Ask the experts:

How can treasurers rate the ratings?

FOR BOTH BORROWERS AND LENDERS, CREDIT RATINGS MAY NOT BE A PERFECT SYSTEM BUT THERE SEEMS LITTLE VIABLE ALTERNATIVE. THE INTRICATE ISSUE OF CORPORATE RATINGS WAS ANALYSED AT AN ACT BREAKFAST MEETING IN SEPTEMBER, SPONSORED BY STANDARDS & POOR'S, AT WHICH THIS MONTH'S THREE EXPERTS GAVE THEIR PERSPECTIVE ON THE ISSUES.

Nigel Youngman, group treasurer, G4S

G4S was formed in 2004 from the merger between Securicor and Group 4 Falck. From the perspective of the corporate issuer we identified the need for a credit rating in the years after this merger and the subsequent alteration in the funding requirement.

After its formation, GS4 embarked on an extensive acquisition programme mostly in emerging markets in the southern hemisphere. We had funding in the shape of a billion-pound bank facility and in March 2007 issued $550m in private placement notes. At the end of 2007 we started to talk to our banks about a £350m short-term facility we needed for an acquisition and it was then that one or two of our bank relationship managers told us that they could not deliver or could only partially deliver. The facility was completed but we realised that the banking market was becoming glued up.

In summer 2008 we completed a £276m share placing and another private placement issue of $650m. At that point we thought we were near full capacity in the private placement market, having taken out $1.2bn.

We then decided to strengthen our finance raising position by seeking an investment-grade rating for three reasons. First, we wanted to raise finance from the public markets, particularly in the UK. Second, there would then be a take-out option available for any additional bank finance we raised. And third, US private placement investors would be dealing with a investment-grade rated company. We found the ratings chapter in the ACT handbook useful in giving background information.

The collapse of Lehmans and AIG strengthened our belief that a rating would serve us well in a difficult credit environment that might take a long time to sort out.

After receiving proposals and talking to six banks during September, we appointed one as a rating adviser. Once we'd appointed a bank as a rating adviser, we started creating the rating information pack. We did this by gathering and updating information from the top 35 businesses in the group, including financial, market share, service lines and so on. We also reviewed and collated the information memoranda and Q&As we had from the private placements and from equity analyst meetings. All this information was very useful for the adviser.

The rating information pack covers six main areas: market overview, corporate history, strategy, operations, financial review (including looking forward to 2013) and financial policies. This pack was completed by the ratings adviser and I acted as project manager, ensuring we maintained momentum and hit deadlines. It took a few iterations to get it right. In February 2009 we held a meeting with the rating agency during which we presented the rating information pack. There were eight people involved in the presentation, including the chief executive and chief financial officer.

We also agreed the timetable for the rating announcement, which was to be one day before the presentation, and the announcement of our final results, which was scheduled within four weeks.

For the UK market and Europe, only one rating is necessary but in the US market we will have two ratings. We were rated BBB/A-2. The process of getting a credit rating was less difficult from a corporate and personal perspective than had been expected.

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Christian Dinwoodie, head of corporate ratings, EMEA, Standard & Poor's Ratings Services

The panel discussion topic of making sense of corporate ratings implies, to me at least, that there is a perception that credit ratings are both complex and confusing. But credit ratings are important to the debt capital markets and one of the tools that are available to investors, so understanding what it is that you're looking at, and what the credit rating agencies do, is integral to making sense of credit ratings.

Credit rating agencies conduct in-depth analysis based on published rules. The agencies' coverage and research are broader than any individual investor can realistically muster, unless as one panellist put it, they are prepared to operate their own credit rating "cottage industry".

Credit ratings are in essence opinions about creditworthiness. They are one of several inputs that investors and other market participants can consider when looking to assess credit risk. Therefore, it is important for investors to benefit from a plurality of opinions. They should look at ratings and then apply their own judgement when comparing securities. Indeed, one panellist reminded the audience that we should not forget that ratings are opinions, and that to view them any other way is to misinterpret the basis on which they are generated and the use to which they should be put.

We appreciate the impact the financial crisis has had on the market's perception of rating agencies such as Standard & Poor's. To this end we have taken a series of important steps to rebuild confidence in ratings, including further strengthening the ratings process, enhancing our analytics and improving transparency.

One improvement, for example, is a change to the information included in our published research. We now refer to specific criteria articles that we have drawn on to generate the opinion we are publishing so that market participants can better understand how we have arrived at that opinion and what factors are likely to influence us in the future.

In turn, the ratings track record of the agencies should be understood and referenced by interested market participants and observers. Standard & Poor's default and transitions studies (you can view the studies at **www.standardandpoors.com**) have repeatedly found that our ratings have been highly effective in informing the markets about deterioration and improvement in credit quality. Notwithstanding the recent high level of defaults in certain areas of structured finance, the historic correlation between ratings and defaults remains strong.

The high cost of bank financing is enticing many corporates to consider – some for the first time – accessing the debt capital market. We believe the outlook for the next 18 months is reassuring for these issuers.

Corporate bonds are more readily marketable and the prospects for new corporate issuance over the near term are positive.

Indeed, issuers currently deciding whether to access the debt capital markets are finding that conditions and prices are moving in their favour. That said, two issues continue to dominate the economic prospects for recovery, and therefore are putting pressure on the debt capital markets: unemployment rates are still rising and the lack of bank financing continues to stifle growth and opportunity.

Paul Phillips, group treasurer, easyjet

This is the first recession that easyjet has been through and we took the decision that we would prefer to draw down on our facilities rather than use the cash we have, although we may use some cash to acquire aircraft – in an event-driven industry it is essential to keep significant cash balances. However, investing surplus cash over the last 18 months has been hard as yet another bank announces it is in trouble. It cannot be said too often that it is no good trying to put together a plan when active management is what is needed. But if you need technical guidance in this area the ACT can help out in areas such as bank counterparty credit assessment and corporate investment of liquid funds.

Policies in this area need to be easy to explain and easily understood. It is no good if everyone thinks they have been complying with company policies only to find out at the reporting date they've been wide of the mark. So when it comes to investment decisions it is clear within easyjet how much can be invested with banks with different ratings. It should be remembered at all times that a rating is an opinion, not a factual process. As treasurer, I can form an opinion on that opinion as a means of trying to stay one step ahead.

Without credit ratings you have to form your own view, which was the case a number of years ago when few companies had ratings. Trying to cope without ratings is extremely difficult: there is so much change which happens quickly and the publicly available information is out of date by the time it is published. It is foolish to set up a cottage industry trying to mimic the work of the rating agencies, so in that way they can be called a necessary evil. A practical point about using ratings is that corporates have to be capable of mechanically monitoring the ratings to make sure they stay on top of events.

You have to understand what ratings mean and then decide how long you wish to invest for. I won't invest for longer than a week with my lowest-rated counterparties. If a bank drops a notch you don't want to have sleepless nights working out how long it is before you can pull your cash back.

Given the returns at the moment you sometimes wish you were a net borrower. There are some strange discussions taking place, with bankers asking what other business you can put their way for placing money with them. This seems counter-intuitive until you realise it is perhaps a question of banks sticking with companies that are already giving ancillary business or where there is a longer-term relationship.

Ratings aren't perfect but there is little by the way of realistic alternatives, and they can form part of the important task of consistently applying the policy.

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