

General Criteria:

Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions

November 19, 2013

(Editor's Note: On Oct. 20, 2023, we republished this article to correct a publication error in paragraph 69 and make nonmaterial changes. See that paragraph and the "Revisions And Updates" section for details.)

1. This methodology addresses the following aspects S&P Global Ratings considers in rating nonsovereign entities at a higher rating level than the sovereign:
 - The potential to rate entities above the sovereign if we believe the entity would not default in the stress scenario likely to accompany a sovereign default;
 - A framework that indicates by how many notches an entity rating can exceed the sovereign rating, depending primarily on the sensitivity of the entity's sector to country risk--up to 2 notches in the case of 'high sensitivity' to country risk and up to 4 notches in the case of 'moderate sensitivity' to country risk; and
 - Rating caps for foreign currency ratings, related to transfer and convertibility (T&C) risk, unless there are mitigating factors for T&C risk.
2. This paragraph has been deleted.
3. These criteria bring additional clarity and comparability to our global approach for considering nonsovereign ratings above that of the sovereign, with respect to corporate and government ratings.
4. S&P Global Ratings' view is that not all ratings need to be constrained at the level of the sovereign rating. Evidence from sovereign crises and defaults (see Appendix II) supports two key notions that are reaffirmed in our criteria: (1) A sovereign default does not imply that every entity in the country will default, but (2) The economic stress that historically accompanies a sovereign default would be considered severe and would lead to a significant increase in nonsovereign defaults.
5. This paragraph has been deleted.
6. This paragraph has been deleted.
7. The criteria constitute specific methodologies and assumptions under "Principles Of Credit Ratings," published Feb. 16, 2011.

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SCOPE OF THE CRITERIA

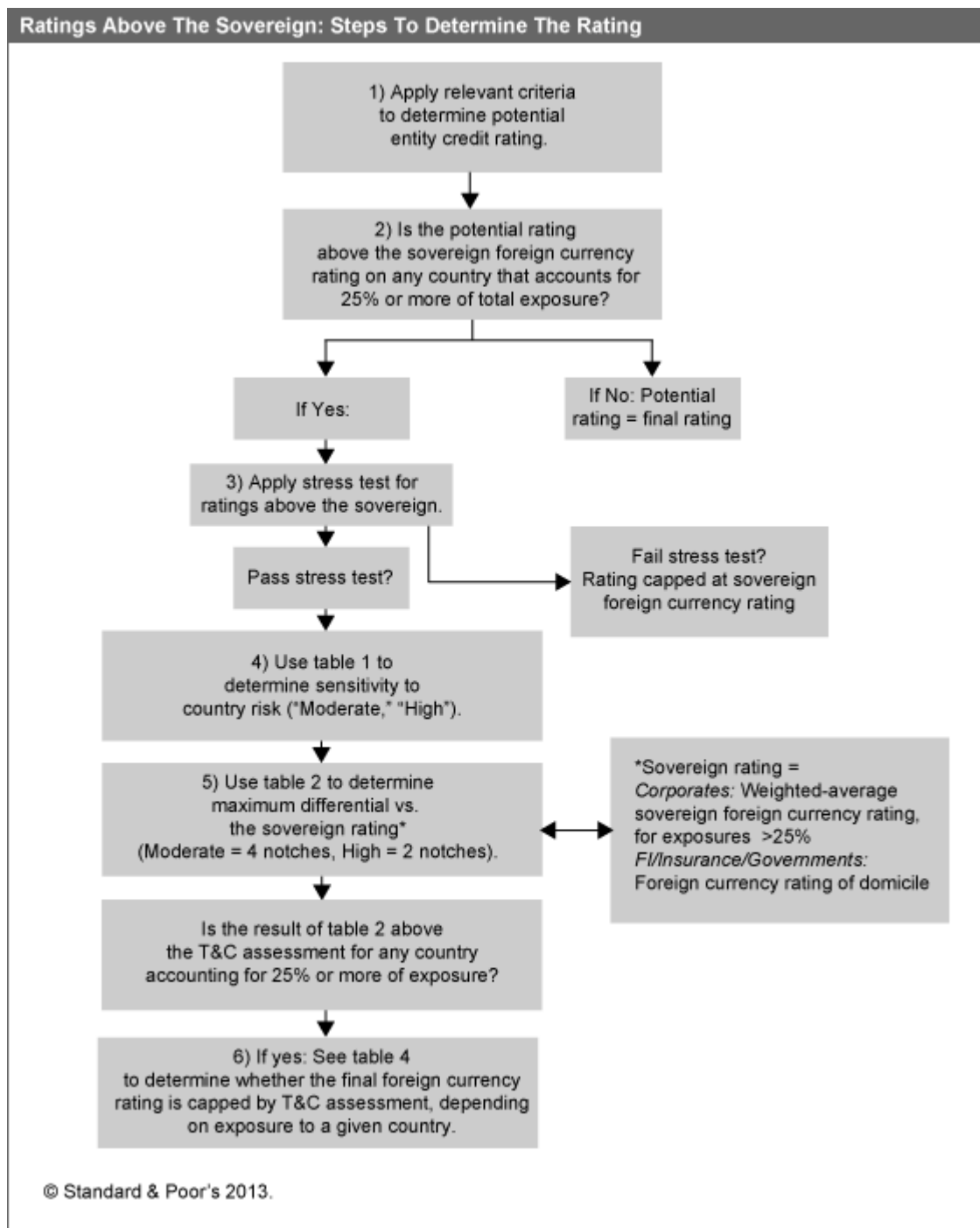
8. The criteria apply to global scale ratings for corporates (including project finance issue ratings); financial institutions; insurance companies; state, local, and regional governments (including public finance issue ratings), inclusive of government-related entities (GREs) and public sector enterprises (both sovereign and local-government-related). Public finance single- and multifamily housing bonds and municipal pools are not within the scope of these criteria; they are covered by the related criteria for structured finance (see "Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions," Jan. 30, 2019).

SUMMARY OF THE CRITERIA

9. An entity can be rated above the sovereign foreign currency rating if, in our view, there is an appreciable likelihood that it would not default if the sovereign were to default. For entities where the sovereign is rated 'A+' or lower, we apply a simulated sovereign stress scenario. Entities that "pass" such a stress test (or, for sovereigns rated 'AA-' and higher, entities that have characteristics that can mitigate a sovereign stress scenario and whose creditworthiness does not depend on direct linkages to the sovereign) can be rated up to 2 or up to 4 notches above the sovereign foreign currency rating, depending on whether we view their sector's sensitivity to country risk as 'high' or 'moderate', respectively. Additional specifics of these steps are explained below.
10. We first determine the entity's potential rating, which we compare with the sovereign foreign currency rating on the country (or countries) where the entity has material exposure(s). By "potential" rating, we mean the rating that we would assign according to the relevant criteria for the entity, such as corporate rating criteria, bank rating criteria, etc., prior to considering any sovereign stress scenario. The potential rating incorporates our view of the entity's exposure to the broad set of relevant country risks. The sovereign rating does not act as a "ceiling" for ratings. However, when rating an entity above the sovereign foreign currency rating, S&P Global Ratings is expressing its view that the entity has sufficient creditworthiness to withstand a sovereign default. In other words, an entity rated above the sovereign should have the ability to service its debt superior to that of the sovereign, and ultimately, if there is a sovereign foreign currency default, there should be an appreciable likelihood that the issuer will not default as a result of the scenario accompanying the sovereign default.
11. Therefore, for an entity to be rated above the respective sovereign foreign currency rating, we will apply a hypothetical sovereign foreign currency default stress scenario (stress test). This stress test is applied with respect to the country (or countries) where the entity has material concentration(s) of exposure and where the potential rating would exceed the foreign currency rating on the sovereign. The general nature of a sovereign default stress scenario as well as sector-specific assumptions are described later, in the section titled "Ratings Above The Sovereign: The Pass/Fail Stress Test."
12. When we are considering a rating above the sovereign local currency rating, even if the latter equals the foreign currency rating, the entity should be able to pass an appropriately more stressful scenario associated with both a sovereign foreign and a local currency default. The main difference between the sovereign foreign and local currency default scenarios is the incremental adverse effect that a default on sovereign local currency securities would have on the liquidity and investment positions of entities holding those securities.
13. For entities that pass the stress test described in the "Methodology" section titled "Ratings Above The Sovereign: The Pass/Fail Stress Test," the criteria allow a rating differential of up to four

notches above the referenced sovereign foreign currency rating, with additional rating elevation possible in case of structural enhancements or external support. The maximum number of notches above the referenced sovereign foreign currency rating depends on the entity's relative sensitivity to country risk, as specified in tables 1 and 2. The referenced sovereign foreign currency rating for a single-jurisdiction entity is the entity's country of domicile; for a multijurisdiction entity, it may be the domicile or derived using a blended approach. The domicile is generally used for financial institutions, insurance, and local governments, and a blended (weighted average) approach is usually used for corporates, as explained in paragraphs 55-58.

14. The purpose of this framework is also to anticipate low-probability but high-severity event risks associated with sovereign distress and default scenarios, which are not specifically captured by the stress test. These types of events could include a deposit freeze, currency redenomination, or geopolitical risks. We evaluate external credit support (such as from a foreign-domiciled entity), under the relevant criteria, such as "Group Rating Methodology" (GRM), published July 1, 2019, or "Financial Institutions Rating Methodology," published Dec. 9, 2021, for implicit parent support; or our guarantee criteria, such as "Guarantee Criteria," published Oct. 21, 2016. Based on these criteria relating to external credit support, we could rate an entity above the maximum rating differential specified by this criteria article.
15. Table 1 lists the relative degree of sensitivity to country risk by sector.
16. The final step in the criteria applies to non-sovereign foreign currency ratings only. It is to consider whether the rating is constrained by the T&C assessment. A country's T&C assessment reflects S&P Global Ratings' view of the likelihood of a sovereign's restricting nonsovereign access to foreign exchange needed to satisfy the nonsovereign's debt-service obligations. (See "Methodology: Criteria For Determining Transfer And Convertibility Assessments," published May 18, 2009.)
17. Foreign currency ratings on nonsovereign entities are generally the lower of the local currency rating on the issuer or the T&C assessment. However, the rating may exceed the T&C assessment, depending on the entity's expected resilience to a T&C event and exposure to a given jurisdiction. (See paragraphs 66-73 for further details, including reference to caps where exposure is 50% or higher to a given jurisdiction, and stress tests for T&C events where exposure is 25% or greater to a given jurisdiction.)
18. The T&C-related stress test and caps apply only to foreign currency ratings; local currency ratings are guided by the application of these criteria, but are not constrained by T&C risk.



