of credit risk across products and geography
  
- > Recalibration effort is not unique -
  - > Fitch conducted inaugural study of municipal defaults in 1999 and in 2000; upgraded 25% of Fitch's GO ratings and 50% of water/sewer ratings
  - > Sector rating revisions have been made in other sectors – Banks, CDOs, RMBS, Non-Investment Grade Corporates



## Key Considerations in Proposed Municipal Ratings Uplift

- > Favorable credit characteristics
- > Low overall default experience
- > Existing rating distribution
- > Outlook for credit quality with special emphasis on current environment and long-term factors
  - > Period of unprecedented stress in the financial markets
  - > Deteriorating housing and employment situation
  - > Pension and OPEB funding requirements



## Comparing the Historical Default Experience of Public Finance vs. Other Sectors

### Fitch Ratings U.S. Public Finance Average Cumulative Default Rates 1990 - 2007

	<u>1 Year</u>	<u>2 Year</u>	<u>3 Year</u>	<u>4 Year</u>	<u>5 Year</u>
AAA	0.00%	0.00%	0.00%	0.00%	0.00%
AA	0.00%	0.00%	0.00%	0.00%	0.00%
A	0.00%	0.00%	0.00%	0.00%	0.00%
BBB	0.03%	0.08%	0.18%	0.38%	0.66%
Investment Grade	0.00%	0.01%	0.03%	0.06%	0.10%
High Yield	1.39%	2.38%	3.75%	5.05%	5.84%
All Public Finance	0.03%	0.05%	0.09%	0.14%	0.19%

### Fitch Ratings Global Corporate Finance Average Cumulative Default Rates 1990 - 2007

	<u>1 Year</u>	<u>2 Year</u>	<u>3 Year</u>	<u>4 Year</u>	<u>5 Year</u>
AAA	0.00%	0.00%	0.00%	0.00%	0.00%
AA	0.00%	0.00%	0.00%	0.03%	0.06%
A	0.03%	0.15%	0.30%	0.44%	0.65%
BBB	0.24%	0.78%	1.48%	2.24%	3.11%
Investment Grade	0.09%	0.32%	0.60%	0.88%	1.21%
High Yield	2.70%	5.26%	7.64%	9.90%	12.26%
All Corporates	0.58%	1.19%	1.79%	2.35%	2.93%



## Comparing the Historical Default Experience of Public Finance vs. Other Sectors

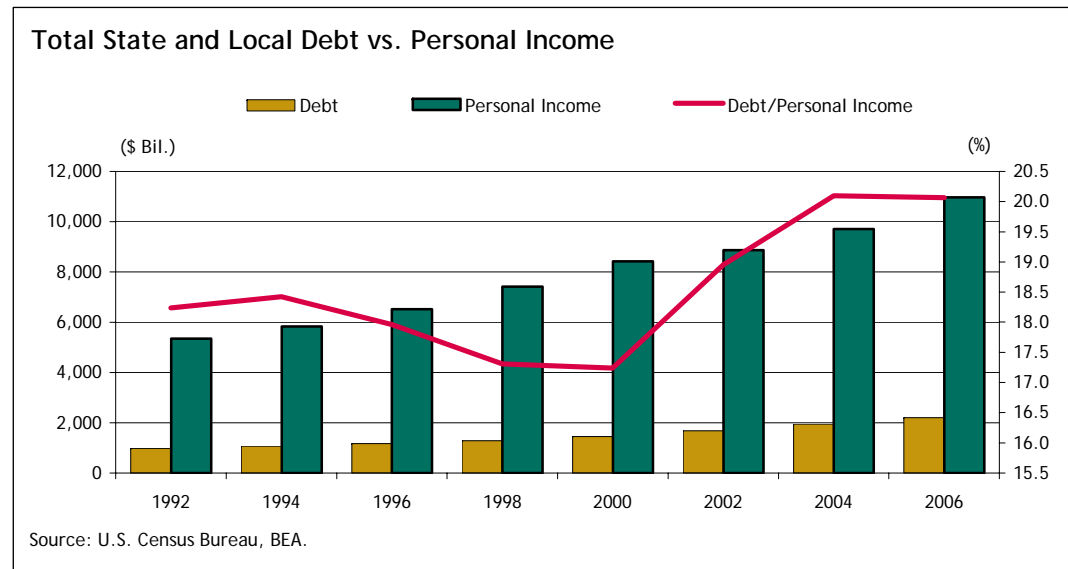
### Fitch Global Commercial Mortgage-Backed Securities Average Cumulative Default Rates: 1991–2007

(%)

	<u>1yr</u>	<u>2yr</u>	<u>3yr</u>	<u>4yr</u>	<u>5yr</u>
AAA	0.00	0.00	0.00	0.00	0.00
AA	0.00	0.00	0.00	0.00	0.00
A	0.00	0.00	0.00	0.00	0.00
BBB	0.00	0.00	0.02	0.06	0.11
	<u>1yr</u>	<u>2yr</u>	<u>3yr</u>	<u>4yr</u>	<u>5yr</u>
Investment Grade	0.00	0.00	0.01	0.02	0.03
High Yield	1.41	3.22	5.28	7.49	9.67
All CMBS	0.38	0.90	1.48	2.09	2.67



# Increasing State and Local Debt vs. Personal Income





## Expected Impact of Rating Recalibration

- > Broad-based upward rating adjustments subject to certain constraints
- > Upward revisions for tax-supported and water/sewer bonds
  - > Typically 2 notches for 'BBB' to 'A' issuers
  - > Typically 1 notch for 'A+' to 'AA' issuers
- > Credits rated 'AA+' and 'BBB-' and below will be reviewed prior to recalibration
- > With some exceptions, Rating Outlook and Watch will be maintained
- > Prior to implementation, ratings will be based on the existing framework



## Fitch Portfolio Average Rating

	<u>Current</u>	<u>Expected Post Recalibration</u>
- State GO	AA	AA+
- Local GO	AA -	AA
- Water/Sewer	A +	AA-
- U.S. Banks	A/A -	A/A-
- U.S. Industrials	BBB-	BBB-



## Feedback Sought

- > Users are invited to comment on:
  - Fitch’s proposal to recalibrate municipal ratings to its international rating scale, as opposed to the alternative of assigning and maintaining ratings on dual scales.
- > Fitch’s proposal on the procedure for implementing the rating calibration.
- > Fitch’s plan to consider recalibration of other municipal sectors at a later date.
- > Feedback should be directed to [muniframework@fitchratings.com](mailto:muniframework@fitchratings.com) through Aug. 29.



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