

**Presentation To: IFA Success Forum 2008  
“Credible Credit Ratings – Helping NZ Financial  
Advisors Make Better Informed Decisions”**

Gavin Gunning  
Director  
Standard & Poor's

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# Agenda

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- Standard & Poor's role in markets & New Zealand
- What are Standard & Poor's Ratings?
- What do Ratings Mean?
- S&P Rating Committee & Analytical Process
- S&P Rating Methodology – NZ Finance Companies
- Key Rating Factors – NZ Finance Companies
- S&P #1 Priority – Market education

# Standard & Poor's

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- S&P is a leading provider of financial market intelligence as the world's foremost source of credit ratings, indices, investment research, risk evaluation and data.
- S&P employs approximately 8,500 employees located in 21 countries and markets.
- Total amount of debt rated by Standard & Poor's Ratings Services globally is approximately US\$34 trillion in over 100 countries.
- Standard & Poor's RatingsDirect<sup>®</sup>, our ratings & research database, houses 240,000 research articles.

# Standard & Poor's - New Zealand

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- S&P has a long-standing presence in New Zealand first rating the New Zealand sovereign over 30 years ago
- NZ is an important market for S&P - S&P has the largest coverage of credible ratings in NZ with approximately 100 corporate and government entities issuers and issues publicly rated (refer [yourinvestments.standardandpoors.co.nz](http://yourinvestments.standardandpoors.co.nz) - NZ Ratings List)
- Large experienced team of ratings analysts

# What are S&P Issuer & S&P Issue Credit Ratings?

## Issuer Credit Rating

- Is an objective, independent opinion of an obligor's capacity and willingness to meet its financial commitments when they fall due.
- Corporate credit ratings and counterparty credit ratings are forms of issuer credit ratings and are current opinions of an obligor's capacity to meet its financial obligations.

## Issue Credit Rating

- An opinion of the creditworthiness of an obligor with respect to a specific financial obligation or specific financial program. It takes into account the terms and conditions of the obligation as well as the creditworthiness of guarantors, insurers and other forms of credit enhancement.

# Features of S&P Issuer Credit Ratings

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- Globally consistent against a well-recognised scale : ‘AAA’ to ‘D’
- Measure of probability of default (PD)
- Refers to the timely payment of interest and principal
- ICRs can be long-term or short-term
- Outlooks are assigned to long-term ICRs indicating likely direction – outlooks can be positive, negative, stable or developing.
- CreditWatches are assigned to long- and/or short-term ICRs and specific obligations, as required, focusing on identifiable events or short term trends – CreditWatches can be positive, negative or developing.

## Features of S&P Issuer Credit Ratings (continued)

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- Methodology underpinning S&P credit ratings is well-established
- Credit ratings are continuously under surveillance
- Each new credit rating assigned forms part of S&P global pool of credit ratings: observations regarding average probability of default and transition trends are possible from S&P global default & transition studies (published annually)
- Credible credit ratings assist in establishing independent risk benchmarks & are a critical component of market infrastructure

# What Not are S&P Issuer Credit Ratings ?

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- Not an equities recommendation – S&P ratings relate to financial strength
- Not a recommendation to buy, sell, or hold a financial obligation
- Not an audit
- Not a measure of market volatility – they indicate credit risk
- Not address recovery – recovery is the subject of a separate S&P rating scale and methodology