19. Note 1: In addition to the steps in this chart, we may evaluate group support, or structural aspects, in order to consider whether a rating can exceed the sovereign. See paragraphs 42 and 63-64.
 Note 2: In a country rated 'AA-' or above, Step 3 is not required ("Apply stress test for Ratings Above the Sovereign"), although as per paragraph 38, we review considerations to be rated above the sovereign from a qualitative perspective.

Table 1

Determining A Non-Sovereign Entity's Sensitivity To Country Risk

Moderate sensitivity examples

Industries not listed in the 'high sensitivity' section are generally considered 'moderate sensitivity,' as per paragraph 48. Below are some examples of 'moderate sensitivity' industries:

Non-life insurers (property/casualty, reinsurance, non-savings-based health insurers)

Financial market infrastructure companies (such as exchanges, transaction processors (for credit card payments), except clearinghouses)

Telecommunications, cable companies

Exporting natural-resource producers

Exporting cyclical companies (steel, chemicals, autos, cement, and capital goods)

Staple consumer product manufacturers, including beverages

Food retailers

Pharmaceutical companies

High sensitivity examples*

Life insurers, life re-insurers, savings-based health insurers, composite insurers with a majority of life liabilities, insurers with business closely correlated with economic cycles

Financial institutions

Financial clearinghouses

Real estate sector: homebuilders, real estate investment trusts, property developers, real estate management companies, construction companies

Non-exporting natural-resource producers

Non-exporting cyclical companies (steel, chemicals, autos, cement and capital goods)

Domestic investment holding companies

Deregulated power generation and supply companies

Regulated utility network infrastructure (investor-owned and not-for-profit)

Transport infrastructure companies

Local and regional governments**

Public finance enterprise sectors: health care, higher education, housing, and not-for-profits**

*Government-related entities (GREs), regardless of their industry sector, typically are considered to have 'high sensitivity' to country risk, with certain exceptions. See paragraphs 60-62 for specific considerations for GREs. **Certain local and regional governments, and certain related enterprise sectors, may have 'moderate' sensitivity to country risk. The requirements are described in paragraph 45. Note: On a country-by-country basis, we may change industry sensitivity classifications. Any such changes are governed by paragraphs 44-45, and listed in Appendix I, as may be updated and republished in the future.

Table 2

Determining The Maximum Rating Differential Between The Sovereign Foreign Currency Rating And The Issuer (Foreign And Local Currency) Rating

Country risk sensitivity*	For sovereign ratings 'B' or higher, the maximum differential above the sovereign rating	For sovereign ratings of 'B-' to 'D' or 'SD', the maximum non-sovereign rating
High	2 notches†	'B+'

Table 2

Determining The Maximum Rating Differential Between The Sovereign Foreign Currency Rating And The Issuer (Foreign And Local Currency) Rating (cont.)

Country risk sensitivity*	For sovereign ratings 'B' or higher, the maximum differential above the sovereign rating	For sovereign ratings of 'B-' to 'D' or 'SD', the maximum non-sovereign rating
Moderate	4 notches†	'BB'

*Per table 1. †We apply analytical judgment in making the final determination about the rating differential, on a case-by-case basis, up to the maximum (see paragraph 50). Limits on the maximum differential may also apply for a given country and sector; for example, certain local and regional governments have 'moderate' sensitivity to country risk, but can be rated only up to 3 notches above the sovereign, subject to certain additional requirements, per paragraph 52. Note: For entities with more than 70% exposure to a single country with 'significant' adverse currency redenomination risk, the maximum rating is 'B'. 'Significant' adverse currency redenomination risk applies when we assess a 1-in-3 or greater likelihood that a country will exit its currency regime, such as leaving a monetary union, and when we expect the redenomination to have a negative credit effect.

20. This paragraph has been deleted.

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METHODOLOGY

A. Criteria Calibration

22. In "S&P Global Ratings Definitions," S&P Global Ratings describes selected financial crises and defines them in terms of the stress associated with a given rating level. The crises associated with sovereign default or distress were among the highest severity: Argentina in 2001 ('AAA' stress scenario), Mexico in 1994 ('AA' stress scenario), Thailand in 1997 ('AA' stress scenario), and Russia in 1998 ('A'/'AA' stress scenarios). The 2011 crisis in Greece exhibited macroeconomic volatility associated with an 'AA' stress scenario. These stress levels informed our stress test for ratings above the sovereign. The macroeconomic stress for this stress test is similar to that used in our definition of an 'AA' stress scenario, as we have typically observed such severity in a sovereign default and distress case. For example, the real GDP declines in the cases listed above were as follows (cumulative declines cited, unless a single year is given): Argentina, 25% (1998-2002); Mexico, 15% (1994-1995); Thailand, 12.5% (1997-1998); Russia, 9.1% (1998); Greece, 7.1% in 2011, followed by 6.8% in 2012, with a cumulative decline over 20% between 2009-2013. (For more details on the observed data, see Appendix II and "S&P Global Ratings Definitions.")
23. There is a high correlation between corporate default rates and sovereign crises and macroeconomic volatility, as our emerging-market default study supports (see "2014 Emerging Markets Corporate Default Study And Rating Transitions," May 28, 2015). According to this study, global emerging-market speculative-grade default rates peaked in 2002 at 16% after the Argentina sovereign crisis and heightened macroeconomic volatility in Brazil. This peak default rate was significantly higher than the record speculative-grade global corporate default rate of 11% in 1991. The other significant peak in emerging-market speculative-grade default rates was 8% in 1998 related to the Russian and Asian macroeconomic crises.
24. For developed markets, our global default studies also demonstrate significant correlation of defaults with weak points in business cycles and banking crises. The 1991 peak default rate referred to above occurred after a mild recession in the U.S., a severe but short recession in the U.K., and the Nordic banking crisis. Other developed-market speculative-grade default peaks were the U.S., at 10.6% in 2001 (the U.S. recession) and 11.4% in 2009 (the global banking crisis

and recession); and Europe, at 12.3% in 2002 (due in part to the bursting of the technology/Internet bubble and failures of a large number of telecom start-ups). (Sources: "2012 Annual Global Corporate Default Study," published March 18, 2013.)

25. For calibration of sensitivity to country risk by industry ('moderate' vs. 'high' sensitivity), we considered sensitivity to economic cycles, as measured by the historical cyclical peak-to-trough decline in profitability and revenues, as described in "Methodology: Industry Risk," published Nov. 19, 2013, Appendix 1; our historical observations of transitions to higher regulatory risk or other types of heightened negative government influence, for industries such as utilities and transport infrastructure, during sovereign stress scenarios; our historical observations of the sensitivity to economic trends and sovereign stress scenarios for financial institutions (see Appendix II for nonperforming loan data); and, for insurers, the tendency to concentrate investments in domestic government and other domestic securities, and the relative size of investments versus capital.
26. When calibrating the thresholds of the maximum rating differential above the sovereign rating (2 and 4 notches, respectively, for 'high' and 'moderate' sensitivity industries), we considered the severity of defaults resulting from observed high-severity events (such as the combination of a deposit freeze, currency devaluation, and price controls in the Argentina stress event of 2001/2002; the bank deposit freeze and capital controls in Cyprus in March 2013); and the expected severity of defaults if a member country were to leave the eurozone, as indicated by the rising risk we saw for such an event in the case of Greece (see "Credit FAQ: What Are The Potential Rating Effects If A Country Exits A Monetary Union?" published Oct. 4, 2012). We impose rating caps because all entities would be affected by such high-severity events; we divide such caps into two categories, recognizing that entities with 'moderate' sensitivity to country risk have a better ability to mitigate the impact of country and sovereign risk.
27. Other studies, such as "This Time Is Different" (Reinhart, Carmen M., and Rogoff, Kenneth S., 2009), also point to the link between corporate defaults and banking crises (see figure 16.1, page 252). The authors indicate that although countries may "graduate" from certain types of crises, such as serial defaults on sovereign debt or hyperinflation episodes, developed and emerging economies alike remain subject to banking and financial crises.

B. Ratings Above The Sovereign: The Pass/Fail Stress Test

28. We first determine the entity's potential rating, which we then compare with the sovereign foreign currency rating on the country (or countries) where the entity has material exposure(s). By "potential" rating, we mean the rating that we would assign according to the relevant criteria for the entity, such as corporate rating criteria, bank rating criteria, etc., prior to applying a stress test for ratings above the sovereign. The potential rating incorporates our view of the entity's exposure to the broad set of relevant country risks. The sovereign rating does not act as a "ceiling" for nonsovereign ratings. However, in rating an entity above the sovereign foreign currency rating, S&P Global Ratings is expressing its view that the entity's willingness and ability to service debt is superior to that of the sovereign, and that, ultimately, if a sovereign foreign currency default occurs, there should be an appreciable likelihood that the issuer will not default as a result of the scenario accompanying the sovereign default.
29. Therefore, for an entity to be rated above the relevant sovereign foreign currency rating, the entity should be able to pass a hypothetical sovereign foreign currency default stress test. We consider this stress test for multijurisdictional entities (or groups of entities) with material exposure to countries whose sovereign foreign currency rating is lower than the potential credit rating on the entity. At a minimum, we apply the stress test to the foreign currency rating on the sovereign to which the entity has the largest material, single-country exposure and whose foreign currency rating is lower than the potential credit rating on the entity. The reason we apply the stress test to

the largest material single-country exposure is that usually, if an entity passes the stress test for countries where it has large exposures, it will also pass the test for countries where it is less exposed. In the case of unrated sovereigns, we will apply the stress test based on our view of sovereign creditworthiness.

