The Association of Corporate Treasurers

Comments in response to
Request for comment: Rating transitions for investment grade issuers subject to event risk
Moody's Investor Service, July 2006

August 2006

The Association of Corporate Treasurers (ACT)

Established in the UK in 1979, The Association of Corporate Treasurers is a centre of excellence for professionals in treasury, including risk and corporate finance, operating in the international marketplace. It has over 3,600 members from both the corporate and financial sectors, mainly in the UK, its membership working in companies of all sizes.

The ACT has 1,500 students in more than 40 countries. Its examinations are recognised by both practitioners and bankers as the global standard setters for treasury education and it is the leading provider of professional treasury education. The ACT promotes study and best practice in finance and treasury management. It represents the interests of non-financial sector corporations in financial markets to governments, regulators, standards setters and trade bodies.

General

The ACT welcomes the opportunity to comment on this matter. Contact details are provided at the end of this document.

This document is on the record and may be freely quoted or reproduced with acknowledgement.

Overview

We are pleased to have an opportunity to respond to your paper "Rating transitions for investment grade issuers subject to event risk". In providing this feedback to you our comments are generally speaking from the point of view of an issuer, although the issuer view must itself take account of the investor perspective and the overall functioning of the market. It is a topic that has engendered much interest from our members since it has the potential to affect many of them, not least in respect of default language used in many borrowing documents.

In summary your proposal involves Moody's reacting to transforming events by adjusting the ratings via a series of rating actions rather than making a significant one-off multi-notch adjustment on consummation of the event. The progression of these sequential rating actions will depend on i) the expected degree of rating migration and ii) on an assessment of probability that the event will be consummated.

Overall it is unclear to us what the real benefits of the changed approach will be and why the current system of placing a rating under review and analysing the potential change does not convey sufficient information to the market. We do not believe that any change is necessary or desirable.

If you do decide to go ahead with the new approach we would urge you to be very cautious in making any rating change and only react with any moves once the event has become highly probable. Any moves at probability levels of just 50% could well turn out to be premature and imply more certainty than is really warranted

The new approach

On the assumption that you feel it appropriate to go ahead with the proposed new approach or something similar there are several aspects which warrant further attention.

The possible milestones you list are good indicators, depending on circumstances. The aim should be to have different milestones in different countries depending on how the regulations, company law and market procedures differ but with the intent of getting to thresholds of probability that are applied consistently across the world.

For example the UK, as opposed to US, environment may pose its own questions, given that the success or otherwise of a conventional bid, as opposed to a takeover achieved by a scheme of arrangement, depends not on a collective shareholder vote (as mentioned in your milestones) but on individual shareholder acceptances of the offer. The trigger would therefore presumably be when the offer became or was declared unconditional in all respects. Would this still be the case even if the bidder had hard irrevocable undertakings for over 50%, so that, once other conditions (competition, etc.) had been satisfied, it would be highly likely that the offer would be declared unconditional in all respects? It should not be enough that a bidder has just passed various points at which it has the capability to proceed. It needs to be clear that it has or will succeed.

You have acknowledged that Moody's need to assess the possible credit impact of any rating action on notes that may benefit from a change of control and associated downgrade type of clause. We would like to reinforce what we assume is your intent here namely that you would focus solely on credit assessment matters which might include the credit impact of certain notes going into default and withdrawal of lending facilities. In other words we assume that the speeding up of the process is not intended to accelerate activation (or to evade) a contractual provision in the debt agreement through a rating decision that you would not otherwise have taken at that time.

Your final paragraph on page 5 notes that in many circumstances borrowing agreements may have a change of control clause linked to a downgrade below investment grade occurring *after* the change of control event so that an early downgrade may prevent Investors getting the protection they expect. This is certainly true and means that your proposed change in approach could be exceedingly disruptive to the market and indeed could significantly disadvantage the investors, even to the extent of calling into question the wisdom of the change.

If clauses in borrowing agreements were to be changed to cater for this you could then have the unwelcome effect on a takeover that the target's debt could default before the event and before the acquirer is in a position to refinance. No doubt in time the wording in agreements will evolve to remove the anomalies but in the meantime the disruption could be severe and leave borrowers and investors potentially disadvantaged with little or no negotiating power to insist on a change to existing agreements

Pitfalls

A new methodology, and in particular the transition effects could throw up some significant pitfalls and unintended consequences. We consider that the overall effect is such that you should not make the proposed change in methodology.

- The proposed methodology could potentially restrict an issuers inclination to communicate with the agency during an 'event' if the agency might change its rating based on private information about the probability of the event occurring.

- It would create an inconsistent approach to other events which do not get factored into ratings until they complete. One of the key building blocks of agencies' activity has been to change only when certain, flagging the risk in the meantime but announcing that the rating is subject to review. We strongly prefer this approach.

- Any change, through its effect on existing debt agreements, would create significant winners and losers, which should be avoided.

- Given the different interests among holders of different obligations of the issuer (or of different combinations of such obligations) pressure on the agency to make or not make/announce or not announce different judgements at different stages of the process leading up to eventual crystallisation in an "event" may give rise to intense pressure on the agency and be an invitation to corruption.

- It follows a complicated approach so that investors will need to teach themselves how table 1 works and should be interpreted. It is helpful that you recognise the seriousness of a migration from investment grade to non investment grade and are therefore proposing to be cautious over such transitions, but this does mean that for a given probability of event your reaction will be different depending on the starting level of the issuer. This might be deemed logical but could still be confusing.

- Presumably a given rating move could be triggered by a low probability of a heavy eventual migration of rating or by a high probability of a more moderate migration. The message being conveyed by the rating action will be unclear unless the investor reads further into the analysis or explanation of why the rating is under review. If the investor still has to take note of the reason for the rating being under review and make his own assessment of the relevance to him how is the new approach superior to just putting the rating on review with explanations for the investors to read into himself?

Conclusion

We believe that you should not proceed with this proposed change.

Contacts:	The Association of Corporate Treasurers
Richard Raeburn, Chief Executive (020 7213 0734; rraeburn@treasurers.org) John Grout, Technical Director (020 7213 0712; jgrout@treasurers.org) Martin O'Donovan, Technical Officer (020 7213 0715; modonovan@treasurers.org)	Ocean House 10/12 Little Trinity Lane London EC4V 2DJ Telephone: 020 7213 9728 Fax: 020 7248 2591 Website: http://www.treasurers.org