Bond credit rating

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In investment, the **bond credit rating** represents the credit worthiness of corporate or government bonds. It is not to be confused with an individual's credit score. The ratings are published by credit rating agencies and used by investment professionals to assess the likelihood the debt will be repaid.

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Credit rating agencies

Credit rating is a highly concentrated industry with the two largest rating agencies — Moody's Investors Service, Standard & Poor's — having roughly 80% market share globally, and the "Big Three" credit rating agencies — Moody's, S&P and Fitch Ratings — controlling approximately 95% of the ratings business.[1]

Credit rating agencies registered as such with the SEC are "nationally recognized statistical rating organizations". The following firms are currently registered as NRSROs: A.M. Best Company, Inc.; DBRS Ltd.; Egan-Jones Rating Company; Fitch, Inc.; HR Ratings; Japan Credit Rating Agency; LACE Financial Corp.; Moody's Investors Service, Inc.; Rating and Investment Information, Inc.; and Standard & Poor's Ratings Services.

Under the Credit Rating Agency Reform Act, an NRSRO may be registered with respect to up to five classes of credit ratings: (1) financial institutions, brokers, or dealers; (2) insurance companies; (3) corporate issuers; (4) issuers of asset-backed securities; and (5) issuers of government securities, municipal securities, or securities issued by a foreign government.[2]

Credit rating tiers

The credit rating is a financial indicator to potential investors of debt securities such as bonds. These are assigned by credit rating agencies such as Moody's, Standard & Poor's and Fitch Ratings to have letter designations (such as AAA, B, CC) which represent the quality of a bond. Moody's assigns bond credit ratings of Aaa, Aa, A, Baa, Ba, B, Caa, Ca, C, with WR and NR as withdrawn and not rated.[3] Standard & Poor's and Fitch assign bond credit ratings of AAA, AA, A, BBB, BB, B, CCC, CC, C, D.

Moody's		S&P		Fitch		Rating description	
Long-term	Short-term	Long-term	Short-term	Long-term	Short-term		
Aaa	P-1	AAA	A-1+	AAA	F1+	Prime	Investment-grade
Aa1		AA+		AA+		High grade	
Aa2		AA		AA			
Aa3		AA−		AA−			
A1		A+	A-1	A+	F1	Upper medium grade	
A2		A		A			
A3	P-2	A−	A-2	A−	F2		
Baa1		BBB+		BBB+		Lower medium grade	
Baa2	P-3	BBB	A-3	BBB	F3		
Baa3		BBB−		BBB−			
Ba1	Not prime	BB+	B	BB+	B	Non-investment grade speculative	Non-investment grade aka high-yield bonds aka junk bonds
Ba2		BB		BB			
Ba3		BB−		BB−			
B1		B+		B+		Highly speculative	
B2		B		B			
B3		B−		B−			
Caa1		CCC+	C	CCC	C	Substantial risks	
Caa2		CCC				Extremely speculative	
Caa3		CCC−				Default imminent with little prospect for recovery	
Ca		CC					
		C					
C		D	/	DDD	/	In default	
/				DD			
				D			