30. On a case-specific basis, we may apply the stress test to more than one country, if we consider the entity to have material exposure to two or more countries. When applying the stress test to more than one country at a time, we might assume the stress affects two or more countries at the same time if we consider economic correlation among the countries to be significant. Should an entity fail the stress test, we would cap the rating at the foreign currency rating on the lowest-rated country for which it failed the test. If we determine that the issuer has no material single-country exposure to a country whose sovereign is rated lower than the potential rating, we may not apply a stress test.
31. We generally consider exposure to be material when it represents approximately 25% or more of an entity's total exposure, (as measured per the metrics in paragraph 43) taking into account our views of current and expected exposures. We also apply the sovereign stress on exposures below 25% with regard to the country of domicile if we believe a company could fail the sovereign stress test. We list examples of how we apply the stress test below.
- Example 1: Issuer domiciled in a highly rated sovereign (rated 'AA+'), with material (30%) exposure to a lower-rated sovereign: An issuer has a potential rating of 'BBB' and 60% exposure to the country of domicile, which has a sovereign foreign currency rating of 'AA+'; 30% exposure to Country A (sovereign foreign currency 'BB'), and 10% exposure to Country B (sovereign foreign currency 'B'). For the issuer to have a credit rating of 'BBB', it would need to pass a sovereign foreign currency default scenario test for Country A. If it failed the test, the credit rating would be capped at 'BB'.
 - Example 2: Issuer domiciled in a highly rated sovereign (rated 'AAA'), with material exposures to two lower-rated sovereigns (35% and 25%): An issuer has a potential rating of 'BBB' and 40% exposure to the country of domicile (sovereign foreign currency 'AAA'), 35% exposure to Country A (sovereign foreign currency 'BB'), and 25% exposure to Country B (sovereign foreign currency 'B'). For the issuer to have a credit rating of 'BBB', it would need to pass a sovereign foreign currency default scenario test for Country A. If it failed the test, the rating would be capped at 'BB'. If, on a case-specific basis, we thought the entity would be particularly vulnerable to a sovereign default in Country B, we might also apply a discrete stress test to the exposure to Country B (and failing the test for Country B would lead to a rating cap of 'B'). If we considered correlation to be significant between Country A and Country B, we might perform an aggregated stress test for hypothetical sovereign defaults in both countries at the same time.
 - Example 3: Issuer domiciled in a low-rated sovereign (rated 'B-'), with a majority (95%) of exposure to higher-rated sovereigns: An issuer has a potential rating of 'BBB-' and 5% exposure to the country of domicile (sovereign foreign currency 'B-'), 50% exposure to Country A (sovereign foreign currency 'BBB'), and 45% to Country B (sovereign foreign currency 'BB'). For the entity to be rated 'BBB-', it would need to pass a sovereign foreign currency default scenario test for Country B. If the issuer failed the test, the rating would be capped at 'BB'. In this case, the exposure to the country of domicile is not material enough to run a stress test for that country. As we note in paragraph 65, ratings are not constrained by the sovereign rating of the country of domicile when exposure is under 10%.
 - Example 4: Issuer domiciled in a 'BBB' rated sovereign, with significant exposure to higher-rated sovereigns: An issuer has a potential rating of 'A-' and 50% exposure to the country of domicile (sovereign foreign currency 'BBB'), 30% exposure to Country A (sovereign foreign currency 'A-') and 20% exposure to Country B (sovereign foreign currency 'AA+'). For the

entity to be rated 'A-', it would need to pass a sovereign foreign currency default scenario test for the country of domicile.

- Example 5: Issuer domiciled in a 'BBB' rated sovereign, with diversified exposures to lower-rated sovereigns: An issuer has a potential rating of 'BBB' and 50% exposure to the country of domicile (sovereign foreign currency 'BBB'), 20% exposure to Country A (sovereign foreign currency 'BB'), 15% exposure to Country B (sovereign foreign currency 'B+'), 10% exposure to Country C (sovereign foreign currency 'B'), and 5% exposure to Country D (sovereign foreign currency 'B-'). For the entity to be rated 'BBB', we would run a stress test on Country A, even though the exposure is under 25%, if we thought the entity might fail the stress test with respect to that country. We may also run a stress test on Country A if we expected exposure to increase to over 25% in the next few years. Alternatively, if we thought Country A and Country B were highly correlated, we may run a stress test on the combined exposure to Country A and Country B.

32. Where a financial institution or insurance company has exposure in excess of about 50% concentrated in its country of domicile, we generally consider it highly likely that the entity would fail a stress test associated with a sovereign foreign currency default. As a result, we would not undertake the stress test unless we saw strong idiosyncratic reasons that could potentially cause the entity to pass the test. Such factors may include exceptionally high levels of capital and liquidity, a predominantly local currency exposure (with matched tenors for assets and liabilities), or the strong possibility of effective external support (in accordance with paragraph 42).
33. The general nature of these sovereign default stress tests is described in table 3. The criteria apply one of three sovereign default scenarios--scenario A, B, or C-- depending on our assessment of the currency regime of the country. The relevant sector-level criteria may indicate more detailed assumptions to be used for these stress tests. The main effects of the stress scenario on liquidity would be reduced revenues and earnings resulting from the severe macroeconomic stress, a haircut to holdings of domestic marketable securities, a sharp increase in funding costs for floating-rate or short-term debt because of the assumed interest rate shock, and lack of capital market access for refinancing. In countries where we also assume a currency shock (see table 3, scenario B), the potential effect would be incremental. The foreign currency rating may also be constrained by the T&C assessment for the country of domicile or the T&C assessment for the countries of material exposure, as described further in paragraphs 66-73.
34. Passing the stress test means the entity likely would not be in default. Therefore, the relevant liquidity measure should indicate that debt-service coverage would be positive, and, where relevant, the capitalization measure would be positive and meet regulatory minimums, as follows (after applying the stresses in table 3):
 - Corporates: Liquidity (the ratio of sources to uses over a one-year stress scenario,) is greater than 1, as defined in "Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers," Dec. 15, 2014. For certain asset-based companies, such as real estate investment trusts and investment holding companies, we also apply a capitalization test: the loan-to-value ratio should remain below 0.8 to pass the stress test.
 - Financial institutions: (1) Liquidity, as defined in the relevant criteria (such as "Financial Institutions Rating Methodology"), remains sufficient; (2) equity is greater than 0; and (3) available regulatory capital is positive--either the institution meets regulatory minimum capital requirements, or S&P Global Ratings expects regulatory forbearance in order not to close down the institution, nor introduce restrictions that would be classified by S&P Global Ratings as a default.
 - Insurance companies/groups of companies: The liquidity ratio (as defined in "Insurers Rating

Methodology," published July 1, 2019) is greater than 100%; available regulatory capital is positive; and regulatory intervention is unlikely.

- Public finance: Liquidity is sufficient to meet debt service. (For further details on the relevant liquidity measures, see the relevant section for the sector criteria, such as "Assessing Liquidity" in "Methodology For Rating Local And Regional Governments Outside Of The U.S.," published July 15, 2019; "Liquidity" (paragraph 46) in "U.S. State Ratings Methodology," published Oct. 17, 2016; and Section H, "Liquidity Score" in "U.S. Local Governments General Obligation Ratings: Methodology And Assumptions," published Sept. 12, 2013).
35. Very infrequently, an issuer might pass the stress test only because we assume the issuer will execute a well-documented risk-mitigation plan that would alleviate the default risk associated with the stress. That plan must be credible and approved by the issuer's board of directors, and the issuer must have clear incentives (that outweigh any drawbacks) to execute such a plan and be able and willing to do so under the stress scenario. For example, for insurers, the risk-mitigation plan might include the sharing of resulting investment losses with life insurance policyholders under policies that have discretionary participation features (sometimes known as "with-profit policies").
36. For cases when we are considering rating an entity above the sovereign local currency rating, the entity should be able to pass an appropriately more stressful scenario associated with both a sovereign foreign and local currency default. The difference between the sovereign foreign and local currency default scenarios is the incremental adverse effect that a default on sovereign local currency securities would have on the liquidity and investment positions of entities holding those securities.
37. We have observed that, regardless of the initial sovereign rating, sovereign defaults over the past two decades have tended to share similar characteristics. As a result, we set out three "standing" theoretical sovereign default scenarios (see table 3) rather than having country-specific scenarios. We could supplement these scenarios with more specific ones, once the scenario is more predictable, where the sovereign is rated 'B' or 'B-', as explained in paragraph 39.
38. For entities we are considering rating above a sovereign that has a foreign currency rating of 'AA-' or higher, the stress test for a sovereign default scenario would generally not be required, given the very low likelihood of a potential sovereign default scenario for such a highly rated sovereign. Nevertheless, we will review, from a qualitative perspective, why the entity or sector would (or would not) be expected to default at a time when the sovereign is defaulting, based on the entity's or sector's expected resilience to a severe stress scenario and limited direct links to the sovereign. For example, we expect entities rated above the sovereign to have the following characteristics:
- The ability to maintain stronger credit characteristics than the sovereign in a stress scenario. For example, the entity would have a lack of dependence on contracts, revenues, subsidies, or guarantees from the central or federal government or its related entities, and limited exposure to domestic government and private-sector securities in the investment portfolio; and
 - The ability to limit the risk of negative sovereign intervention.
39. Specifically for local or regional governments or public-sector enterprises (health care, higher education, housing, or other not-for-profit sectors), they must meet the following three conditions to qualify for a rating above the sovereign (in addition to passing the pass/fail test, if the sovereign foreign currency rating is 'A+' or below):
- The ability to maintain stronger credit characteristics than the sovereign in a stress scenario, such as having a predominantly locally derived revenue base (i.e., a lack of dependence on central government revenues, subsidies, or other government transfers);

- An institutional framework that is predictable and limits the risk of negative sovereign intervention, such as revenue and expenditure autonomy supported by both constitutional and statutory provisions; and
- The ability to mitigate negative intervention from the sovereign because the entity has high financial flexibility and independent treasury management.

40. When the sovereign rating is 'B' or lower, the specific default scenario might be more predictable. If the sovereign rating is 'B' or 'B-', we might develop a country-specific default scenario to determine whether we could rate entities above the sovereign. For sovereign ratings of 'CCC+' and below, we expect the current stressed conditions to represent both our base case and the expected default scenario, and we generally will not perform a stress test for entity ratings up to 'B-' (unless the transfer and convertibility assessment were also 'CCC+' or below). Where the sovereign rating is 'CCC+' or below, we would still perform a stress test for entity ratings that could exceed 'B-'.

Table 3

Sovereign Default Scenario Stress Tests

Scenario A: Economic stress, no currency devaluation

Country scope	This scenario would apply for eurozone member countries, countries with a fixed and permanent tie to another currency (e.g., Panama), and other countries with international reserve currencies (the U.S., Japan). The sovereign foreign and local currency ratings will be the same for these countries.
GDP	The country experiences a deep recession. GDP declines by approximately 6% to 10% in one year.
Unemployment	Unemployment increases by 20% to 30%, subject to a minimum assumed unemployment rate of 15%.
Interest rates	Doubling of local nominal interest rates, subject to a minimum of at least the historical peak interest rate for that country, over a relevant time horizon, plus "flight to quality" or, where available, assumptions calibrated to a severe level of economic stress: we expect the rationing of credit to the highest-rated domestic issuers.
Sovereign securities, and local and regional government securities	Short-term securities (less than one year), 65% of face value (haircut = 35%); long-term securities (one year or longer), 40% of face value (haircut = 60%). Note: These haircuts applied to bonds/securities and for sovereign debt would also be applied to loans. For long-term loans to the central government, 40% of face value (haircut = 60%). For loans to local and regional governments, see "Banking and insurance sector-specific assumptions," below.
Commodity price shock	For countries where commodities account for a significant percentage of exports or GDP, apply a severe commodity price drop, which is applied to the country related stress test for commodity producers (e.g., drops to the historical low three-month average price observed over the last severe industry downturn, adjusted for global inflation and/or structural changes in the market).
Private-sector debt securities	The following haircuts apply to all bonds/securities and to loans that are held for liquidity purposes (trading/investment portfolios). For the impact on loan portfolios, see "Banking and insurance sector-specific assumptions," below.
	• Bank senior debt drops to 40% of face value (haircut = 60%)
	• Bank short-term (less than one year) senior debt, certificates of deposit drop to 65% of face value (haircut = 35%)
	• Corporate senior debt: 60% haircut to face value, for liquidity test; 30% haircut to face value, for capital test
	• Bank/corporate junior debt (equity hybrids): 100% haircut (0% of face value)

Table 3

Sovereign Default Scenario Stress Tests (cont.)

