S&P Global
Ratings

RatingsDirect®

RFC Process Summary:

Fund Credit Quality Ratings Methodology And Fund Volatility Ratings Methodology

Analytical contacts:
Wendy T Immerman, San Francisco (1) 212-438-5052; wendy.immerman@spglobal.com
Francoise Nichols, Paris (33) 1-4420-7345; francoise.nichols@spglobal.com
Peter G Gargiulo, New York (1) 212-438-5423; peter.gargiulo@spglobal.com
Joseph Giarratano, New York (212) 438-8942; joseph.giarratano@spglobal.com
Peter L Rizzo, New York (1) 212-438-5059; peter.rizzo@spglobal.com

Criteria contacts:
Nik Khakee, New York (1) 212-438-2473; nik.khakee@spglobal.com
Mark Puccia, New York (1) 212-438-7233; mark.puccia@spglobal.com

Table Of Contents

1874259 | 300000186

RFC Process Summary:

Fund Credit Quality Ratings Methodology And Fund Volatility Ratings Methodology

On Sept. 26, 2016, S&P Global Ratings published its request for comments (RFCs) on our proposed fund credit quality (FCQR) and fund volatility (FVR) ratings methodologies. In the RFCs, we encouraged interested market participants to submit their written comments to us.

We'd like to thank the market participants who provided feedback. After careful consideration, we finalized and published the final criteria articles, "Fund Credit Quality Ratings Methodology" and "Fund Volatility Ratings Methodology," on June 26, 2017. This RFC Process Summary provides an overview of the changes, if any, between the RFCs and the final criteria, and the rationale behind those changes.

Feedback Summary

Because the FCQR and FVR RFCs share similarities and are tangentially related rating products, we believe it is beneficial to provide a singular RFC Process Summary rather than separate ones. Our RFCs included several specific questions on which we asked for feedback:

- Do you have alternative views on the proposed updates to the criteria, and if so, why? In particular, do you have views on the application and effect of the rating sensitivity tests?
- In your opinion, do the proposed criteria contain any significant redundancies or omissions? Are any factors significantly over- or underweighted, and if so, why? For example, do you have alternatives to how we have differentiated the treatment of hedging and speculative credit derivatives?
- Do you have alternate views on how we capture repo and reverse repo activity?
- Do you have alternate views on the composition and content of our management assessment?
- Do you have alternate views on the composition and content of our portfolio risk assessment?
- Do you have alternative views on the updates to the statistical analysis of fund return volatility?
- Do you believe we are appropriately capturing portfolio risk and agree with the indicators we propose to assess this risk? If not, what alternatives would you propose?
- Do you believe we are appropriately capturing management risk? Do you agree with the components and categories we propose to assess this risk? If not, what alternatives would you propose?

Respondents addressed these and other issues, with the bulk of the feedback centered on the following areas:

- The factors developed may be too punitive (both for rated and unrated assets)
- Clarity on the comparable rating analysis portion of the FCQR RFC and potential for portfolio ratings fluctuations more broadly
- Alignment of principal stability fund ratings (PSFR) criteria and the FCQR criteria
- The qualitative elements of the RFCs seemingly favored large fund sponsors over smaller

There were minimal comments directed toward the FVR RFC, and minimal changes were made outside of the management assessment, described below in "Refinement of scoring of Management Assessment categories for FCQR and FVR."

Points Of Clarification

Factors

Changes adopted or considered. Feedback suggested that the fund credit quality asset factors proposed in the FCQR RFC were overly conservative, inasmuch as changes in bank and other criteria resulted in the underlying ratings on fund asset holdings to have already been adjusted downward. We also received comments on how pricing of securities and differently rated securities did not match the factor distinctions. After carefully considering these comments, we determined no change would be made based on this feedback. The development of the updated factors was informed by our studies of historical defaults and include the data from the period between 2007-2015.

Alignment with principal stability fund ratings credit quality criteria

Changes adopted or considered. Feedback received indicated there was a misalignment between S&P Global Ratings' approach to credit quality between the published PSFR criteria and the proposed criteria for FCQR. As the short-term categories and cutoffs were proposed in the FCQR RFC, it was possible that a fund, just on the basis of maturity and credit quality of assets (irrespective of other factors), could qualify for a 'AAAm' PSFR but would only qualify for a 'AAf' FCQR. The market saw this as a misalignment on how fund ratings across fixed income mutual funds are viewed.

We also received comments stating that 'AAAf' and 'AAAm' rated funds often invest in assets with short-term ratings of 'A-1', which maps to long-term ratings of 'A+' or 'A'. Some asset managers also noted that the FCQR RFC insufficiently recognized the differences in the likelihood of asset default as maturity shortens, and that the asset factors proposed for extremely short-term paper did not recognize the lower likelihood of default of assets at maturities even shorter than three months.

Commenters further expressed concern that our proposed thresholds were based upon two instead of four ratings levels, which, when considered with the comments above, increased the disparity in approaches, particularly as a 'AAAm' rated fund cannot only invest in 'A-1+' ('AAA', 'AA+', 'AA', 'AA-'), but also 'A-1' ('A+', 'A') rated assets.