Rating tier definitions

Moody's	Standard & Poor's	Fitch	Credit worthiness[4][5]
Aaa	AAA	AAA	An obligor has EXTREMELY STRONG capacity to meet its financial commitments.
Aa1	AA+	AA+	An obligor has VERY STRONG capacity to meet its financial commitments. It differs from the highest-rated obligors only to a small degree.
Aa2	AA	AA	
Aa3	AA−	AA−	
A1	A+	A+	An obligor has STRONG capacity to meet its financial commitments but is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligors in higher-rated categories.
A2	A	A	
A3	A−	A−	
Baa1	BBB+	BBB+	An obligor has ADEQUATE capacity to meet its financial commitments. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitments.
Baa2	BBB	BBB	
Baa3	BBB−	BBB−	
Ba1	BB+	BB+	An obligor is LESS VULNERABLE in the near term than other lower-rated obligors. However, it faces major ongoing uncertainties and exposure to adverse business, financial, or economic conditions which could lead to the obligor's inadequate capacity to meet its financial commitments.
Ba2	BB	BB	
Ba3	BB−	BB−	
B1	B+	B+	An obligor is MORE VULNERABLE than the obligors rated 'BB', but the obligor currently has the capacity to meet its financial commitments. Adverse business, financial, or economic conditions will likely impair the obligor's capacity or willingness to meet its financial commitments.
B2	B	B	
B3	B−	B−	
Caa	CCC	CCC	An obligor is CURRENTLY VULNERABLE, and is dependent upon favourable business, financial, and economic conditions to meet its financial commitments.
Ca	CC	CC	An obligor is CURRENTLY HIGHLY-VULNERABLE.
	C	C	The obligor is CURRENTLY HIGHLY-VULNERABLE to nonpayment. May be used where a bankruptcy petition has been filed.
C	D	D	An obligor has failed to pay one or more of its financial obligations (rated or unrated) when it became due.
e, p	pr	Expected	Preliminary ratings may be assigned to obligations pending receipt of final documentation and legal opinions. The final rating may differ from the preliminary rating.
WR			Rating withdrawn for reasons including: debt maturity, calls, puts, conversions, etc., or business reasons (e.g. change in the size of a debt issue), or the issuer defaults. [3]
Unsolicited	Unsolicited		This rating was initiated by the ratings agency and not requested by the issuer.
	SD	RD	This rating is assigned when the agency believes that the obligor has selectively defaulted on a specific issue or class of obligations but it will continue to meet its payment obligations on other issues or classes of obligations in a timely manner.
NR	NR	NR	No rating has been requested, or there is insufficient information on which to base a rating.

Investment grade

A bond is considered **investment grade** or **IG** if its credit rating is BBB- or higher by Standard & Poor's or Baa3 or higher by Moody's. Generally they are bonds that are judged by the rating agency as likely enough to meet payment obligations that banks are allowed to invest in them.

Ratings play a critical role in determining how much companies and other entities that issue debt, including sovereign governments, have to pay to access credit markets, i.e., the amount of interest they pay on their issued debt. The threshold between investment-grade and speculative-grade ratings has important market implications for issuers' borrowing costs.

Bonds that are not rated as investment-grade bonds are known as **high yield** bonds or more derisively as junk bonds.

The risks associated with investment-grade bonds (or investment-grade corporate debt) are considered significantly higher than those associated with first-class government bonds. The difference between rates for first-class government bonds and investment-grade bonds is called investment-grade spread. The range of this spread is an indicator of the market's belief in the stability of the economy. The higher these investment-grade spreads (or risk premiums) are, the weaker the economy is considered.

Criticism

Until the early 1970s, bond credit ratings agencies were paid for their work by investors who wanted impartial information on the credit worthiness of securities issuers and their particular offerings. Starting in the early 1970s, the "Big Three" ratings agencies (S&P, Moody's, and Fitch) began to receive payment for their work by the securities issuers for whom they issue those ratings, which has led to charges that these ratings agencies can no longer always be impartial when issuing ratings for those securities issuers. Securities issuers have been accused of "shopping" for the best ratings from these three ratings agencies, in order to attract investors, until at least one of the agencies delivers favorable ratings. This arrangement has been cited as one of the primary causes of the subprime mortgage crisis (which began in 2007), when some securities, particularly mortgage-backed securities (MBSs) and collateralized debt obligations (CDOs) rated highly by the credit ratings agencies, and thus heavily invested in by many organizations and individuals, were rapidly and vastly devalued due to defaults, and fear of defaults, on some of the individual components of those securities, such as home loans and credit card accounts.

Municipal bonds

Municipal bonds are instruments issued by local, state, or federal governments in the United States. Until April-May 2010 Moody's and Fitch were rating municipal bonds on the separate naming/classification system which mirrored the tiers for corporate bonds. S&P abolished dual rating system in 2000.

Default rates

The historical default rate for municipal bonds is lower than that of corporate bonds. The Municipal Bond Fairness Act (HR 6308),[6] introduced September 9, 2008, included the following table giving bond default rates up to 2007 for municipal versus corporate bonds by rating and rating agency.

