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Moody's Analysis of US Corporate Rating Triggers Heightens Need For Increased Disclosure

Summary Opinion

Rating triggers vary in severity of impact from benign to severe. Our analysis determined that a large proportion of triggers consist of a requirement to reset pricing (pricing grids) which Moody's views as relatively benign. On the other end of the risk spectrum we found triggers that cause a loss of availability under credit lines, events of default, acceleration or "puts". The liquidity implications of these more risky rating triggers can be severe – a back-up revolving credit that goes away in the event of a downgrade below a certain level, or a large bond that can be "put" in the event of a downgrade can be potentially life-threatening. Such triggers exacerbate liquidity strains at the precise moment when an issuer is least able to deal with such problems. Investors who think that they might be protected by a rating trigger contained in their respective agreement may well find – as in recent cases – that there is no protection because the trigger could potentially cause a default or bankruptcy ***adversely affecting all creditors.***

In general, rating triggers may result in downward rating pressure depending on their severity, the underlying facts and circumstances surrounding the credit, the rating of the issuer and the distance to the trigger. For the most part, Moody's ratings factor in the existence of the triggers that have been disclosed to us and which serve as the basis of this report. We do not expect rating actions solely based on the existence of these disclosed triggers. However, some of the more risky triggers can exacerbate a ratings downgrade made for fundamental reasons. Moody's will not forebear from taking a rating action because of the potential adverse consequences resulting from the existence of a ratings trigger.

We have observed that not only are rating triggers most often used in agreements for low investment grade and crossover credits, but also that the most consequential rating triggers which result in default, acceleration, early amortization or puts often occur when a company's ratings fall below Investment Grade.

We found that a very low percentage of triggers were disclosed in the SEC filings of the responding issuers. Nearly 87.5% of responding companies whose debt is rated Ba1 or higher reported that they had rating triggers. According to information supplied by these companies, only 22.5% of the triggers were disclosed in their SEC filings. Some of the most problematic triggers may not be disclosed as more than half of the disclosed triggers related to pricing grids.

Going forward, Moody's will highlight, where possible, the existence of rating triggers in each issuer's financial structure. Although Moody's will not disclose the particulars of any undisclosed triggers due to confidentially constraints, we will factor the effects of each rating trigger (whether or not publicly disclosed by the issuer) into the rating. An issuer's refusal to provide information about its rating triggers to Moody's will be considered a negative factor in the ratings process.

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Introduction

In December 2001, Moody's published a report entitled "*The Unintended Consequences of Rating Triggers*".¹ In that report Moody's identified various forms of rating triggers and described how they work, when they are employed, and how they can have unexpected – and sometimes highly disruptive consequences for issuers and creditors alike. In connection with that report and as part of Moody's stepped-up approach to the analysis of rating triggers, Moody's undertook a comprehensive review of all rating triggers. This report summarizes our findings to-date for all non-financial issuers of rated US corporate debt. A separate piece will be issued shortly for all non-financial issuers of rated European corporate debt.

MOODY'S INFORMATION REQUEST ON RATINGS TRIGGERS

In December 2001, Moody's asked nearly 1,900 US corporate issuers of rated debt to provide a list of all rating triggers contained in all "on-balance sheet" and "off-balance sheet" financial arrangements whether rated or not rated, as well as triggers included in contracts covering other agreements with third parties. The request was made to all issuers irrespective of rating and amount of rated debt. We further asked the issuers to reference the amount of debt involved and the possible effect of each rating trigger.

In this context, we defined ratings triggers broadly to include clauses or agreements the effect of which:

- (1) depend upon rating actions, or
- (2) relate to events which would result in the termination or acceleration of credit availability.

We furnished a sample list of agreements (set forth below) in which rating triggers may be found. This list was not intended to be all-inclusive, and we asked that issuers identify any and all triggers irrespective of whether they are included on this list.

On Balance Sheet Financial Arrangements

- CP back-stop lines
- Revolving Credit and Term Loans
- Indentures

Off-Balance Sheet Financial Arrangements

- Securitization Agreements
- Liquidity Trust Vehicles
- Special Purpose Vehicles
- "Minority Interest Transactions"
- Sale-and-Leaseback Arrangements

Financial Contracts

- Swap Agreements
- Derivatives
- Counterparty Trading Agreements

Corporate Governance Agreements

- Joint-Venture Agreements
- Shareholder Agreements
- Partnership Agreements

Agreements with Third Parties

- Vendor Financing

1. Pamela M. Stumpp, "The Unintended Consequences of Rating Triggers". Moody's Investors Service, December 2001.

Asset Purchase Agreements

Asset Divestiture Agreements

Servicing Agreements or other agreements of an operational nature

In addition to the schedule of such triggers, we asked that issuers provide us with all relevant documentation governing triggers presently in force for the company and subsidiaries, and an indication as to which triggers have been disclosed in SEC filings.