We agreed with commenters that the disparity between the RFC proposal and the PSFR criteria had become more distinct, which was not our intent. As a result, we introduced further gradation into the maturity buckets by breaking down the less than or equal to 90 day maturities into two buckets: less than or equal to 31 days, and greater than 31 and less than or equal to 92 days. At the same time, we revised the fund rating thresholds applied to the rating categories and refined the definition of maturity buckets to meet market convention.

Rationale. The greater granularity in maturity buckets was an approach we considered early in our criteria development but decided the market would deem a fourth asset maturity bucket burdensome and unnecessarily complex. The feedback indicated otherwise.

In the RFC, the rating thresholds for each category were based on an assumed mix of assets. The threshold represented 60% of the higher one-year rating factor and 40% of the lower rating factor. For example, the 'AAA' factor is 10 and the 'AA+' factor is 25. The 'AAAf' rating threshold was proposed as (10*0.6) + (25*0.4), which equals 16. After carefully considering the feedback received, we revised the fund rating thresholds based on an asset breakdown of 60% of the current category, and 25%/10%/5% of the next three rating notches lower.

Comments received also prompted us to look at more portfolios where we observed 'AAAf' rated asset portfolios distributed across four long-term ratings ('AAA' to 'AA-') as opposed to only 'AAA' and 'AA+'. This reflects the four long-term ratings that map to the short-term rating 'A-1+'. In fact, we also observed portfolios whose asset portfolios were distributed across six long-term ratings, including 'A+' and 'A'.

In determining the revised thresholds, we evaluated how they would appear in relationship to the raw default rate for each rating level, and we limited the threshold to a number less than the factor of the next lowest rating level. For example, the new fund rating threshold for 'AAf' rated funds is 58. We made sure this threshold was lower than the factor for the greater than 365 bucket for the 'AA-' asset credit factor , which has a factor of 70.

We believe these adjustments better address concerns regarding the nature and extent of differences in approaches between criteria, and better capture our analytical intent.

Comparable rating analysis and fund ratings fluctuations

Changes adopted or considered. Comments suggested that readers were unclear on the comparable rating analysis portion of the FCQR RFC and what would warrant raising fund ratings. Others suggested that strong management scoring should lead to FCQRs that were higher than the preliminary FCQR or matrix score, or that the proposal could result in portfolio ratings that continually fluctuate.

After carefully considering these comments, we determined no change would be made based on this feedback.

Rationale. When assessing funds, the final step in our analysis is holistic, wherein we look at all the elements of the analysis completed up to that point in relation to other funds. In doing this holistic analysis, we look at the fund portfolio's credit quality and characteristics relative to its peers with similar portfolio strategies, composition, and management. We may raise or lower the intermediate FCQR by up to one notch where we believe the combination of all factors on balance demonstrates strengths or weaknesses not otherwise captured by the various steps in the analysis.

Refining the scoring of management assessment categories for FCQRs and FVRs

Changes adopted or considered. We received feedback indicating a belief that the criteria do not seem to recognize that proactive management can reduce credit risk and enhance a fund's credit, and therefore do not recognize the potential for ratings uplift. Further, comments indicated a belief that subjective elements within the analysis favor larger firms, although the comments also indicated the qualitative analysis appropriately captured portfolio risk.

These criteria incorporate the potential for uplift, based on the assessment of management within the context of the comparable ratings analysis. Where one or more management assessment categories are assessed as "strong," and none are "weak," a fund's management strength may factor into the final step, the comparable ratings analysis. A positive comparable ratings assessment, supported by a strong management assessment, would lead to a rating one notch higher, whereas a negative assessment leads to a rating that is one notch lower, and a neutral assessment results in no change to the intermediate FCQR. In considering management and its capabilities, we focus on management's capabilities rather than on the size of the firm, which is not an element in our assessment.

We revisited the methodology by which we assess management. Rather than assessing management through separate and distinct components, we determined to simplify the assessment of management by assessing each category holistically.

Rationale. We determined that scoring of subcomponents was unnecessarily prescriptive, whereas a more holistic assessment better captured our analytical intent. Otherwise, we believe the criteria achieve an appropriate balance between the quantitative and qualitative elements of our analyses.

Other points of clarification

Changes adopted or considered. We received a number of other comments that were largely application-type comments or requests for clarification, that is, comments as to how the criteria would be applied rather than comments specific to the proposal itself. We considered the extent of clarification needed to address these items, and incorporated these into the final criteria. Also, we incorporated editorial clarifications throughout to aid in readability and clarity of the intent of the criteria.

Related Criteria

- Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Guarantee Criteria, Oct. 21, 2016
- Request For Comment: Fund Credit Quality Ratings Methodology, Sept. 26, 2016
- Request For Comment: Fund Volatility Ratings Methodology, Sept. 26, 2016
- Principal Stability Fund Rating Methodology, June 23, 2016
- Global Methodologies And Assumptions For Corporate Cash Flow And Synthetic CDOs, Aug. 8, 2016
- Mapping A Third Party's Internal Credit Scoring System To Standard & Poor's Global Rating Scale, May 8, 2014
- Group Rating Methodology, Nov. 19, 2013
- Assessing Bank Branch Creditworthiness, Oct. 14, 2013
- Counterparty Risk Framework Methodology And Assumptions, June 25, 2013
- Methodology: Updated Fund Credit Quality Ratings Criteria For Counterparty Transactions, July 22, 2011