	Covered bonds drop to 40% of face value for the liquidity stress test, and for the capital stress test, drop to 70% of face value, where the cover pool is RMBS, CMBS, or ABS; drop to 40% of face value where the cover pool is public sector assets, for both the liquidity and capital tests
	RMBS, CMBS, and ABS: For the liquidity stress test, we assume a 100% haircut (0% of face value) due to a very illiquid market in general, and in particular at a time of sovereign stress. For the capital stress test, we assume a 30% haircut to face value.
Bank deposits	We assume a 10% haircut, unless mitigated by deposit insurance or use of systemically important banks
Equity: listed, liquid securities	Price falls to 30% of carrying value recorded as of the previous fiscal year-end reporting date; in case of a substantial observed price decline from recent peak values or since the year-end reporting date, we may modify this assumption on a case-by-case basis
Property price decline	For issuers with a combined portfolio of residential and commercial property, we assume a 50% price decline since the last fiscal year-end reporting date, with adjustments depending on our view of the point at which the real estate cycle for that country is. In case of (i) a substantial observed price decline from recent peak values or since the year-end reporting date, or (ii) a country with a property asset bubble where a 50% assumption may be insufficiently prudent, we may modify this assumption on a case-by-case basis.
Other securities or investments	For funds, we haircut in line with the type of holding (government versus private-sector debt securities, or equity); for other types of securities or investments (private equity, other illiquid holdings), we assume a 100% haircut (0% of face value)
Other	We assume no access to domestic or external capital markets. No access to external bank financing, including cross-border swaps, except for committed lines in which we do not expect "material adverse change" clauses or similar triggers in case of a sovereign default scenario. Tariffs for utilities are frozen. Commodity exporters face increased export duties. For issuers rated 'BB+' or lower, we assume domestic bank financing is available for rollovers of existing short-term domestic bank lines only. For issuers rated 'BBB-' and higher, we assume domestic bank financing is available for rollovers of existing short-term domestic bank lines and refinancing of medium-term domestic bank loans.
Sector-specific assumptions	
Stress test duration	All of the factors above are stressed for at least one year in our projections. Regarding the effect on balance-sheet measures (financial institutions, insurance), the stress test is performed on a pro forma basis with respect to the latest available reporting date. Regarding liquidity measures where the related sovereign is rated 'BB+' or lower, we stress the entity or transaction (for project finance) for the first projection year; where the relevant sovereign is rated 'BBB-' or above, we stress the entity or transaction for the second projection year.
Banking and insurance sector-specific assumptions	Banking and insurance: Nonperforming loans increase to the higher of 20% or twice the current level (average for consumer and commercial loans). Loss given default (LGD) is 70% for unsecured loans, 50% for secured loans (e.g., mortgages). If a very substantial deterioration in asset quality has already occurred, we may modify these assumptions on a case-by-case basis.
	Banking: Pre-provision profits are subject to a haircut of 30% for those arising from the country of stress, and 10% for all other post-provision profits.
	Insurance: Pre-stress profits are subject to a haircut of 30% for those arising from the country of stress, and 10% for all other post-provision profits.

Table 3

Sovereign Default Scenario Stress Tests (cont.)

	Regional and local governments: If loan exposures to domestic regional and local governments are substantial, we may assume additional sector-specific nonperforming loan rates or add a haircut.
	Domestic deposit run-off: we assume 15% run-off of retail deposits, 25% of wholesale deposits, and 20% of all deposits where the mix is undisclosed. Outflows are halved where we expect the bank would benefit from a flight to quality. At a minimum, we would expect such a bank to have an SACP at least 2 notches above the average bank SACP in the system. See paragraph 84 for assumptions for cross-border funding.
	The central bank remains available (for domestic banks) only as a source of local currency liquidity (against eligible collateral). If the central bank is a supranational institution rated higher than the respective sovereign, where there is a realistic prospect of access, we may assume limited access to foreign currency liquidity.
	In countries where the central bank is a supranational institution, such as the European Central Bank, and rated higher than the respective sovereign, the liquidity stress test takes into account the expected access to central bank repo facilities, with the haircuts applied by the central bank.
Insurance sector-specific assumptions	We apply a 35% policy lapse assumption; for credit insurance, we apply an increase in the loss ratio by 150% (2.5x).
Corporate, project finance, and government/municipal enterprise sector-specific assumptions	Haircut to liquidity held in local banks and government securities (value decline as specified above), interest rate shock to funding costs for floating-rate or short-term debt, risk to domestic lines of credit, GDP-related decline in domestic demand. For the latter, we may use sector-specific assumptions for a given industry, although case-specific assumptions may apply. For corporate ratings, we may alternatively use the following guidance for EBITDA declines assumed for purposes of the stress test, depending on the industry's country risk sensitivity:
	MODERATE sensitivity, 15%-20% EBITDA decline
	HIGH sensitivity, 30% EBITDA decline
Public finance-specific assumptions, regional and local governments	Haircut to liquidity held in local banks and government securities (as specified above); drop in income tax revenues related to GDP and unemployment assumptions; drop in property tax revenues related to property price-decline assumptions
Scenario B: Economic stress with currency devaluation	
General assumptions	Scenario B would apply for all countries that do not fall within sovereign default scenario A or C. This scenario would include, for example, developed-market countries that are not members of a monetary union and do not have a reserve currency (such as New Zealand), and most emerging-market countries. This scenario includes all the stresses in Scenario A and adds a currency stress. Because the sovereign foreign and local currency ratings may be different, there are related differentiated stresses.
	Note: For any variable not listed below, the stresses are identical to the assumptions in Scenario A, including: GDP, unemployment, interest rates, market-value haircuts (except for sovereign local currency securities), and access to refinancing, as well as "Corporate & government-specific assumptions."
Local currency devaluation	Local currency loses 50% of its value versus the hard currency benchmark (i.e., U.S. dollar for Latin America, Asia/Pacific; euro for Eastern Europe). By 50% loss of value versus the hard currency benchmark, we mean if the exchange rate is currently 10 local currency units per 1 hard currency unit, the stressed exchange rate would be 20 local currency units per 1 hard currency unit.
	General: Entity- or transaction-specific effect for currency mismatch (assets versus liabilities) and/or related un-hedged debt-service costs

Table 3

Sovereign Default Scenario Stress Tests (cont.)

	For corporates, add currency depreciation effect on revenues, imported raw material costs, and capital expenditure costs
Inflation	Assume a doubling of inflation, subject to a minimum of at least the historical peak in inflation rates for that country over a relevant time horizon
Sovereign foreign currency securities	Assume market value drops to 40% of face value
Sovereign local currency securities	Short term, valued at 75% of face value for two-notch differential, 70% of face value for one-notch differential. Long term, valued at 60% of face value for a two-notch differential, 50% of face value for a one-notch differential.
For the stress test for ratings above the sovereign local currency rating, or where the sovereign local currency and foreign currency ratings are the same	Assume market value drops to 30% of face value for all securities
Scenario C: Significant risk of exiting a monetary union	
General assumptions	Country with a 50% or greater likelihood of transitioning out of a monetary union or other fixed tie to another currency; assumptions are similar to Scenario B, plus deposit freeze and redenomination of liabilities into new local currency (at an assumed government-mandated conversion rate that is 50% of the market foreign exchange rate)

C. Ratings Above The Sovereign: The Maximum Rating Differential Between Nonsovereign Entity Ratings And The Related Sovereign Rating

41. For entities that pass the relevant stress test described in table 3, the criteria allow a rating differential of up to 4 notches above the referenced sovereign foreign currency rating. The latter is either that of the country where the entity is domiciled or, for nonfinancial corporate entities operating in multiple jurisdictions, is determined by a weighted average of the sovereign ratings on countries where the entity has material exposures. The maximum number of notches above the referenced sovereign foreign currency rating depends on the entity's relative sensitivity to country risk. The purpose of this framework is to anticipate the risk of low-probability but high-severity events associated with sovereign distress and default scenarios that are not captured by the stress test. These types of events could include a deposit freeze, currency redenomination, or geopolitical risks.
42. We evaluate external credit support (for example, from a foreign-domiciled entity), such as implicit parent support or a guarantee, under the relevant criteria, and we could rate an entity above the maximum rating differential specified by this criteria. In the case of implicit support, such support would need to be, in our view, resilient to a sovereign default scenario, which would weigh on incentives for the parent to extend support in the first place, and we analyze the support according to the relevant criteria (see the GRM).
43. We apply the methodology in paragraphs 44-48 to determine an entity's relative degree of sensitivity to country risk. If an entity has exposure to a number of sectors or countries, the criteria will gauge exposures using the following measures:
 - Corporate ratings--EBITDA or revenues or other volume-based measures, as appropriate. For example, for the purposes of this calculation, we apply a "weak-link" approach to exporters. If assets are based in a high-risk country, and cannot be relocated elsewhere, we test exposure to

the high-risk country, even if the products are exported to a low-risk country. Similarly, if exports are made to a high-risk country and cannot be easily redirected elsewhere, but we will measure exposure to the high-risk country, even if assets are based in a low-risk country;

- Banks and other balance-sheet-intensive financial institutions--The adjusted exposure used in risk-adjusted capital analysis (see "Risk-Adjusted Capital Framework Methodology"), or where not available, the geographic breakdown of a bank's loan book (including off-balance-sheet items);
- Clearinghouses and asset managers--Revenues;
- Insurance companies--General account investments (an insurer's investment portfolio, which excludes investments of policies where the policyholder carries default risk); and
- Local and regional governments--Revenues.