THE RESPONSE RATE

Table #1 shows the response rate to Moody's request for information on ratings triggers. The issuer count includes a number of subsidiary companies in the telecommunications, media and power and energy sectors that have rated debt. To-date, the combined response rate for all rated issuers covered by Moody's US Corporate Finance Group is 94.5%. The response rate excludes a limited number of non-responding issuers whose debt ratings are below B1. Importantly, 97.6% of issuers whose debt is rated Ba1 or higher have responded, and 91.9% of issuers whose debt is rated below Ba1 have responded. Moody's continues to follow-up with those few companies who have yet to respond. While the quality and quantity of any issuer's disclosure to Moody's will be held confidential, lack of disclosure by an issuer about its rating triggers is considered to be a negative factor in our analysis.

Table 1: Issuer Response Rate to Moody's Information Request On Rating Triggers

Total Number of Issuers Contacted	1,867
Total Number of Issuers Responding	1,639
Total Number of Non-Respondents	228
Total Number of Non-Respondents Rated Below B1	133
Effective Combined Response Rate	94.5%
<u>Issuers With Debt Rated Ba1 or Higher</u>	
Total Number of Issuers Contacted	790
Total Number of Issuers Responding	771
Total Number of Non-Respondents	19
Response Rate – Ba1 and Higher	97.6%
<u>Issuers With Debt Rated Below Ba1</u>	
Total Number of Issuers Contacted	1,077
Total Number of Issuers Responding	868
Total Number of Non-Respondents	209
Total Number of Non-Respondents Rated Below B1	133
Response Rate – Below Ba1	91.9%

HOW COMPANIES HAVE RESPONDED

The level of detail provided by issuers varied widely. A number of companies provided very detailed responses while others provided summary information. Interestingly, the financial staffs of some companies viewed our inquiry as an opportunity to conduct extensive internal document reviews in order to determine their exposures to rating triggers. Some companies found triggers that they were previously unaware of and some reported that following internal reviews they implemented controls regarding the incurrence of new rating triggers.

A number of rated issuers, including **Dynergy, Inc.**, **El Paso Corp.** and **The Williams Companies** have announced and have followed through (or are following through) on refinancing debt in order to remove certain consequential rating triggers. However, expunging rating triggers can be a complex and expensive undertaking. **Northern Border Partners** (“NBP”), for example, determined that it would be too costly to remove a risky rating trigger in its \$475 million senior notes indenture. The indenture requires that NBP offer to repurchase the notes in the event that NBP's rating from either Moody's or Standard & Poor's falls below investment grade; however, a tender offer for the notes would constitute an event of default

under its existing bank credit agreement. The only way for NBP to rectify the situation would be to refinance or renegotiate the terms of its credit facility, a step that the company is not willing to take at this point.

SCOPE OF THE ANALYSIS – FOCUS ON ISSUERS WHOSE DEBT IS RATED BA1 OR HIGHER

Our study focuses on the data provided by 771 responding companies whose debt is rated Ba1 or higher. These companies have higher average ratings relative to all issuers rated by Moody's Corporate Finance Group. Ninety-six, or 12.5%, of the companies reported that they have no rating triggers. The remaining 675 companies, or 87.5%, reported an aggregate of 2,819 rating triggers that could produce 3,681 consequences or "effects". This population provides a good basis for evaluation because it captures the bulk of consequential rating triggers. We have observed that not only are rating triggers most often used in agreements for low investment grade and crossover credits, but also that the most consequential rating triggers which result in default, acceleration, early amortization or puts often occur when a company's ratings fall below Investment Grade.

Number of Responding Issuers Whose Debt is Rated Ba1 or Higher	771
Number of Issuers Reporting Rating Triggers	675
Total Number of Rating Triggers	2,819
Total Number of Effects	3,681

TRIGGER COUNT LIKELY UNDERSTATED

The trigger count is actually understated for this group because some companies did not specify the total number of trigger incidences, particularly those for swap and lease agreements, citing instead "multiple occurrences" without providing numerical specificity. Additionally some companies provided detailed information on triggers existing in commercial agreements, while other companies provided no information relating to commercial agreements. For these reasons, including the fact that some companies were less precise in their response, we think that the number of rating triggers communicated to us is understated.

ONE RATING TRIGGER MAY PRODUCE MORE THAN ONE EFFECT

Rating triggers can sometimes have multiple effects with escalating severity as the company's ratings are further downgraded.