Cumulative Historic Default Rates (in percent)

Rating categories	Moody's		S&P	
	Municipal	**Corporate**	**Municipal**	**Corporate**
Aaa/AAA	0.00	0.52	0.00	0.60
Aa/AA	0.06	0.52	0.00	1.50
A/A	0.03	1.29	0.23	2.91
Baa/BBB	0.13	4.64	0.32	10.29
Ba/BB	2.65	19.12	1.74	29.93
B/B	11.86	43.34	8.48	53.72
Caa-C/CCC-C	16.58	69.18	44.81	69.19
Investment Grade	0.07	2.09	0.20	4.14
Non-Invest Grade	4.29	31.37	7.37	42.35
All	0.10	9.70	0.29	12.98

A potential misuse of historic default statistics is to assume that historical average default rates represent the "probability of default" of debt in a particular rating category. However, [...] default rates can vary significantly from one year to the next and the observed rate for any given year can vary significantly from the average.[7]

Standard & Poor's One-Year Global Corporate Default Rates By Refined Rating Category, 1981-2008

Year	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B+	B	B-	CCC to C
1981	0	0	0	0	0	0	0	0	0	0	0	0	0	0	3.28	0	0
1982	0	0	0	0	0	0.33	0	0	0.68	0	0	2.86	7.04	2.22	2.33	7.41	21.43
1983	0	0	0	0	0	0	0	0	0	1.33	2.17	0	1.59	1.22	9.80	4.76	6.67
1984	0	0	0	0	0	0	0	0	1.40	0	0	1.64	1.49	2.13	3.51	7.69	25.00
1985	0	0	0	0	0	0	0	0	0	0	1.64	1.49	1.33	2.59	13.11	8.00	15.38
1986	0	0	0	0	0	0	0.78	0	0.78	0	1.82	1.18	1.12	4.65	12.16	16.67	23.08
1987	0	0	0	0	0	0	0	0	0	0	0	0	0.83	1.31	5.95	6.82	12.28
1988	0	0	0	0	0	0	0	0	0	0	0	0	2.33	1.98	4.50	9.80	20.37
1989	0	0	0	0	0	0	0	0.90	0.78	0	0	0	1.98	0.43	7.80	4.88	31.58
1990	0	0	0	0	0	0	0	0.76	0	1.10	2.78	3.06	4.46	4.87	12.26	22.58	31.25
1991	0	0	0	0	0	0	0	0.83	0.74	0	3.70	1.11	1.05	8.72	16.25	32.43	33.87
1992	0	0	0	0	0	0	0	0	0	0	0	0	0	0.72	14.93	20.83	30.19
1993	0	0	0	0	0	0	0	0	0	0	0	1.92	0	1.30	5.88	4.17	13.33
1994	0	0	0	0	0.45	0	0	0	0	0	0	0.86	0	1.83	6.58	3.23	16.67
1995	0	0	0	0	0	0	0	0	0	0.63	0	1.55	1.11	2.76	8.00	7.69	28.00
1996	0	0	0	0	0	0	0	0	0	0	0.86	0.65	0.55	2.33	3.74	3.92	4.17
1997	0	0	0	0	0	0	0	0.36	0.34	0	0	0	0.41	0.72	5.19	14.58	12.00
1998	0	0	0	0	0	0	0	0	0.54	0.70	1.29	1.06	0.72	2.57	7.47	9.46	42.86
1999	0	0	0	0.36	0	0.24	0.27	0	0.28	0.30	0.54	1.33	0.90	4.20	10.55	15.45	32.35
2000	0	0	0	0	0	0.24	0.56	0	0.26	0.88	0	0.80	2.29	5.60	10.66	11.50	34.12
2001	0	0	0	0	0.57	0.49	0	0.24	0.48	0.27	0.49	1.19	6.27	5.94	15.74	23.31	44.55
2002	0	0	0	0	0	0	0	1.11	0.65	1.31	1.50	1.74	4.62	3.69	9.63	19.53	44.12
2003	0	0	0	0	0	0	0	0	0.19	0.52	0.48	0.94	0.27	1.70	5.16	9.23	33.13
2004	0	0	0	0	0	0.23	0	0	0	0	0	0.64	0.76	0.46	2.68	2.82	15.11
2005	0	0	0	0	0	0	0	0	0.17	0	0.36	0	0.25	0.78	2.59	2.98	8.87
2006	0	0	0	0	0	0	0	0	0	0	0.36	0	0.48	0.54	0.78	1.58	13.08
2007	0	0	0	0	0	0	0	0	0	0	0	0.30	0.23	0.19	0	0.88	14.81
2008	0	0	0.43	0.40	0.31	0.21	0.58	0.18	0.59	0.71	1.14	0.63	0.63	2.97	3.29	7.02	26.53