44. Our classification of the sensitivity of a corporate and government issuer to country risk, based on historical sensitivity of sectors and asset types to economic volatility, and to potential changes in the legal and regulatory environment during sovereign stress and default, generally breaks down as outlined in paragraphs 46-47. We assess this sensitivity to country risk in two categories: 'high' or 'moderate.' However, on a country-specific basis, we might determine that a sector usually considered to have 'moderate' sensitivity instead has 'high' sensitivity, or conversely, that a sector usually considered to have "high" sensitivity instead has "moderate" sensitivity, based on historical data and our prospective view. For example, we classify the telecommunications and cable industry as having 'moderate' sensitivity to country risk. If country-specific historical data and our prospective view of an entity in that sector support our view that that industry may be more sensitive to country risk in a particular country, we might change the country risk classification to 'high.' We list any country-specific, sector-specific determinations for sensitivity in Appendix I, or in the future, as a published update to Appendix I.

45. In order to make the unusual determination to move an industry from 'high' to 'moderate,' we would need to expect country-specific characteristics that shelter that industry from macroeconomic and country risk and from the direct impact of sovereign default, and we would need to expect such characteristics would continue to be present even if the sovereign transitioned to greater degrees of stress in the future. In the unusual case where this country-specific determination has been made for local and regional governments (i.e., moving from 'high' to 'moderate' sensitivity), and potentially for certain of their related enterprise sectors, there are additional requirements and restrictions on the maximum rating differential between the sovereign and entity rating, as per paragraph 52. In order to make a determination of 'moderate' sensitivity, governments, in our view, would need country-specific characteristics which shelter them from macroeconomic and country risk and from the direct impact of a sovereign default, in addition to the factors mentioned in paragraph 39.

High sensitivity

46. We qualify the following sectors and asset types as having 'high' sensitivity to country risk, which means they are highly sensitive to a combination of economic volatility and potential changes in the legal and regulatory environments. Government-related entities, regardless of their industry sector, typically are considered to have 'high' sensitivity to country risk, with certain exceptions. See paragraphs 60-62 for specific considerations for GREs.

- Life insurers, life reinsurers, savings-based health insurers, and composite insurers with a majority of life liabilities, because their business is heavily influenced by the pace of wealth accumulation in a country and because a significant share of assets tend to be invested in

domestic government debt and domestic bank deposits. To relieve resulting stress on life insurers, some past sovereign defaults have led some governments to mandate changes in insurance contract terms that would prompt us to consider the affected insurers to be in default;

- Insurers with businesses closely correlated with economic cycles, such as mortgage insurers and trade credit insurers;
- Financial institutions, as they often hold domestic government debt, including for liquidity purposes, and because their businesses are affected by domestic economic trends. Financial institutions are typically exposed to fiscal policies and are subject to domestic regulation;
- Financial clearinghouses;
- Real estate sector companies--Homebuilders, real estate investment trusts, property developers, real estate management companies, and other construction companies because of the high impact of economic cycles on their business volumes and cash flows;
- Deregulated power generation and supply companies;
- Regulated utility network infrastructure companies (including both investor-owned and not-for-profit entities);
- Transport infrastructure companies, given their exposure to both economic conditions and potential changes in regulatory frameworks;
- Non-exporting natural-resource producers, given the fiscal and political risks we believe they face;
- Non-exporting cyclical companies that produce steel, chemicals, autos, cement, and capital goods, given our view of their extreme sensitivity to their domestic economy;
- Domestic investment holding companies, given their exposure to equity markets in a sovereign stress scenario;
- Local and regional governments, as we typically view their revenue base as closely correlated with domestic economic conditions (subject to paragraph 45); and
- Public finance enterprise sectors--Health care, higher education, housing, and other not-for-profit issuers, given their links with domestic economic conditions and/or links with their respective central, state, local, or regional governments (subject to paragraph 45).

Moderate sensitivity

47. For example, we qualify the following sectors and asset types as having 'moderate' sensitivity to country risk (with the exception of most government-related entities, as noted in paragraph 46):

- Financial market infrastructure companies (such as exchanges and transaction processors {for credit card payments}), except clearinghouses;
- Non-life insurers (property/casualty, non-life reinsurance, non-savings-based health insurers and composite insurers and reinsurers with a majority of non-life liabilities);
- Telecommunications and cable companies;
- Exporting natural resource producers and cyclical companies that are primarily exporters (steel, chemicals, autos, cement and capital goods). Although demand for their products might not be tied to domestic conditions, exporters are still exposed to the direct and indirect

sovereign intervention of their country of domicile (e.g., export duties, export quotas, obligations to repatriate export proceeds and convert them to local currency, etc.);

- Staple consumer product manufacturers, including beverages;
- Food retailers;
- Pharmaceutical companies

48. Any other industry not listed as 'high sensitivity,' per paragraph 46, will generally be considered as "moderate sensitivity." The examples listed above are summarized in table 1.

D. Determining The Final Rating Differential From The Sovereign Rating

49. The final rating differential between the issuer rating (or equivalent) and the relevant sovereign foreign currency rating can be up to the maximum differential, for sovereign ratings of 'B' or higher, or result from the application of the rating cap, for sovereign ratings of 'B-' or lower, determined using table 2. To apply table 2, we would have first determined: a) the potential rating for the entity, according to the relevant criteria; b) the sensitivity of the entity to country risk, using the guidance in table 1; and c) the relevant sovereign rating (domicile or weighted average by exposure; see paragraph 55).
50. It is important to note that entities passing the test would not always be rated up to the caps or maximum rating differentials indicated in table 2. We apply analytical judgment when making the final determination about the rating differential, up to the cap. For example, let's say we are analyzing a telecommunications company with a potential rating of 4 notches above the sovereign foreign currency rating, based on its stand-alone credit characteristics and its being in a 'moderate' sensitivity industry. We may decide to rate the entity only one or two notches above the sovereign, due to substantial business volumes with government entities, or due to a track record of government restrictions on its pricing flexibility.
51. When we apply recovery ratings or other structural aspects to our issue rating analysis, the final issue rating might exceed the rating determined using table 2 to reflect such structural characteristics. In such cases, we would allow issue rating elevation above the sovereign foreign currency rating if we expected the enhancements to still apply in the case of the sovereign default scenario.
52. In the unusual, country-specific case where local and regional governments have been classified, per paragraph 45, as having 'moderate' sensitivity, the maximum rating differential between the sovereign foreign currency rating and issuer (or issue) rating is capped at 3 notches. If any government-related entities associated with such governments are classified as having 'moderate' sensitivity, they are subject to the same maximum rating differential of 3 notches above the sovereign foreign currency rating. The reason for this differentiated approach for governments is that even local and regional governments with 'moderate' sensitivity are more linked to central government influence than other 'moderate' sensitivity industries. In addition, we would apply an increased severity stress test in order for a given entity or debt rating to reach this maximum 3-notch gap, in line with an 'extreme' level of economic stress (which we define as a 'AAA' stress scenario in "S&P Global Ratings Definitions"), rather than merely a 'severe' level of economic stress (which we define as a 'AA' stress scenario). Such a stress test would be applied regardless of the current sovereign rating.
53. Our matrix in table 2 links sovereign ratings and an entity's country risk sensitivity because sovereign credit quality weighs to varying degrees on all entities in the jurisdiction. We believe that the closer the sovereign is to distress (rated 'B-' or below), the more predictable is its actual

default scenario. We factor this in by applying absolute rating-level caps in place of a specified rating differential if the sovereign rating is 'B-' or below.

54. The differential above the sovereign rating applies only if the entity has passed the stress test (or subject to related qualitative analysis), as described in the section "Ratings Above The Sovereign: The Pass/Fail Stress Test," for being rated above the sovereign. This is, therefore, less likely if sensitivity to country risk is high.
55. For purposes of applying table 2, the "relevant" sovereign rating we use to determine the maximum rating differential is usually that on the country of domicile. For multijurisdictional entities, the relevant sovereign rating is: a) for financial institutions and insurance companies, the country of domicile (because of the critical role of regulations and funding); b) for corporates (industrials and utilities), a weighted average computed according to the sovereign ratings of countries where the company has material exposures, subject to the conditions in the following two paragraphs. In the case of unrated sovereigns, we apply the maximum rating differentials and maximum rating levels in table 2 based on our view of sovereign creditworthiness.
56. For the weighted-average measure, we generally consider all countries that account for 25% or more of the issuer's exposure, but we apply judgment where relevant. For example, if a corporate entity had 10% exposure to each of 10 'B' rated sovereigns, we would likely consider the relevant sovereign rating to be 'B' despite the fact that no single country accounted for 25% or more exposure. Alternatively, if a corporate entity had 5% exposure to each of 20 sovereigns ranging from 'B' to 'AAA', we might estimate a weighted average (unless we use the country of domicile, as mentioned above). Where we expect projected exposures to be significantly different from historical ones, we would use the projected exposures.
57. For corporates, the country of domicile may still be relevant. We may use the country of domicile as the reference point in some cases--for instance, for globally diversified multinational companies operating in a large number of countries, if we believe there is no material exposure to a single country. Alternatively, the weighted average may be raised by one notch if all of the following conditions are met:
 - The company's head office is located in a country with a sovereign rating higher than the preliminary weighted average of the sovereign ratings corresponding to its material exposures;
 - No country, with a sovereign rating equal to or lower than the preliminary weighted average of the sovereign ratings, represents or is expected to represent more than 20% of revenues, EBITDA, or fixed assets, or other appropriate financial measures; and
 - The company is primarily funded at the holding company level, or through a finance subsidiary located in a country with a stronger sovereign rating than the holding company, or if any local funding could be very rapidly substituted at the holding company level.
58. Similar to the preceding paragraph, for corporates, the weighted average sovereign rating used to apply table 2 may be lowered by one notch if either of the following conditions are met:
 - The company's head office is located in a country with a sovereign rating lower than the preliminary weighted average of the sovereign ratings corresponding to its material exposures; or
 - The company is primarily funded at the holding level, or through a finance subsidiary located in a country with a weaker sovereign rating than the weighted average.

Short-lived sovereign defaults of a technical nature

59. If we lowered a sovereign rating to 'SD' (selective default) because of a default event that we expect to be short-lived and technical in nature, or if we lowered the sovereign rating to the 'CCC' category or to 'CC' in anticipation of such an event, nonsovereign entities might not be affected directly in terms of rating caps. In such a scenario, the reference point for nonsovereign ratings, for purposes of applying table 2, would be the expected post-default sovereign rating, or the upper end of the range of the expected post-default sovereign rating, as indicated in conjunction with the related sovereign rating action.