For example, some swap agreements contain rating triggers that can produce three effects as the underlying rating drops down the rating scale: (1) pricing grids that call for higher pricing, (2) requirements for collateral to be posted when the ratings are lowered to the next rating trigger level, and (3) termination of the swap if the company's ratings are further downgraded.

Accounts receivable securitizations can also contain triggers that produce multiple effects. **WorldCom, Inc.** had a two-step rating trigger (which no longer exists) in its former \$2 billion accounts receivable securitization program. The first trigger effect occurred when the company's rating fell below Baa2 by Moody's or BBB by Standard & Poor's, upon which the company was required to establish a dilution reserve. The second trigger effect occurred if the company's rating fell below Baa3 by Moody's or BBB- by Standard & Poor's, at which point the company's ability to sell receivables into its securitization program would be terminated unless the agreement was amended. Thus, for purposes of our analysis, the type of trigger contained in WorldCom's former securitization program would be considered as "one trigger" with "two effects".

MOST COMMON TRIGGER EFFECTS – HOW THEY WORK AND SEVERITY OF IMPACT

Rating triggers vary in severity, from a requirement to reset pricing on a borrower's obligations (not very risky) to a perilous trigger intended to precipitate a loss of availability under credit lines, events of default, acceleration or "puts" (very risky). The liquidity implications of rating triggers can be very negative – a backup revolving credit that goes away in the event of a downgrade below a certain level, or a large bond that can be "put" in the event of a downgrade are potentially life-threatening. Such triggers exacerbate liquidity strains at the precise moment when an issuer is least able to deal with such problems. Investors who think that they might be protected by a rating trigger contained in their respective agreement may well find – as in

recent cases – that there is no protection because the trigger could potentially cause a default or bankruptcy **adversely affecting all creditors**.

We categorized the 3,681 trigger effects into broadly defined groupings. Table 2 lists the groupings in descending order of occurrence.

Table 2: Trigger Effects In Descending Order Of Occurrence

Trigger Effect	Total Number Of Trigger Effects	Percent Of Total Effects
Collateral/LC/Bonding Provision	794	21.6%
Pricing Grid	776	21.1%
Self-Insurance Limitation	440	12.0%
Termination Event (mainly associated with ISDA agreements)	313	8.5%
M&A	256	7.0%
MAC	197	5.4%
Default	194	5.3%
Acceleration	148	4.0%
Put	110	3.0%
Early Amortization of A/R Facilities	108	2.9%
Covenant Kick-In	53	1.4%
Disclosure (must notify lenders/counterparties of downgrade)	50	1.4%
Covenant Release	22	0.6%
Springing Lien	20	0.5%
Dilution Reserve (associated with A/R Securitizations)	18	0.5%
Conversion to Equity	18	0.5%
Guarantee Replacement	10	0.3%
Change of Servicer or Counterparty	9	0.2%
Other	145	3.9%
Total	3,681	100%

The following describes each of the trigger effects and their related severity of impact on the issuer.

1. Collateral – L/C - Bonding Provision – 21.6% Of Total Trigger Effects

This category includes triggers that require the borrower to post letters of credit, collateral, a surety bond, or some other acceptable form of security enhancement to guarantee performance. These triggers are found in many different types of agreements such as ISDAs, commercial agreements, sale and leaseback agreements, accounts receivable securitizations, and bond indentures.

These triggers could cause a problem if the requirement to collateralize an exposure conflicts with a negative pledge clause or a limitation on liens provision contained in a credit agreement or a bond indenture. For example, rating triggers contained in ISDA agreements may require an issuer to post collateral upon a downgrade in conflict with the negative pledge provisions contained in a credit agreement or a bond indenture.

2. Pricing Grid – 21.1% Of Total Trigger Effects

Pricing Grids constitute the most widespread single form of ratings triggers and can be found in a variety of agreements, from lease agreements to swap agreements, but are most commonly found in bank credit agreements.²

Credit agreements containing ratings based “pricing grids” are constructed to tie pricing on a borrower’s loans to the inherent credit risk as manifested by the ratings. Rating triggers contained in pricing grids are less risky than other forms of triggers. However, such triggers can result in a material increase in the cost of borrowing co-incident with a ratings drop and can exacerbate a company’s ability to comply with its covenants, thereby adversely affecting a borrower’s access to its liquidity facility at a time when availability is most needed.

3. Self-Insurance Limitation – 12.0% Of Total Trigger Effects

Certain lease agreements contain rating triggers whereby a ratings downgrade below a certain rating would eliminate a company’s ability to self-insure and require that the company purchase 3rd party insurance.

2. Note that category #1 above aggregates several types of rating triggers.

This trigger effect could result in higher insurance expense for a company at a time when it can least afford the additional outlay. One company with multiple retail units, each of which has a separate lease arrangement with a trigger, represents a large part of this category and thus overstates the frequency of this trigger.