Summary statistic	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B+	B	B-	CCC to C
Mean	0	0	0.02	0.03	0.05	0.06	0.08	0.16	0.28	0.28	0.68	0.89	1.53	2.44	7.28	9.97	22.67
Median	0	0	0	0	0	0	0	0	0.08	0	0.18	0.83	0.86	2.06	6.27	7.69	22.25
Minimum	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Maximum	0	0	0.43	0.40	0.57	0.49	0.78	1.11	1.40	1.33	3.70	3.06	7.04	8.72	16.25	32.43	44.55
Standard Deviation	0	0	0.08	0.10	0.14	0.13	0.20	0.32	0.36	0.43	0.96	0.84	1.83	2.02	4.51	7.82	11.93

Standard & Poor's One-Year Global Structured Finance Default Rates By Refined Rating Category, 1978-2008

Year	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B+	B	B-	CCC to C
1993	0	0	0	0	0	0	0	0	0	0	0	0	0	0	6.25		0
1994	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1.85	0	0
1995	0	0	0	0	0	0	0	0	0.43	0	0	0.98	0	0	0.95	0	52.63
1996	0	0	0	0	0	0.15	0	0	0	0	0	0.61	12.50		0	0	31.03
1997	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	20.69
1998	0	0	0	0	0	1.04	0.91	0	0.19	0	0	1.03	0	0	2.34	0	22.58
1999	0	0	0	0	0	0	0.77	0	0	0.39	0	0	0	0	1.54	0	19.35
2000	0	0	0	0	0	0	0	0	0.11	0	0	0.61	0	0	2.19	0	5.26
2001	0.05	0	0	0	0	0.12	0	2.22	0	0.86	0.83	0.55	0.91	2.00	2.69	3.27	26.87
2002	0	0	0.06	0	0.27	0.14	0	1.77	0.19	0.70	1.26	2.03	1.12	2.50	3.60	23.24	27.03
2003	0	0	0	0	0.19	0.03	0.16	0.20	0.60	0.50	0.75	0.84	1.43	3.28	1.64	5.15	32.58
2004	0	0	0	0	0	0	0	0	0.16	0.17	0.50	0.81	0.29	0.79	2.23	3.56	13.79
2005	0	0	0	0	0	0	0	0	0.08	0.06	0.15	0.14	0.45	0.33	1.34	2.53	16.08
2006	0	0	0	0	0	0	0	0	0.06	0.20	0	0.33	0.36	0.26	0.36	1.42	19.18
2007	0.04	0.03	0.07	0.08	0	0.10	0.21	0.48	0.47	1.27	5.07	1.61	1.53	0.68	1.55	1.47	24.11
2008	0.53	0.35	0.57	1.15	1.15	0.87	1.42	2.27	1.26	3.45	5.60	4.21	5.07	8.53	12.84	10.28	56.92

Summary statistic	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B+	B	B-	CCC to C
Mean	0.02	0.01	0.02	0.05	0.06	0.08	0.14	0.37	0.16	0.38	3.56	0.81	1.24	1.22	2.18	2.83	16.73
Median	0	0	0	0	0	0	0	0	0	0	0	0.61	0	0.26	1.55	0	17.63
Minimum	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Maximum	0.53	0.35	0.57	1.15	1.15	1.04	1.42	2.27	1.26	3.45	57.14	4.21	12.50	8.53	12.84	23.24	56.92
Standard Deviation	0.09	0.07	0.10	0.23	0.23	0.24	0.35	0.76	0.29	0.78	12.39	1.02	2.90	2.20	2.93	5.59	16.60

See also

- Credit risk
- Default (finance)
- List of countries by credit rating

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7. "Understanding Standard & Poor's Rating Definitions" (PDF). standardandpoors.com.

External links

- "What Is A Corporate Credit Rating?" (http://www.investopedia.com/articles/03/102203.asp), Investopedia.com
- "As company priorities shift, fewer get AAA debt rating," USA Today (http://www.usatoday.com/money/companies/management/2005-03-15-aaa-usat_x.htm) (Mar 2005)
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