E. Government-Related Entities (GREs)

60. GREs are typically more subject to country risk, and negative sovereign intervention risk, than private-sector entities, since they usually have direct links to governments. When considering whether to rate a GRE above the sovereign, we consider the provisions of these "Ratings Above the Sovereign" criteria ("RAS criteria") as well as our criteria for GREs, "Rating Government-Related Entities: Methodology And Assumptions," published March 25, 2015 ("GRE criteria"). The GRE criteria (in the section, "Other Considerations/Rating a GRE above the rating on its government") set the general conditions for rating a GRE above the sovereign. The RAS criteria set the maximum rating differential over the sovereign rating, as well as the specifics for the stress test we run to assign ratings above the sovereign. The special provisions for GRE ratings depend on whether the GRE is related to a sovereign government or to a local or regional government. The following special conditions apply with respect to sovereign-related GREs and local and regional government-related GREs. Note: the provisions below with respect to "maximum rating differential" address the maximum rating differential between the GRE rating and the sovereign foreign currency rating, for cases where the sovereign is rated 'B' or higher. Where the sovereign is rated 'B-' or lower, we apply the provisions of table 2 with respect to the maximum nonsovereign rating, according to the GRE's sensitivity classification.
61. The RAS criteria apply to sovereign-related GREs, with the following special conditions:
- Industry sensitivity: For the purposes of applying table 2, we classify the GRE's sensitivity as 'high' unless it meets both of the following conditions: a) its "link" (as determined according to the GRE criteria) is 'limited,' and b) the industry sensitivity for the GRE's sector is 'moderate,' either due to the industry classification per table 1 or Appendix I.
 - Maximum rating differential: For the purposes of applying table 2, the maximum rating differential will generally correspond to the sensitivity determination in item 1, above. However, for domestic utilities (defined as those with 70% or greater exposure to a single jurisdiction), the maximum differential is 1 notch.
 - For purposes of clarity, if the GRE's government support category is 'almost certain' or 'extremely high,' no stress test is needed to align the GRE's ratings with the sovereign foreign and local currency ratings (for those in the 'almost certain' category) or with the rating outcome of table 4 of the GRE criteria ('extremely high').
62. The RAS criteria apply to local and regional government-related GREs, with the following special conditions:
- Industry sensitivity: The industry sensitivity follows that of the GRE's sector, either per table 1 or Appendix I, with the following proviso: the GRE sensitivity can be 'moderate' as long as either the link with the government is 'limited,' or the related government's sensitivity is 'moderate.'

- Maximum rating differential: For the purposes of applying Table 2, the maximum rating differential will generally correspond to the sensitivity determined in item 1, above. For domestic utilities, the maximum differential is 1 notch, unless the related local or regional government itself is 2 notches above the sovereign, in which case the utility can be rated up to 2 notches above the sovereign. If the related government itself is 3 notches above the sovereign (as per Appendix I), the utility can be rated 3 notches above the sovereign if the application of the GRE criteria supports that conclusion.

F. Other Situations

63. **Guarantees:** The maximum rating differentials vis-à-vis the sovereign do not apply where financial obligations are guaranteed by a counterparty rated higher than the primary obligor's sovereign, where the guarantor is located outside the jurisdiction, and where the guarantee meets our rating substitution criteria (see "Guarantee Criteria," published October 21, 2016).
64. **Implicit parent/group support:** When the issuer in question is a subsidiary, we apply the GRM to determine whether the entity can be rated above the sovereign, and by how much, depending on our view of the likelihood of receiving group support during a potential future sovereign stress event.
65. **Issuers or transactions with under 10% exposure to the jurisdiction of domicile:** These are not capped by table 2, based on their jurisdiction of domicile. However, where such entities have significant, concentrated exposures outside their jurisdiction of domicile, we may apply caps relevant to those exposures. For example, if a financial institution is domiciled in a country where it has only 5% exposure, but it has over 25% exposure to another, single country rated below the potential rating of the entity, then we still perform a stress test associated with a sovereign default scenario in such (nondomicile) country, and we may apply rating caps relative to such exposure.

G. Transfer & Convertibility Assessment

66. The final step in applying these criteria (to foreign currency ratings only) is to consider whether the rating is constrained by the T&C assessment. This assessment reflects S&P Global Ratings' view of the likelihood of a sovereign's restricting nonsovereign access to foreign exchange needed to satisfy the nonsovereign entity's debt-service obligations. Local currency ratings are not constrained by the T&C assessment.
67. The paragraphs below specify certain tests to consider ratings above the T&C assessment. However, with respect to the country of domicile, we also analyze legal, regulatory, and other qualitative considerations. These considerations might lead in turn to rating constraints on the T&C assessment for the country of domicile, regardless of the entity's exposure to that country.
68. For sovereign ratings or T&C assessments of 'B' or higher, foreign currency ratings on any entity that derives 90% or more of its exposure from a single jurisdiction will generally be capped at the T&C assessment for that jurisdiction. However, if the entity is a nonfinancial corporate entity, it could have a foreign currency rating up to one notch above the T&C assessment, if it meets all of the following conditions (for cases where we might consider more than one notch above the T&C assessment, see other mitigating factors in the following paragraph):
- Derives its revenues principally from exports;

- Has established off-shore accounts to capture export sales;
- Has strong incentives to continue paying foreign debt through a sovereign stress scenario, judged by the degree of integration in the global trading system and capital markets (that is, geographical diversification of its customer base, foreign debt and/or equity registrations, and a track record in previous economic crises, if relevant);
- Passes our T&C stress test (in addition to meeting the standard stress test for rating above the sovereign; see the "Rating Above the Sovereign: The Pass/Fail Stress Test" section), meaning we think the entity could still service debt if a) we assume only 25% of export revenues would be available for foreign debt service, due to export repatriation requirements; b) the remaining 75% of export revenue, and any other domestic-source cash flow and assets, will not be available to service foreign currency debt; and c) we assume restricted access to foreign exchange available for imported raw materials, and imported capital goods.

69. Structural mitigants for T&C risk, which could lead to a rating more than 1 notch above the T&C assessment, include political risk insurance, third-party guarantees, or a project finance transaction with structural mechanisms that mitigate T&C risk by segregating foreign currency receivables into offshore accounts.
70. When the sovereign foreign currency rating, or T&C assessment, is 'B-' or lower, we may alternatively decide there is a country-specific T&C scenario, similar to paragraph 40 for the sovereign stress scenario. Such a scenario may conclude, for example, that there would be harsher T&C restrictions (i.e., no export revenues permitted to be kept offshore for debt service), or potentially less harsh restrictions, such as specific exemptions for certain industries.
71. For entities with less than 90% exposure to a single jurisdiction, we apply the framework indicated in table 4 to determine whether an entity could be rated above the T&C assessment of that jurisdiction, and if so, by up to how many notches. For entities with exposure between 25% and 90% to a single jurisdiction, we require a stress test for a T&C event. For this stress test, we make the assumption that domestic-source cash flow and assets will not be available to service foreign currency debt, nor pay for imports of raw materials or capital goods. However, for exporters, we assume 25% of stressed export revenues remain available in hard currency for debt service, and 10% of export revenues remain available to pay imports of raw materials or capital goods.

Table 4

Determining The Rating Effect Of The Transfer & Convertibility Assessment

Exposure to jurisdiction	>90%, Sells domestically	>90%, Exporters	70%-90%	50%-70%	25%-50%	<25%
Stress test for T&C event?	No	Yes	Yes	Yes	Yes	No
Rating cap	T&C	Up to 1 notch above T&C , if pass stress test; cap at T&C if fail stress test	Up to 1 notch above T&C , if pass stress test; cap at T&C if fail stress test	Up to 2 notches above T&C , if pass stress test; cap at T&C if fail stress test	No cap if pass stress test; cap at T&C if fail stress test	None

Note: In this table, all references to stress tests refer to the stress test for a T&C event.

72. Therefore, as long as the entity would not default on foreign currency financial obligations during the single-country T&C stress test (or exporter T&C stress test, where relevant), the entity's foreign currency rating can be:
- Up to one notch above the T&C assessment of that jurisdiction for non-exporters with 70% to

90% of exposure derived from the jurisdiction or exporters with over 90% exposure;

- Up to two notches above the T&C assessment of that jurisdiction (50% to 70% of exposure); or
- No limit relative to the T&C assessment (below 50% exposure).

73. The T&C test applies only to foreign currency ratings; local currency ratings are not constrained by T&C. On the other hand, local currency ratings do reflect relevant country risks, with the exception of T&C. Foreign currency issuer credit ratings on domestic non-sovereign entities are generally the lower of a) the issuer local currency rating or b) the T&C assessment, unless the rating can exceed the T&C assessment as per the previous paragraph.

APPENDIX I

74. In reference to table 1 and paragraphs 44 and 45, we have classified the following sectors for the listed countries as having 'moderate,' instead of 'high,' sensitivity:

State and local governments, United States.

75. Rationale: The following characteristics distinguish U.S. state and local governments from the U.S. federal government, and also demonstrate autonomy and relative stability of revenues, even under stressed conditions.
- Exceptionally strong and predictable legal framework governing autonomy; long track record of decentralized institutional framework protection. Responsibility for the delivery of a wide range of services—and the authority to levy taxes sufficient to finance their provision—remains the states' under the Tenth Amendment to the constitution. The federal system in the U.S. empowers states as sovereign entities. Local entities are governed by state laws. States' rights and their powers were established from the bottom up, creating a unique, distant relationship between the federal government and state/local forms of government.
 - There is no history of direct negative intervention by the federal government to state and local government entities in the U.S.
 - Exceptionally strong autonomy of decision-making/revenue collection/spending adjustments.
 - The arrangement of U.S. fiscal federalism encourages fiscal discipline by having state and local governments largely internalize the costs of discretionary fiscal decisions. This discipline is well-embedded and evidenced by fiscal policies such as the requirement to have balanced budgets.
 - Relatively low leverage of U.S. state and local governments.
 - The debt structure for state and local governments provides for significant strength during a stress scenario. Debt is generally amortizing, and nearly all of the ratings in U.S. public finance are issue ratings, which reflect specific security structures, pledged/dedicated revenues, legal provisions that provide priority of payment to bondholders on a first-dollar basis, and frequently have a built-in stress scenario (priority, coverage and limits on leverage).
 - Strong credit performance over time. U.S. public finance ratings have endured an 'AAA' stress scenario with relatively strong credit performance: one default at the state level during the Great Depression and very few defaults at the local level over time.
 - Very high flexibility of revenues and expenditures. State governments have autonomy over their tax structure, including tax base composition, rate setting, and collection. Local governments in

the U.S. derive a majority of their revenues (generally between 60%-70%) from local property taxes. Property tax revenues have two defining features that help create stability for local governments: 1) real estate declines are not immediately reflected in property values due to the lag in property revaluations; and 2) the flexibility of local governments to compensate for declining value with autonomy in rate or levy setting.