4. Termination Event – 8.5% Of Total Trigger Effects

Termination events are mainly effects of triggers located in swap agreements, wherein a downgrade of a company's ratings to below investment grade would result in termination of the swap agreement and payment of any out-of-the-money positions.

5. M&A – 7.0% Of Total Trigger Effects

Various types of agreements such as bank credit agreements, ISDAs, lease agreements, accounts receivable securitizations, bond indentures, etc. contain triggers which cause acceleration of debt, termination of an agreement, or enable creditors to "put" their notes back to the issuer if there is a change of control or spin-off. In some cases the trigger is tripped if the borrower merges with a lesser-rated entity, merges with a non-investment grade company, or if the issuer's ratings are downgraded subsequent to the consummation of a merger.

Although this trigger appears insignificant because the company has direct control over whether or not the trigger is tripped, the perverse effect is that such triggers could actually delay or discourage beneficial corporate actions from taking place.

For example, **AT&T Corp.** (Baa2 - negative) plans to separate its cable TV business from its telephone business with the expectation that a significant portion of AT&T's existing debt will stay with the telephone business. AT&T's \$8 billion bank credit facility includes a covenant that requires the company, among other conditions, to maintain a rating on its senior unsecured debt of at least Baa1 from Moody's and BBB+ from Standard & Poor's in order to access its credit facility subsequent to the spin-off. Since its long-term debt is currently rated Baa2 at Moody's, the company is in the process of renegotiating its credit facility because under present terms the company can not conclude the spin-off and have access to its credit facility.

6. MAC (Material Adverse Change) – 5.4% Of Total Trigger Effects

While not explicitly a rating trigger, MACs are a form of "conditionality" that can abruptly curtail a company's access to cash just at the time when it is most needed. MACs can result in default and or an acceleration of debt and can be extremely problematic for a company.

MACs are contained in many credit agreements, bond indentures, and merger agreements. In some cases MACs only apply upon the consummation of an acquisition or at the initial sale of various debt instruments. Other times, the MAC is applicable each time the company draws on its line of credit.

Our findings in this category are likely understated due to the fact that not all companies have viewed MACs as being comparable to a rating trigger. Thus, some companies did not include MACs in their response to our inquiry.

7. Default – 5.3% Of Total Trigger Effects

Default is an effect of a tripped rating trigger in a variety of different types of agreements whereby the borrower loses access to a line of credit or some other form of funding and may enable the creditor to "put" or accelerate the debt. This is a very risky trigger effect because the company does not have access to funding at a time when it is most needed.

8. Acceleration – 4.0% Of Total Trigger Effects

Acceleration occurs when a bank line of credit must be fully repaid prior to maturity as a result of a ratings downgrade. Depending on the particular circumstances, this effect could trigger amounts due under other agreements. Acceleration can have major adverse consequences on all creditors.

9. Put – 3.0% Of Total Trigger Effects

In certain instances bond indentures may incorporate rating triggers that allow noteholders to "put" the notes back to the issuer if the company's ratings are downgraded to a specified level. The debt obligations

are due and payable by the company within a short period of time. A large bond that is puttable can potentially be fatal to a company.

10. Early Amortization Of Accounts Receivable Securitization Facilities – 2.9% Of Total Trigger Effects

Early amortization of an accounts receivable securitization program is most commonly an effect if a company's ratings are lowered to non-investment grade. Lenders stop purchasing new receivables from the company, which can be problematic for a company that relies on its accounts receivable securitization facility as a core and continuing source of financing. Since companies can no longer sell their receivables under their existing programs, they need to either amend the terms of their programs or obtain alternate sources of funding. Refinancing may require reclassification of an otherwise "off-balance sheet" to an "on-balance sheet" treatment.

11. Covenant Kick-In – 1.4% Of Total Trigger Effects

Bank agreements and bond indentures at times contain triggers that cause particularly restrictive covenants to spring into effect if the company's ratings drop to a predetermined level. The covenant kick-in often occurs when the company's ratings cross the threshold from investment grade to non-investment grade. Often these covenants relate to dividend limitations and restricted payments provisions. Depending on how restrictive the covenants are, compliance may be difficult.

12. Disclosure – 1.4% Of Total Trigger Effects

Various agreements such as bank agreements, CP backstop facilities, accounts receivable securitizations, bond indentures and lease agreements contain rating triggers that require notification of a ratings downgrade to the lender or trustee. Notification is a relatively minor trigger.