# Standard & Poor's Long-Term Rating Scale

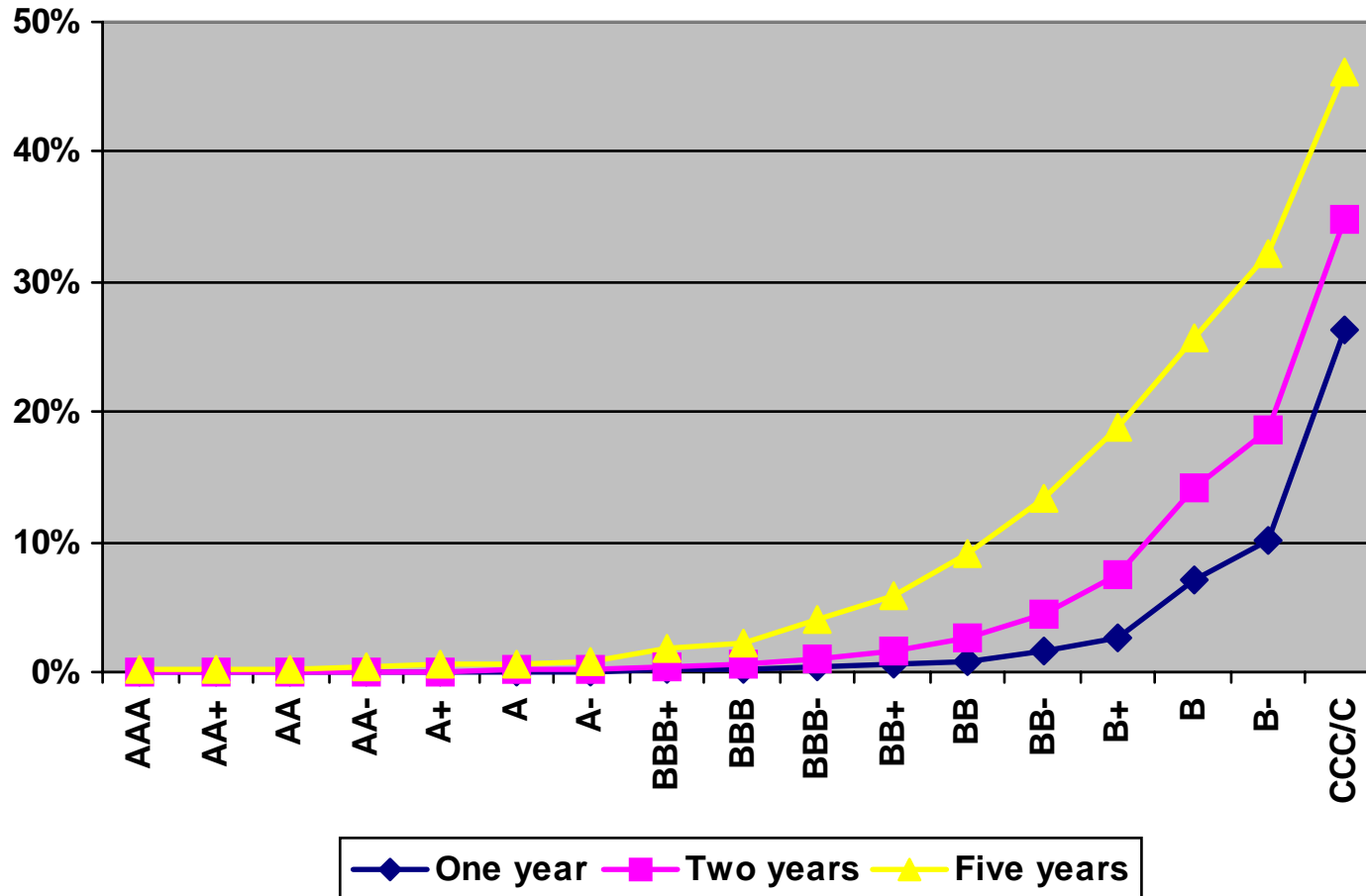
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Capacity To Make Timely Payment	AAA	Extremely Strong
	AA	Very Strong
	A	Strong
	BBB	Adequate
Vulnerable To Non Payment	BB	Less Vulnerable
	B	More Vulnerable
	CCC	Currently Vulnerable
	CC	Currently Highly Vulnerable
	D	Default