- Limited reliance on direct federal funding. Direct funding from the federal government represents only about 4% of total local government revenues, much of which represents funds designated for capital spending. While states have a higher reliance on federal funding, the primary area of fiscal integration with the federal government is Medicaid, which is a voluntary program.

76. Despite the characteristics above, U.S. state and local governments are limited to three notches above the sovereign. An individual government would need to demonstrate resilience to an 'extreme' stress test in order to qualify for more than two notches above the sovereign.

Higher-education, independent schools, United States.

77. Rationale: Universities in the U.S. have demonstrated a proven ability to withstand declining revenue sources, variability in endowment values, changing demographics, and various competitive pressures over a range of economic cycles. Universities in the U.S. are autonomous entities and have operated without any direct negative government intervention and retain full authority to implement adjustments necessary to respond to changing economic climates. These institutions operate separately from the state or federal government. However, public universities (those associated with, or funded by, state or city governments) are limited to 3 notches above the sovereign, the same as the related government; an individual university would need to demonstrate resilience to an 'extreme' stress test in order to qualify for more than two notches above the sovereign.
78. Private universities and independent schools are treated the same as other 'moderate sensitivity' industries; they can qualify for up to 4 notches above the sovereign.

Not-for-profits, United States.

79. Rationale: U.S. not-for-profits are considered to have 'moderate' sensitivity due to typically robust endowment levels and a demonstrated ability to perform through various economic cycles. However, an individual not-for-profit would need to demonstrate resilience to an 'extreme' stress test in order to qualify for more than 2 'notches' above the sovereign.
80. S&P Global Ratings may periodically update this Appendix with additional country-specific sector reclassifications.

APPENDIX II: Data And Additional Details For "Sovereign Default Scenarios": Basis For Stress Test For Ratings Above The Sovereign

GDP peak-to-trough decline

81. See "S&P Global Ratings Definitions." In the 'AA' stress scenario, we indicate a GDP decline of up to 15%, and in the 'A' stress scenario, we indicate a GDP decline of up to 6%. In the article cited above, and in the 2011 case of Greece, we also observed GDP declines as follows for select

sovereign stress events:

- Mexico, 1994: 15%;
- Thailand, 1997: 12.5%;
- Russia, 1998: 9.1%; and
- Greece, 2011: 7.1%

82. We chose a 6%-10% one-year GDP decline for the sovereign stress test in the criteria for rating above the sovereign--worse than the 'A' stress scenario, but not up to the maximum indicated in the 'AA' stress scenario.

Currency movements (all sectors)

83. Our scenario calls for a 50% loss of value vis-à-vis the relevant benchmark currency (US\$/euro). That severity is more harsh than the 30%-40% movements observed in September and October 2008, yet less than the 70%-plus movements observed during sovereign crises during which a currency came off a fixed exchange rate.

Historical examples of a 30%-40% loss in value.

- Brazil, 2008--The Brazilian real lost 33% of its value against the dollar.
- Mexico, 2008--The Mexican peso lost 30% of its value against the dollar.
- Brazil, 2002, after the Argentine default and amid fears about policy prospects under a potential Lula government--The Brazilian real lost 41% of its value against the dollar.

Historical examples of a 50% loss in value.

- Mexico, 1994-1995--The "Tequila" crisis.

Historical examples of a 70%-plus loss in value.

- Argentina crisis, 2001-2002--The peso lost 71% of its value against the dollar, off a fixed exchange rate.
- Indonesia, 1998--The rupiah lost 76% of its value.
- Russia, 1998--The ruble lost 74% of its value.

Access to cross-border funding (all sectors).

84. Our scenario indicates that entities would have no access to new cross-border funding, from either foreign banks or capital markets (and for banks, from wholesale deposits) for one year. Maturing short-term or long-term loan facilities or bond issues would need to be repaid out of cash flow, other forms of liquidity, or domestic sources of financing. The exception would be bank lines for which we do not expect "material adverse change" clauses or similar triggers in case of a sovereign default scenario. The rationale for this is that nondomestic sources of financing dry up quickly in a sovereign crisis.

Access to domestic funding (all sectors).

85. Our scenario assumes no access to domestic capital markets. In reference to bank funding, we expect a doubling of local nominal interest rates. For speculative-grade issuers, we assume domestic bank financing will be available for rollovers of existing short-term domestic bank lines only. For investment-grade issuers, we assume domestic bank financing would be available for maturing long-term bank debt. The rationale for this is that we expect domestic interest rates to rise sharply during a sovereign default crisis. We also expect credit availability to be curtailed in line with liquidity/funding issues at domestic banks.

Value of liquidity position/assets invested in local government bonds, local banks, and domestic corporates.

86. We assume a haircut of 60% of par on the value of foreign currency government securities. The haircut assumption we use recognizes the likely severe market discount in case entities need to sell domestic debt securities to cover immediate liquidity needs.
87. For countries where the sovereign foreign and local currency ratings differ by two notches, scenario B calls for a haircut of 40% to par on the value of long-term local currency government securities, and a haircut of 50% to par for a 1-notch differential between the sovereign foreign currency and local currency ratings. Short-term (maturing in less than one year) local currency government securities are assumed to hold greater valuations. We assume a haircut of 25% of par for a 2-notch differential, and 30% of par for a 1-notch differential.
88. Our assumptions for non-sovereign security haircuts are as follows:
- Bank senior debt and debt of local and regional governments are treated similarly to sovereign government foreign currency bond assumptions because banks generally trade in line with the sovereign and are assumed to have a high default correlation with the sovereign;
 - Corporate senior debt is assumed to get a 60% haircut to face value, for purposes of the liquidity test, which is in line with assumptions we use in our market value (MV) criteria (see: "Methodology And Assumptions For Market Value Securities," published Sept. 17, 2013). On the other hand, we assume a 30% haircut to face value, for the purpose of our capital test, in order to better align with our nonperforming loan assumptions for banks (20% NPLs, with loss given default (LGD) of 70% for unsecured loans and 50% for secured loans).
 - Securitizations (RMBS, CMBS, and ABS) are assumed to have no liquidity in a sovereign stress scenario; the haircut for purpose of our liquidity test is assumed to be 100%. This is similar to the assumptions we use in our MV criteria for these asset classes. On the other hand, we assume a 30% haircut to face value, for the purpose of our capital test, reflecting the fact that the higher-rated securitizations in a given country tend to be rated well above the sovereign, indicating that we expect significant resilience of these asset classes to a sovereign default scenario.
 - Covered bonds are assumed to have similar haircuts to bank and sovereign securities for our liquidity test (60% haircut to par), and similar to assumptions for the cover pool assets for the purpose of our capital test (60% haircut to par for local and regional government securities, 30% haircut to par for RMBS/CMBS/ABS securities).

Price controls

89. We expect a utility rate/price freeze for one year. The rationale for this is that price controls are common during severe currency depreciations and in times of economic stress. Examples of this are Argentina's long-term price freeze or price controls for electric and gas utilities; Indonesia's utility rate freezes in the 1997-1998 crisis; Venezuela's price controls on utility tariffs and basic foodstuffs; and Mexico's price controls during the 1994 "Tequila" crisis (bread and utility tariffs).

Nonperforming loans

90. We expect NPLs to rise to at least 20% of total loans. According to the "World Bank Database of Banking Crises" (http://www1.worldbank.org/finance/World_Bank_Database_of_Banking_Crises_October_6_2003.xls), 30% was the typical peak reached in the Asian crisis of 1997-1998 (Malaysia, 30%; Korea, 35%; and Thailand, 33%; although Indonesia reached 70%). Other data points: Argentina, 20% (2002); Uruguay, 25% (2002); Brazil, 15% (1999); Costa Rica, 32% (1996); Mexico, 18.9% (1995). According to World Bank data for Greece, NPLs to total gross loans reached 11.5% in 2011, and we estimate that NPLs in Greece reached 20%-25% by the end of 2012.

Deposit run-off

91. We assume domestic banks would experience a significant deposit run-off in the period leading up to, during, or following a sovereign default event, as follows: 15% of retail deposits and 25% of wholesale domestic deposits (cross-border wholesale deposit run-off should be 100%, i.e., time deposits are not renewed at maturity). The basis for this assumption is observed deposit outflows in sovereign stress scenarios, including: Uruguay reached 33% deposit run-off in 2002; Argentina reached 18% in 2001 prior to the deposit freeze; and Greece reached 37% peak-to-trough run-off (December 2009 to June 2012).

APPENDIX III: Frequently Asked Questions

Foreign currency versus local currency ratings: impact of cross-default clauses and acceleration provisions

What is the impact of cross-default clauses in determining whether an unsupported* nonsovereign entity can have a local currency ICR above the T&C assessment (i.e., LC ICR above the foreign currency ICR, when the latter is capped at the T&C assessment)? (*Unsupported' means we are here excluding potential group support.)

In order to have the LC (local currency ICR) above the FC (foreign currency ICR), we must envision the company can pay all FC and LC debt as scheduled (for single-country companies, that means in domestic currency equivalent, stressed for currency depreciation visa-vis foreign currencies), through a sovereign default and T&C event scenario: The only reason they are not paying FC debt must be directly due to T&C. Once there is a failure to pay FC debt due to T&C, the FC ICR moves to

'SD' or 'D'; but if we conclude that the company has enough domestic currency to settle all maturing FC and LC debt, and is willing to do so, at that point the LC ICR does not move to 'SD' nor 'D'.

What assumptions do we make about acceleration, with respect to foreign currency debt, and the related impact on local currency ratings?

With respect to acceleration, we assume: a) foreign currency creditors will accelerate upon a payment default on their own debt instrument: therefore, within six months, nearly all FC debt will have coupon or principal to service, and would be in default, and therefore, accelerated, and immediately due and payable (this assumption reflects in particular our view of the lack of predictability on the duration of the T&C event); b) foreign currency creditors with cross-default clauses will accelerate even sooner, upon the first material foreign currency default; c) local currency creditors with cross-default clauses will accelerate upon the first material foreign currency default; this is because they'd see downside in staying put while value leaks to FC debtholders. Note that we assume creditors accelerate, regardless of whether these clauses are mandatory/automatic or merely provide the counterparty with an option to accelerate.

Therefore, in order for a company to have a LC ICR above the FC ICR, it must have sufficient liquidity, in the stress scenario, to pay the sum of: a) all FC obligations (including leases, derivatives), assuming it's all accelerated due to T&C-caused default, to be settled in local currency at the stressed rate; b) all LC debt with cross-default clauses, to be settled in local currency; and c) other LC debt without cross-default clauses maturing in the stress period (first or second year out) as per the original maturity schedule.