13. Covenant Release – 0.6% Of Total Trigger Effects

This trigger is the opposite of the covenant kick-in and usually occurs when a company's ratings are upgraded from non-investment grade to investment grade status. Upon upgrade, certain covenants fall-away. Restricted payments provisions (designed to protect the bondholders against material decapitalization) and limitations on subsidiary debt are examples of covenants that sometimes fall-away once the bonds are rated investment grade. Occasionally these triggers will contain a clawback, which would reinstate the covenants that were released if the company's ratings were subsequently lowered to non-investment grade.

Elimination of material covenant protection once a credit reaches the Baa3 level can be abrupt for credits at the early stage of investment grade when their credit profiles are still moderately fragile.³ Fall-away of these important covenants and guarantees once a bond is rated investment grade may possibly constrain upgrades to such levels.

14. Springing Liens – 0.5% of Total Trigger Effects

Bank agreements on occasion contain springing liens. The springing liens may be on inventory, accounts receivable, or other identified assets and become effective when the borrower's ratings are downgraded to a predetermined level, often below investment grade. This trigger can be detrimental to a company if the springing lien leaves the company without unencumbered assets at a time when it has little borrowing availability. Additional financing would be hard to come by without available assets to pledge to prospective lenders.

Some springing liens may trip even if the company is investment grade. For example, **Motorola Inc.'s** \$1 billion five-year revolving credit agreement contains a rating trigger in which a lien on domestic receivables and inventories would be triggered if Moody's rating falls below Baa2 or BBB.

3. Pamela M. Stumpp, "Indenture Covenants Are Important – But Protective Attributes Are Eroding In This Late Stage Of The Credit Cycle". Moody's Investor Service, June 1998.

A downgrade based on a company's changing fundamentals may trip the springing lien requiring that a portion of the debt be secured. This may result in an additional ratings impact due to the effective subordination of existing unsecured debt to the newly collateralized secured debt. This can create a material ratings cliff as the unsecured debt may be downgraded an additional one or more notches, depending on the amount of secured debt vis-a-vis total debt and the issuer's overall ratings profile.

15. Dilution Reserve – 0.5% Of Total Trigger Effects

Accounts receivable securitization programs sometimes have triggers that require the company to set up a dilution reserve, or if it already had a reserve in place to increase the level of funding of the reserve to support the receivables being purchased. A significant reserve payment could put pressure on a company's liquidity just at the time when the company most needs the cash.

16. Conversion To Equity – 0.5% Of Total Trigger Effects

Some convertible bonds have triggers that give noteholders the right to convert their notes to equity. The issuer would have to issue equity to satisfy the noteholders' right to convert, thus resulting in equity dilution.

17. Guarantee Replacement – 0.3% Of Total Trigger Effects

Various types of agreements, such as lease agreements, commercial agreements, bank agreements, etc. require that the agreement be guaranteed by a third party – oftentimes the parent company – and if the parent company's rating falls below a specified threshold (most often below investment grade), the subsidiary would be required to find a replacement guarantor.

18. Change Of Servicer – 0.2% Of Total Trigger Effects

These triggers are mainly found in securitizations and entail a change in servicer of the securitized assets. The servicing primarily includes the duties of monitoring and tracking all assets and collecting receivables from obligors. For example, in accounts receivable securitizations, the originating companies usually act as the servicer and collection agent for receivables, but when downgraded, the bank has the right to choose another party to act in these capacities.

This trigger has a beneficial effect for investors in asset backed securities because it gives the securitization agent the right to assign the collection of the receivables to a third party, if the originator servicer is perceived not to be doing an adequate job, or if these functions could materially deteriorate upon a bankruptcy of the originator servicer. Transferring of servicing is a severe and unusual occurrence in securitizations and is often only invoked as a precursor to liquidation. From the originator's perspective, the effect of this trigger is to lose the fee income associated with the servicing as well as control with respect to the underlying accounts receivables.

19. Other – 3.9% Of Total Trigger Effects

“Other” consists of those trigger effects that are company-specific and/or unique. This category contains triggers with a variety of obscure effects. The triggers are located in many different types of agreements. Some examples are:

In one case, a joint venture agreement between two parties contains a rating trigger that gives Partner A the option to put its equity in the JV to Partner B if Partner B's rating falls below a specified level.

In a commercial agreement, if the company is downgraded to non-investment grade, the company's certification to do business in a particular State could be repealed.

HOW DO TRIGGERS CORRELATE WITH RATING LEVELS?

Table 3 lists the breakdown of triggers and effects by rating for the 675 companies reporting that they have rating triggers.