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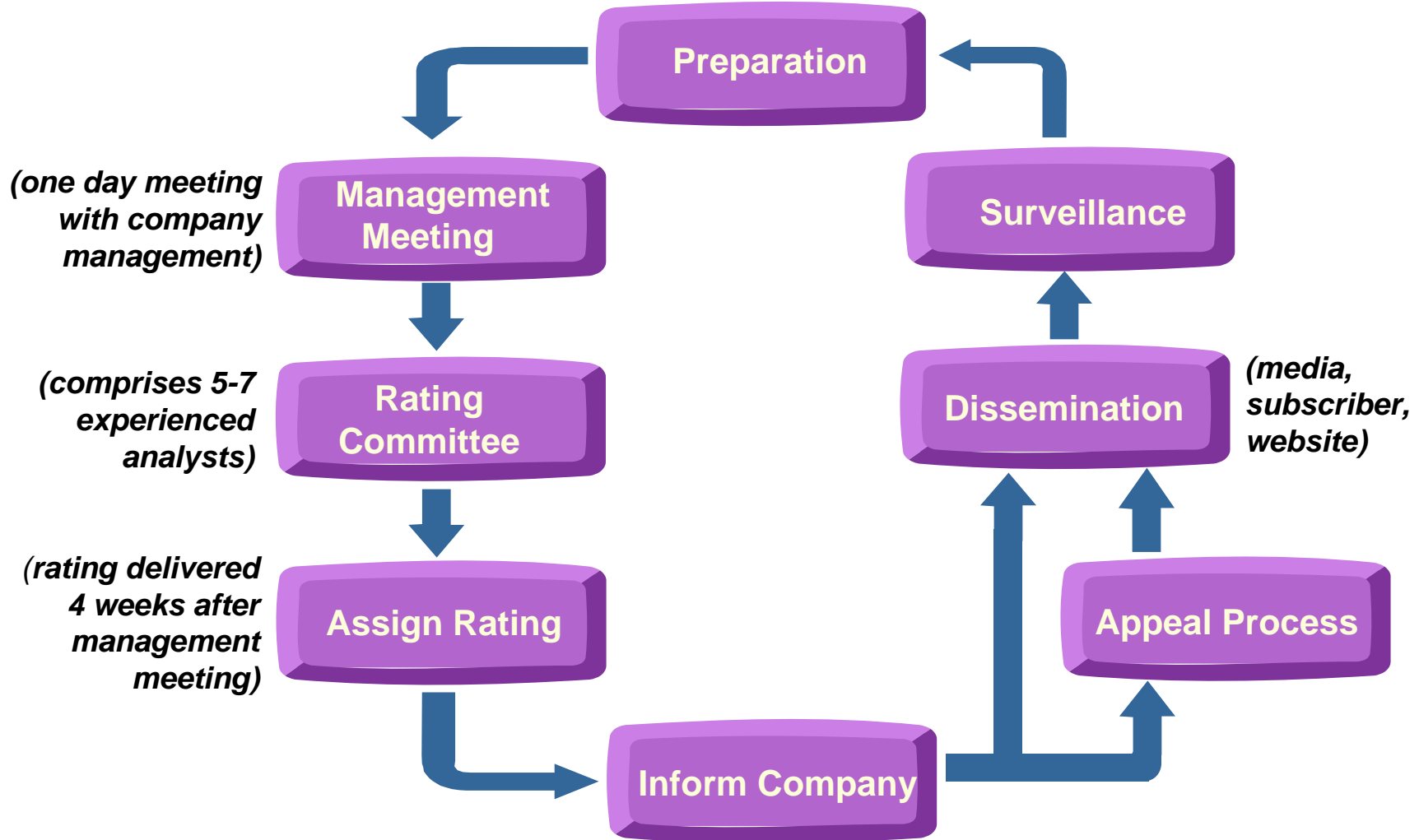
# What Do Ratings Mean?

Probability of default rates for different ratings over 1,2 and 5 years



\*Data derived from Standard & Poor's global pool of rated issuers for the period 1981 to 2006.

