

Fitch Announces Potential Complementary Rating Scales For Structured Finance

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Fitch Ratings-London/New York/Sydney-29 April 2008: Fitch Ratings is currently engaged in a review to identify and evaluate potential complementary scales or indicators for structured finance transactions. The complementary scales are designed to improve transparency, provide market participants with additional information regarding structured finance securities, and help address recent critiques of structured finance rating scales.

Currently Fitch has one ordinal rating scale used throughout its rating activities, including financial institutions, corporates, sovereigns and structured finance. In recent months, there has been increased debate, particularly in the policy-making community, about the appropriateness of this approach for structured finance transactions.

In 2007 Fitch carried out an in-depth verbal consultation process with major issuers, investors and regulators regarding complex structured finance products. At that time, feedback suggested limited interest in adopting a different rating scale for structured finance. However, seasoned market participants also typically indicated an understanding that the current rating scale, which addresses default probability, does not convey all of the risks present in structured finance transactions.

In an effort to add greater transparency and capture additional risks, Fitch has identified three potential additional and complementary rating scales for structured finance securities. These are as follows:

Loss Given Default (LGD) Ratings This scale would attempt to quantify the recoveries on a tranche-level basis that a structured finance (SF) creditor would likely receive in the event of default. Such a scale would be similar to the Recovery Ratings Fitch introduced for corporate finance in 2005. An LGD scale would help address one of the common criticisms of SF ratings compared to corporates. That is, while a SF tranche and a corporate bond that are rated the same may possess similar default characteristics, actual losses given default may differ materially. Note that Fitch already assigns Distressed Recovery ratings to SF tranches, but only where the security is either currently distressed or defaulted.

Transition/Stability Ratings Such a rating scale would attempt to capture the potential for rating migration - the rating transition or volatility risk. In other words, how likely is it that the rating would change for a given time period? This could be measured in a number of ways, either in isolation or in combination. For example, it could be measured over the short-term, from the perspective of current events (similar to the tranche-level outlooks currently being rolled out by Fitch across its SF ratings), or as a measure over the long-term, based on historical or projected performance of that asset class. It could also be measured as a purely relative measure distinguishing between static and dynamic pools.

Collateral Ratings These ratings would attempt to measure on a consolidated basis the quality of the underlying collateral or pool of assets for a given transaction. Said differently, such a rating would assess the quality of the underlying assets, independent of all or most of the additional structural features that determine a traditional SF rating. However, such an approach may only be feasible for concentrated loan pools, e.g., commercial mortgage-backed securities.

Fitch will begin to issue exposure drafts on these proposals by early-June. However, in the interim, Fitch looks forward to receiving preliminary feedback on the merits of these initiatives and other potential ratings scales (e.g., liquidity risk) through the usual response channels. Additionally, Fitch will continue to monitor feedback on the idea of a fully separated primary scale for structured finance securities. Feedback on these topics can also be sent directly to sfeedback@fitchratings.com.

For topical commentary on the European structured finance market, along with global capital markets coverage, please see www.fitchratings.com/capitalmarkets.

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