Table 3: Breakdown Of Triggers And Effects By Rating Category

Moody's Rating	Number Of Companies	Number Of Effects	Percent Of Total Effects	Number Of Triggers	Percent Of Total Triggers	Triggers Excluding Company With 404 Triggers	Percent Of Total Triggers
Aaa	8	19	0.5%	16	0.6%	16	0.7%
Aa1	4	27	0.7%	19	0.7%	19	0.8%
Aa2	5	53	1.4%	27	1.0%	27	1.1%
Aa3	25	100	2.7%	65	2.3%	65	2.7%
A1	37	212	5.8%	143	5.1%	143	5.9%
A2	92	806	21.9%	702	24.9%	298	12.3%
A3	87	593	16.0%	375	13.3%	375	15.5%
Baa1	113	540	14.7%	434	15.4%	434	18.0%
Baa2	146	601	16.3%	483	17.1%	483	20.0%
Baa3	114	466	12.7%	350	12.4%	350	14.5%
Ba1	44	264	7.2%	205	7.3%	205	8.5%
Total	675	3,681	100%	2,819	100%	2,415	100%

Overall, the majority of rating triggers (90.4% of total triggers) are found in the Ba1 to A2 rating range and are most frequently located in bank agreements, ISDA agreements, lease agreements, commercial agreements and bond indentures.

Pricing grids and collateral /LC/bonding provision, are the most common effects in the Ba1 to A2 category, representing 44% of the 3,270 effects in this rating range. Also, termination, default, acceleration, put and early amortization, problematic rating triggers, represent a noteworthy 22% of trigger effects in the Ba1 to A2 rating category.

- The highest occurrence of triggers in any one rating category is in the agreements of A2 rated companies (24.9% of total triggers); however, this is attributable to a single company that has 404 rating triggers of which 402 are related to sale-leaseback transactions. If we exclude this one company with 404 triggers, the largest percentage of triggers (20.0% or 483 triggers) is found in agreements of companies rated Baa2.

But higher rated investment grade credits also have rating triggers.

- 127 triggers creating 199 effects were found in the highest rating range (Aaa to Aa3), -- 65% of those triggers creating 100 effects were triggers of Aa3 rated companies, the majority of these 127 rating triggers were located in bank agreements (35%) and ISDAs (22%), and the effects of these triggers ranged from collateral provision and pricing grids (31% of the 199 effects) to the more severe termination of ISDA agreements and default and/or acceleration of bank lines of credit (38% of the 199 Aaa to Aa3 effects).

WHAT DOCUMENTS MOST COMMONLY CONTAIN TRIGGERS?

Table 4 lists the most common agreements in which rating triggers were found in our study; the total number of trigger occurrences in each category; and the number of triggers found in each category as a percentage of the total trigger count.

Triggers can be found in many different types of agreements. However, nearly 92% of the rating triggers reported to Moody's are contained in bank agreements and CP backstop facilities, sale and leaseback agreements, swap agreements, commercial agreements, bond indentures, lease agreements, and accounts receivable securitizations.

Table 4: Agreements In Which Triggers Were Found

Trigger Location	Total Number Of Triggers	Percentage Of Total Triggers
Bank Agreements/ CP Backstop Facilities	868	30.8%
Sale Leaseback Agreements	433	15.4%
ISDA/Swap/Hedge/Derivative	391	13.9%
Commercial Agreements	295	10.5%
Bond Indentures	231	8.2%
Lease Agreements	230	8.2%
A/R Securitizations	141	5.0%
Project Financings	22	0.8%
Environmental/Regulatory	19	0.7%
Support Agreements	18	0.6%
Supply Agreements	18	0.6%
Convertible Bond Indentures	18	0.6%
Preferred Stock	16	0.6%
Other	119	4.2%
Total	2,819	100.0%

OBSERVATIONS

Pricing grids constitute the majority of rating triggers found in **bank agreements** and **commercial paper backstop facilities**. Default, acceleration and MACs associated with loan agreements and CP backstop facilities are not as common, but extremely risky and can result in an abrupt decline in confidence and liquidity.

In some instances triggers based on a company's ratings are incorporated into loan covenants. This is the case more often in the loan agreements of lower rated investment grade companies and can place restrictions on uses of cash. In one example, 50% to 100% of excess cash flow is captured until 6 months of fixed charges are accumulated. In another, new debt or equity proceeds from asset sales must permanently reduce the company's credit line. Restrictions on subsidiary debt and cash flow sweeps are other covenants that can be triggered if a company's ratings are downgraded.

There is a single retail company that represents 402 or 92.8% of the 433 total **sale-leaseback agreements** with rating triggers. The 402 sale-leaseback transactions are of the company's retail stores and distribution centers. If the trigger were tripped, the company would be required to purchase 3rd party insurance instead of self-insuring.

Rating triggers are also used in **commercial agreements** and **supply agreements** to govern the relationship between a company and parties with whom it conducts business. Power purchase and sale agreements and gas supply agreements are examples of agreements included in the commercial/supply category. It is important to note that commercial/supply agreements are often company specific and relate to a unique set of circumstances related to the particular companies involved in the agreement. Commercial and supply agreements are often at the heart of a company's ability to operate, and triggers can have a material financial impact. Those that result in termination of such agreements could even put the company out of business.