# S&P Rating Committee and Analytical Process



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# Methodology to Arrive at an Issuer Credit Rating

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## Example: NZ Financial Institution

- While factors are scored, they are not weighted:

<b>Risk Factor</b>	<b>Score</b>
<b>Economic &amp; Industry Risk Assessment</b>	
<b>Business profile</b>	
- Market position	
- Diversification	
- Management/strategy	
<b>Financial profile</b>	
- Credit risk/asset quality	
- Funding/liquidity/market/non-credit risks	
- Profitability	
- Capital and financial flexibility	
<b>ERM, Governance, Ownership</b>	

# Key Rating Factors: NZ Finance Companies

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## Economic & Industry Risks

- Congested industry - large number of small players
- Historically regulatory approach has been “light-touch” - new regulations will strengthen the industry long-term, but in short-term many companies will be stretched to transition to new regulations
- Lack of benchmarks for risk vs return in NZ finance company sector
- Industry has performed poorly in what have been relatively benign economic times – major red flag
- Recent industry failures have negatively affected investor confidence which has placed pressure on funding & liquidity – currently liquidity is key industry sensitivity
- Some sub-sectors of the economy relevant to finance companies have been experiencing more difficult times – property sector, retail sector; asset quality is key industry sensitivity
- Despite recent market stress, finance companies have a meaningful role to play in the disintermediation of credit in NZ, & there are some companies in the industry that demonstrate some sound financial strength characteristics

# Key Rating Factors: NZ Finance Companies

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## Business Risks

- business lines of many finance companies reflect some higher-risk characteristics – consumer, asset-based, property finance
- business diversification is generally lacking - many finance companies are niche players although some demonstrate good competencies in their niche
- market position and share of many companies is small - price-takers not makers
- many companies are staffed by appropriately experienced personnel although lack bench strength - “key person risk” is an issue for many companies; management style can be “entrepreneurial”; governance generally has scope for improvement
- while Standard & Poor’s ratings are forward-looking, past track record can afford greater confidence regarding execution of future strategy - many companies are untested through an economic cycle or in illiquid markets, and some companies have short track records

# Key Rating Factors: NZ Finance Companies

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## Financial Risks

- credit policies and practices of many finance companies require development
- many companies have grown strongly and have unseasoned loan books – rapid growth is a natural red flag
- funding is concentrated – some companies risk not making payment because they are vulnerable to liquidity shortfall – diversification of funding and liquidity earns a “big tick”
- policies for the management of structural balance sheet risks, market and other non-credit risks is rudimentary
- some companies demonstrate lucrative interest margins and very good profitability although this is expected because of higher-risk higher-return nature of business activities
- small capital affords modest protection against unexpected risks (vs provisioning for expected risks) – good capitalisation relative to risk is valued highly in rating assessments

# S&P Priority in NZ Finance Company Sector is Market Education

## **S&P initiatives to improve literacy regarding credible credit ratings in NZ NBDT sector include:**

- engagement with wide range of industry stakeholders & participants – finance companies, financial advisors, industry forums, regulators etc
- webpage ***yourinvestments.standardandpoors.co.nz*** (launched Sep. 17, 2007) which houses credit rating toolkit for advisors and investors to facilitate a better understanding of credible credit ratings
- tailored credit rating collateral to suit the NZ NBDT industry - available free on web – analytical rating criteria, rating lists, FAQ, abridged rating reports, explanatory materials
- credit training
- speaking opportunities – Pacific Prospect, INFINZ, IFA, advisor offsites

## **S&P Credit Rating Toolkit for NZ NBDT Sector:**

### **Selected Publications**

Ratings and Your Investments: Helping New Zealand Investors Make More Informed Financial Decisions

Frequently Asked Questions: New Zealand Non-Bank Deposit-Taking Institutions

Ratings List – New Zealand Rated Entities

Commentary Article: "Bridgecorp Default a Major Wake-Up Call for New Zealand Non-Bank Sector"

Criteria Brief: "New Zealand Non-Bank Deposit-Taking Institutions"

Commentary Article: "Standard & Poor's Annual 2006 Global Default and Transition Study".

### **Abridged Credit Rating Reports**

### **News & Commentary**

### **Press Kit**

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