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Rating Research Services

Credit FAQ:

How A Debt Issue Rating Differs From An Issuer Credit Rating

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From time to time, market participants ask what about the difference between an issuer credit rating and an issue rating. Taiwan Ratings Corp. (TRC) believes there are important distinctions between the two rating types, as well as other key factors which are important for market participants to consider.

Frequently Asked Questions

What are TRC's issuer credit rating and issue rating?

Taiwan Ratings assigns two types of credit ratings; one to issuers and the other to specific financial obligations such as a debt issue. According to "Taiwan Ratings' Rating Definitions", a TRC issuer credit rating (ICR) is a forward-looking opinion about the overall capacity of a debt issuer, guarantor, insurer, or other provider of credit enhancement ("obligor") to meet its financial obligations relative to other obligors active in the Taiwanese domestic financial markets. Such obligors may include corporates, government enterprises, financial institutions, and insurance companies, among other types of entities.

A TRC issue credit rating is a forward-looking opinion about the capacity of an obligor to meet the financial commitments associated to a specific debt, bond, lease, commercial paper program, certificate of deposit, or other financial instrument ("obligation"), relative to the debt servicing and repayment capacity of other obligors active in the Taiwanese domestic financial markets, with respect to their own financial obligations.

In short, an ICR generally indicates the likelihood that a company may default with regard to all its financial obligations. An issue rating, however, is based on a blend of default risk and the priority of a creditor's claim in bankruptcy associated with the specific debt being rated.

How do you decide how much to "notch down" the rating on the specific debt from the ICR in the corporate sector?

In general, the holders of secured debts have a higher recovery prospect than those of unsecured debts. Accordingly, we may "notch down" the issue rating on unsecured debts from the ICR by one or two notches, depending on the recovery prospects.

Based on our "TRC Corporate Sector Issue Rating Criteria," as default risk increases, the concern over what can be recovered takes on greater relevance and, therefore, greater rating significance. Accordingly, we give more weight to the loss-given-default aspect of ratings further down the rating spectrum.

For example, we can rate subordinated debt up to two notches below an issuer credit rating of 'twBB+' or lower, but one notch at most if the issuer credit rating is 'twBBB-' or above based on how much priority liabilities rank ahead of the rated debt issue. For example, if the ICR on the issuer is 'twBBB-' and the issuer's priority liabilities account for more than 20% of its tangible assets, then we generally rate its unsecured debt 'twBB+'.

Are there any instances that a "tw" issue rating is lower than the ICR?

Sometimes, issuers will collateralize their assets for borrowings to lower their funding costs and consequently have more secured debts on their balance sheet. As a result, the unsecured debts of those issuers may have lower recovery prospects in the event of a default. We see such instances in the transportation industry, such as shipping and airlines, as well as the independent power sector.

We have assigned an ICR of 'twAA-' to **Ho-Ping Power Co.**, but the issue rating on its unsecured corporate bond is 'twA+'. Other instances include **Wan Hai Lines Ltd.** (ICR: 'twA-'; unsecured corporate bond rating: 'twBBB+'), **Yang Ming Marine Transport Corp.** (ICR: 'twBBB'; unsecured corporate bond rating: 'twBBB-'), and **China Airlines Ltd.** (ICR: 'twBBB+'; unsecured corporate bond rating: 'twBBB').

In general, how do you rate the bonds issued by Taiwan's financial services sector?

We first differentiate if this bond is issued by a bank or non-bank financial service entity because they have slightly different treatments under our criteria ("TRC Financial Services Sector Issue Rating Criteria"); particularly for hybrid issuance. The term "banks" includes finance companies and non-operating holding companies whose main subsidiaries are banks, while the term "non-bank financial services entity" includes securities firms and insurers and non-operating holding companies whose main subsidiaries include securities firms or insurers.

What are the major factors for consideration when you assign a bank debenture issue rating?

We mainly focus on the subordination, deferral clause, and nonviability contingency clause based on "TRC Financial Services Sector Issue Rating Criteria".

- For senior bank debentures, the issue rating is the same as the issuer credit rating on the respective obligor.
- For subordinate bank debentures issued before the release of the Basel III framework (i.e., issued before 2013), the issue rating is one notch down from the ICR on the respective obligor if the obligor is rated 'twBBB-' or above, and at least two notches down from the respective obligor ICR if the obligor is rated 'twBB+' or below.
- We generally rate subordinate bank debentures issued after the Basel III framework (issued from 2013 onwards) two notches below the bank's stand-alone credit profile (SACP) if the SACP is 'twbbb-' or above. One notch reflects the debenture's subordinated status and the other notch reflects the nonviability contingent clause.
- For perpetual hybrids under Tier II capital that banks issued after the Basel III framework with a SACP of 'twbbb-' or above, we would also generally apply a two notch-down approach if there is no interest deferral clause based on the same rationale as above.
- For perpetual hybrids under Tier I capital that banks issued after the Basel III framework with a SACP of 'twbbb-' or above, we generally would apply a three notch-down approach if the possibility for the bank to trigger the contingent clause is remote. One notch reflects the subordinated status, one notch the nonviability contingent clause, and the other notch reflects that the bank can absorb losses on a going-concern basis.

What are the major factors when you assign an issue rating for bonds issued by financial holding companies?

Given that the regulator in Taiwan does not differentiate between insurance holding companies and bank holding companies, we also apply the same treatment in our general rating assessment according to "TRC Financial Services Sector Issue Rating Criteria." The most common bonds issued by financial holding companies in Taiwan are subordinated debts with an interest deferral clause. We generally rate these bonds two notches down from the ICR of the holding company if we believe the possibility to trigger the interest deferral is remote. We will increase the notching differences if the capital adequacy ratio is closer to the regulatory requirement of 100%.

Related Criteria And Research

- **TRC Financial Services Sector Issue Rating Criteria,** www.taiwanratings.com, Nov. 29, 2011
- **Understanding TRC Rating Definitions,** www.taiwanratings.com, Aug. 6, 2010
- **Taiwan Ratings' Ratings Definitions,** www.taiwanratings.com, Aug. 6, 2010
- **TRC Corporate Sector Issue Rating Criteria,** www.taiwanratings.com, Aug. 6, 2010