For example, smaller and more financially vulnerable airlines implicitly or explicitly have triggers with credit card companies that require an increase in cash holdbacks as their ratings fall. These exist to protect the card processor in the event that charge-backs are necessary due to ticket cancellation. Some carriers have triggers written into their agreements with credit card processors requiring an increase in unrestricted cash balances as their ratings fall or otherwise cash holdbacks increase. These triggers can have a material cash flow impact on such carriers.

Benefits Programs on occasion include rating triggers. For instance, the deferred compensation plan of an issuer whose debt is rated A1 states that if its rating falls below investment grade by both rating agencies, the deferred compensation balance is immediately payable in a lump sum (participants may elect to receive all cash). According to the company's amendment to its deferred compensation plan, if its rating falls below investment grade by both rating agencies and no change of control takes place, then unpaid compensation and accrued death benefits must be transferred into a trust immediately. The company also has a supplemental retirement plan for officers, which is effective during the period in which its ratings are below

Investment Grade. This supplemental retirement plan includes annual payments to each officer participant under the Plan equal to his/her retirement income.

Other obscure rating triggers are located in the **Environmental/Regulatory** category. This group of rating triggers spans into environmental or governmental regulation. The following are examples:

- In accordance with governmental regulations, a company must provide financial responsibility compliance reporting for the estimated costs of cleaning areas used for waste disposal or for areas with underground storage tanks. If the company’s ratings fall below investment grade, a letter of credit, surety bond, or outside insurance must be provided to cover the company’s outstanding exposure.
- In another case, mine and mill closure regulations in the Province of Ontario require companies, which can satisfy financial tests for self assurance, to provide bonding, letters of credit or other acceptable forms of security if their ratings fall below investment grade.

Some triggers are tied to events other than rating changes. While such forms of conditionally fall outside the explicit scope of this study, one such trigger, for example, allows holders of preferred stock to put the stock if the company’s founder passes away. The company would have 120 days to redeem the shares after the death of the founder.

THE NEED FOR HEIGHTENED DISCLOSURE – FEW TRIGGERS ARE DISCLOSED IN SEC FILINGS

We found that a very low percentage of triggers were disclosed in the SEC filings of the responding issuers. Table 5 shows that only 22.5%, or 635 of the 2,819 triggers were actually disclosed. The table also shows that 22.0% of the 810 corresponding trigger effects were disclosed. Moody’s relied on the information provided by each company in generating this data. Some companies reported that their triggers were disclosed in exhibits to SEC filings rather than directly in the SEC financial reports and in those cases we considered the trigger as disclosed for purposes of our analysis. It is possible, however, that the disclosure percentage is higher because some companies may not have realized that their triggers were contained in exhibits to their SEC filings.

The modest percentage of disclosed rating triggers is even lower if triggers relating to pricing grids – which in turn account for 51.8% of the disclosed triggers – are excluded. Excluding triggers used in pricing grids – a mere 10.9%, or 306 triggers, were disclosed.

Some companies, which have not disclosed triggers to date, have indicated that they intend to provide such disclosure in the future.

Table 5: Disclosure Of Rating Triggers In SEC Filings

Disclosure Rate Based on Triggers	
Number of Rating Triggers for Issuers Whose Debt is Rated Ba1 or Higher	2,819
Number of Triggers Disclosed In Issuers’ SEC Filings	635
Disclosure Rate	22.5%
Disclosure Rate Based on Trigger Effects	
Number of Effects for Issuers Whose Debt is Rated Ba1 or Higher	3,681
Number of Effects Disclosed In Issuers’ SEC Filings	810
Disclosure Rate	22.0%

RISKY TRIGGERS MAY NOT BE DISCLOSED

Table 6 categorizes the 810 trigger effects disclosed by issuers in their SEC filings.

From this data we observed the following major points about disclosure:

- A very large portion – 40.6% – of the trigger effects disclosed in SEC filings relate to pricing grids
- Some of the most problematic triggers may not be disclosed. Triggers that had the effect of Puts, MAC, Default, and Acceleration comprised only 186 or 23% of disclosed trigger effects. Moreover termination provisions or those provisions that reduce the availability of back up lines of credit typically are not disclosed
- Some of the most common triggers – such as those requiring the provision of collateral, posting of a bond or letter of credit are not likely to be disclosed
- Triggers associated with Accounts Receivable Securitizations – especially those requiring the payment of a dilution reserve are rarely disclosed
- Triggers contained in Commercial Agreements, which can be very significant to a company’s operations, are typically not disclosed
- The effects of triggers contained in agreements such as Counterparty Trading Agreements that may be entered into by a company and numerous other parties and which could produce material adverse consequences if cumulatively set-off but are typically not disclosed
- Triggers contained in Swaps and Derivatives are typically not disclosed