The other provisions of Ratings Above the Sovereign criteria apply: the local currency rating for a non-sovereign entity can be above the foreign currency rating on that entity if: the SACP is above the T&C assessment, and is resilient to stress tests set out in Rating Above the Sovereign (RAS) criteria for a sovereign FC default, and a sovereign LC default (the latter if the SACP is above the sovereign LC rating), and in addition, should be resilient to the incremental stress associated with a T&C event (for the latter, the focus is on the impact of T&C controls on factors other than debt-service, such as ability to import needed raw materials and capital equipment).

What assumptions do we make with respect to the T&C event stress scenario, for local currency debt that has a cross-default clause, including a cross default to foreign currency debt?

As per paragraph 70 of Ratings Above the Sovereign criteria, when the sovereign FC rating, or the T&C assessment, is 'B-' or lower, we may decide there is a country-specific T&C scenario, which may allow for case specific assumptions on acceleration and cross-default clauses. In addition, "Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings," Oct. 1, 2012, remain over-arching criteria for ratings in the 'CCC' and 'CC' categories.

Applying sovereign stress tests to banks and insurance companies with material exposures in the UAE and the individual emirates within that federation

How do you apply sovereign stress tests to banks and insurance companies with material exposures in the UAE and the individual emirates within that federation?

For banks and insurance companies (including their nonoperating holding companies) with material exposures in the individual emirates that make up part of the UAE federation, we apply the sovereign stress test at the UAE level and not at the level of each individual emirate. This is because we view the UAE as the relevant level of jurisdiction for banks and insurance activities.

Our view is based on the nature of the regulation and supervision of these sectors within the UAE. The strength of the federal links are deeper than links seen between countries associated in a nonfederal manner. Within the UAE, banks and insurance companies are regulated and supervised at the federal level. The Central Bank of the UAE, among other prerogatives, licenses, prudentially regulates, and supervises banks. Similarly, the Insurance Authority UAE, among other prerogatives, licenses, prudentially regulates, and supervises insurance companies. We determine a Banking Industry Country Risk Assessment (BICRA) and an Insurance Industry Country Risk Assessment (IICRA) at the level of the UAE, rather than for individual emirates.

The UAE is a federation of seven emirates comprising Abu Dhabi (which serves as the capital), Ajman, Dubai, Fujairah, Ras Al Khaimah, Sharjah, and Umm Al Quwain. Each emirate is governed by a ruler, and they jointly form the Federal Supreme Council. We use, among other criteria, our "Sovereign Rating Methodology" (published Dec. 18, 2017) to derive ratings on such emirates. For the purpose of determining other ratings in the UAE, S&P Global Ratings may also assess the creditworthiness of the federation using its sovereign rating methodology.

REVISIONS AND UPDATES

This article was originally published on Nov. 19, 2013. The criteria became effective on Nov. 19, 2013.

The criteria were published following our request for comment titled "Request For Comment: Ratings Above The Sovereign--Corporate And Government Ratings," published April 12, 2013.

Changes introduced on Nov. 19, 2013, compared with the previous criteria, "Nonsovereign Ratings That Exceed EMU Sovereign Ratings: Methodology And Assumptions" ("EMU criteria"), published June 14, 2011:

The main changes with respect to the EMU criteria were:

- We changed certain classifications for industry sensitivity to country risk, such as eliminating the 'low sensitivity' classification; considering property/casualty insurance companies to have moderate' sensitivity, compared with 'high' sensitivity in the EMU criteria; and bringing regional and local governments and public finance enterprises into the framework as sectors that generally have 'high' country risk sensitivity. We also allowed for country-specific industry determinations, such as moving from 'high' to 'moderate,' or from 'moderate' to 'high,' on a country-specific basis (such determinations appear in Appendix I)
- The stress test for rating a nonsovereign entity above the related sovereign is new as an explicit requirement, even for EMU-based entities. At the same time, the criteria include a wider rating differential between a nonsovereign entity and the related sovereign for 'moderate' and 'high' sensitivities.
- For nonfinancial corporate ratings, we have broadened the definition of country exposure. We

consider the relevant measure for a particular industry or sector, which can be EBITDA, revenues, or other volume-based measures, as appropriate.

- Also for corporate ratings, we now generally determine the referenced sovereign foreign currency rating for entities operating in multiple jurisdictions using a weighted average of the sovereign foreign currency ratings on the countries where the entity has material exposures; however, there are certain situations where the domicile is the reference.

For entities outside the EMU, the main changes from the previous criteria are the following:

- For entities that pass the stress test, we introduced more specificity for the maximum rating differential from the sovereign, depending on the industry's sensitivity to country risk. We could rate an entity up to 2 notches above the sovereign if the entity is in an industry we consider to have "high" sensitivity to country risk, or up to 4 notches if we consider the industry to have "moderate" sensitivity to country risk.
- We introduced more specificity regarding assumptions for an explicit stress test for rating a nonsovereign above the sovereign for sovereigns rated 'A+' and below (see table 3).
- For insurance companies, there is an increased focus on the risks associated with a sovereign foreign currency default scenario and the insurer rating differential versus the sovereign foreign currency rating, compared with our current criteria, which focuses on the rating differential versus the sovereign local currency rating. We believe that although most insurers have local currency-denominated investments and policy obligations, the insurers would still be significantly affected by the economic stress that may accompany a sovereign foreign currency default. For example, we would expect a significant market-value loss in the domestic bond, equity, and real estate portfolios, a significant drop in new business volumes, and for the life insurance sector, a hike in policy lapses. In addition, since we assume no access to capital markets, insurers dependent on capital market access would experience a significant decline in credit availability.
- We also added more specificity to our criteria for potential ratings above the T&C assessment. Entities with 50% or more domestic-source revenues, including exporters that produce exports from a local asset base, may be able to have a foreign currency rating above the T&C assessment subject to certain stress tests and rating caps. Exporters that produce exports from a local asset base may have a foreign currency rating one notch above the T&C assessment even with 90% exposure to a single country, subject to constraints detailed in the T&C section.

Changes introduced after original publication:

- We updated this article on Nov. 20, 2013, for minor formatting changes and to incorporate a correction to table 2. These changes did not affect the substance of the criteria.
- Following our periodic review completed on Oct. 30, 2014, we added a clarifying example to table 3, scenario B, regarding the local currency devaluation assumption.
- Following our periodic review completed on March 14, 2016, we added a "Frequently Asked Questions" section.
- On May 31, 2016, we corrected an error in table 3, "Sovereign Default Scenario Stress Tests." Specifically, the haircuts applied for sovereign debt (long-term loans) were equalized with the haircuts applied for sovereign debt (long-term securities). The correction had no ratings impact.
- Following our periodic review completed on Oct. 28, 2016, we updated criteria references, deleted obsolete text, and corrected a typo.

- Following our periodic review completed on Oct. 19, 2017, we updated the criteria and research lists.
- On Dec. 14, 2018, we republished this criteria article to make nonmaterial changes to the contact information.
- On July 1, 2019, we republished this criteria article to make nonmaterial changes. We updated references to "Group Rating Methodology" (GRM), published July 1, 2019, in paragraphs 14, 42, and 64. In addition, we removed outdated criteria text that is now covered in the GRM from paragraph 69. We also updated the "Related Publications" section.
- On Sept. 5, 2019, we republished this criteria article to make nonmaterial changes. We updated criteria references and the contact information, and we deleted obsolete text.
- On Sept. 8, 2020, we republished this criteria article to make nonmaterial changes. We updated criteria references and the contact information.
- On Sept. 13, 2021, we republished this criteria article to make nonmaterial changes. We updated criteria references and the "Related Publications" section.
- On Dec. 13, 2021, we republished this criteria article to make nonmaterial changes. We updated criteria and related research references.
- On June 29, 2022, we republished this criteria article to make nonmaterial changes related to the archiving of "Guidance: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions," published Feb. 13, 2019. As announced in "Evolution Of The Methodologies Framework: Introducing Sector And Industry Variables Reports," published Oct. 1, 2021, we are phasing out guidance documents over time. As part of that process, we have archived "Guidance: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions" and moved its contents into a new UAE portion of the "Frequently Asked Questions" section of these criteria without any substantive changes. In addition, we updated contact information and the "Related Publications" section.
- On Sept. 21, 2022, we republished this criteria article to make nonmaterial changes to update references to related criteria and related guidance.
- On Aug. 22, 2023, we republished this criteria article to make nonmaterial changes to remove outdated text.
- On Oct. 20, 2023, we republished this criteria article to correct a publication error in paragraph 69 by deleting a sentence related to implicit parent support as a means to mitigate T&C considerations. This sentence should have been removed after the publication of "Group Rating Methodology" on July 1, 2019 (GRM). Under GRM criteria, implicit parent support can no longer elevate a company's foreign currency ICR above the relevant sovereign's T&C assessment. In addition, we updated the "Related Publications" section.

RELATED PUBLICATIONS

Related Criteria

- Financial Institutions Rating Methodology, Dec. 9, 2021
- Methodology And Assumptions For Rating Aircraft-Backed Debt And Enhanced Equipment Trust Certificates, May 26, 2021

- Global Methodology And Assumptions For Nonfinancial Future Flow Transactions, Jan. 16, 2020
- Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- Group Rating Methodology, July 1, 2019
- Insurers Rating Methodology, July 1, 2019
- Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions, Jan. 30, 2019
- Sovereign Rating Methodology, Dec. 18, 2017
- Risk-Adjusted Capital Framework Methodology, July 20, 2017
- Guarantee Criteria, Oct. 21, 2016
- U.S. State Ratings Methodology, Oct. 17, 2016
- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Methodology: Rating Non-U.S. Local And Regional Governments Higher Than The Sovereign, Dec. 15, 2014
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Methodology And Assumptions For Market Value Securities, Sept. 17, 2013
- U.S. Local Governments General Obligation Ratings: Methodology And Assumptions, Sept. 12, 2013
- Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- Principles Of Credit Ratings, Feb. 16, 2011
- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- Criteria For Determining Transfer and Convertibility Assessments, May 18, 2009

Related Research

- S&P Global Ratings Definitions, June 9, 2023
- Evolution Of The Methodologies Framework: Introducing Sector And Industry Variables Reports, Oct. 1, 2021
- Credit FAQ: How Standard & Poor's Applies Its Rating Above The Sovereign Criteria To The Financial Market Infrastructure Sector, Nov. 12, 2014
- Credit FAQ: How Does Standard & Poor's Apply Its Ratings Above The Sovereign Criteria To Insurers?, Dec. 20, 2013
- Credit FAQ: U.S. Public Finance Ratings And Criteria For Ratings Above The Sovereign, Dec. 19, 2013

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