

CFA Trending Topics

Week of October 29, 2018

2. Global leveraged transactions: a shift to 3 credit rating agencies

Key Takeaways

- There is an increasing trend of obtaining credit ratings from all three major agencies (Moody's, S&P, and Fitch), particularly for large leverage finance transactions.
- The benefits of three ratings can be meaningful for bond and loan issuers, allowing broader access within the high yield index and CLO investor universe.

Refinitiv and Akzo Nobel Specialty Chemicals – two of the largest post-crisis LBOs – obtained ratings from each of S&P, Moody's and Fitch. A clear benefit of holding three ratings in both transactions was demonstrated by achieving 'B range' ratings on the junior notes from each of S&P and Fitch – this compares to Moody's providing 'Caa range' ratings on the notes. Crucially, having two out of three 'B range' instrument ratings made the notes eligible for 'B' indices and baskets for many investors. This would not have been possible if the same notes had only been rated with one 'B range' and one 'Caa range' rating. Allowing the junior debt to qualify as a 'B' instrument with investors helped create meaningful cost saving for the issuers.

In Europe, one third of €500m+ Term Loan B issuers in 2018 have published three ratings, a 9x increase from 2017. The value of obtaining three corporate ratings is partially driven by changes in CLO rating requirements. 80% of new 2018 European CLOs are Fitch + Moody's rated vehicles and therefore require the Term Loans in which they invest to be assessed by both of these agencies. This has resulted in Fitch loan ratings becoming more relevant for new CLO investors. By comparison, pre-2018 CLOs still typically require a combination of S&P + Moody's ratings before they can invest in a loan. Therefore, although it is not a necessity to obtain three ratings, larger Term Loan transactions can maximize market access by providing the investor base with three ratings.

The increasing presence and acceptance of Fitch across debt products is a positive development for issuers and investors. The trend of obtaining three ratings (or two of any three agencies) is likely to continue through 2019.

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