Table 6: Breakdown By Effect Of Triggers Disclosed In SEC Filings

	(1) Number Of Trigger Effects Disclosed In SEC Filings	(2) Percent Of Total Trigger Effects Disclosed In SEC Filings	(3) Total Number Of Trigger Effects	(1) / (3) Disclosed Effects/ Total Effects
Most Common Trigger Effects				
Collateral/LC/Bonding Provision	49	6.0%	794	6.2%
Pricing Grid	329	40.6%	776	42.4%
Self-Insurance Limitation	0	0.0%	440	0.0%
Termination Event (mainly associated with ISDA agreements)	16	2.0%	313	5.1%
M&A	69	8.5%	256	27.0%
MAC	68	8.4%	197	34.5%
Default	39	4.8%	194	20.1%
Acceleration	29	3.6%	148	19.6%
Put	50	6.2%	110	45.5%
Early Amortization of A/R Facilities	15	1.9%	108	13.9%
Covenant Kick-In	38	4.7%	53	71.7%
Disclosure (must notify lenders/counterparties of downgrade)	13	1.6%	50	26.0%
Covenant Release	13	1.6%	22	59.1%
Springing Lien	13	1.6%	20	65.0%
Dilution Reserve (associated with A/R Securitizations)	2	0.2%	18	11.1%
Conversion into Equity	15	1.9%	18	83.3%
Guarantee Replacement	6	0.7%	10	60.0%
Change of Servicer or Counterparty	1	0.1%	9	11.1%
Other	45	5.6%	145	31.0%
Total Trigger Effects	810	100%	3,681	

COMPANIES CAN HAVE MORE THAN ONE TRIGGER

Table 7 shows a breakdown of the 771 responding issuers whose debt is rated Ba1 or higher and the number of triggers contained in the agreements of each of the companies.

The table reflects three broad categories:

1. 96 companies, or 12.5% -- reported no triggers,
2. 369 companies, or 47.9% -- reported one or two triggers,
3. 306 companies, or 39.6% -- reported three or more triggers.

Interestingly 41 companies or 5% reported having 10 or more triggers.

The 96 companies that reported having no rating triggers had ratings that were scattered over the full Aaa – Ba1 spectrum.

Table 7: Distribution Of Triggers By Company

Company Count	Number of Triggers
96	0
209	1
160	2
93	3
70	4
27	5
33	6
17	7
14	8
11	9
41	10 or more
Total 771	

MOODY'S APPROACH TO RATING TRIGGERS

In general, rating triggers may result in downward rating pressure depending on their severity, the underlying facts and circumstances surrounding the credit, the rating of the issuer and the distance to the trigger. For the most part, Moody's ratings factor in the existence of the triggers that have been disclosed to us and which serve as the basis of this report. We do not expect rating actions solely based on the existence of these disclosed triggers. However, some of the more risky triggers can exacerbate a ratings downgrade made for fundamental reasons. Additionally, some rating triggers, such as those engendering springing liens, can result in multi-notch rating downgrades because of additional downward rating actions to recognize the effective subordination of existing unsecured debt to the newly secured debt. Moody's will not forebear from taking a rating action because of the potential adverse consequences resulting from the existence of a ratings trigger.

Going forward, Moody's will highlight, where possible, the existence of rating triggers in each issuer's financial structure. Although Moody's will not disclose the particulars of any undisclosed triggers due to the confidential nature of the information, it will factor the effects of each rating trigger (whether or not publicly disclosed by the issuer) into its ratings. An issuer's refusal to provide information to Moody's on rating triggers will be considered a negative factor in the ratings process.

Our analysis will examine whether those issuers whose agreements contain particularly risky rating triggers have the wherewithal to survive a downgrade to the specified trigger level and the consequences of the trigger.

In conducting its stress case analysis for those issuers that have truly risky rating triggers such as ratings-based default or acceleration provisions, or "puts" in back-up lines, indentures, and counterparty agreements, Moody's must assume that triggers which specify default or acceleration outcomes are set off, and that the underlying debt is "put" and or availability under the back-up credit line goes away. This means that the issuer must have the wherewithal to survive such a downgrade and the consequences of the trigger. The issuer must be able to repay its obligations including any accelerated debt without needing to borrow under the triggered back-up lines.

We will incorporate the serious negative consequences of those triggers in our ratings and in our research. For US Commercial Paper issuers, we will also comment on such triggers in our short-term opinions and Liquidity Risk Assessments to the extent that they are disclosed by the issuer.

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