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DBRS Criteria: Guarantees and Other Forms of Explicit Support

It is a common occurrence for a parent company with a favourable credit rating to give some form of explicit support to a weaker subsidiary or affiliated company. If structured properly, the credit rating of the entity receiving support can be elevated to a level that would be unattainable on its own strength. There are generally three types of explicit support that DBRS will consider: guarantees, keepwell agreements (also referred to as credit support agreements) and comfort letters. If the explicit support provided is with respect to obligations other than those that are generally rated by DBRS (i.e., other than principal and interest), the requirements set out below may not apply.

Please note that this document is not intended to address circumstances in which DBRS may consider business and reputational interests that could motivate a parent or affiliated company to support an issuer. In the absence of such implicit considerations or in combination with explicit support, DBRS may look to the rating of the parent or related entity on the basis of such implicit support in appropriate circumstances.

Please note also that DBRS is a global rating agency that rates issuers in numerous countries. Legal systems and laws vary from jurisdiction to jurisdiction, meaning that this criteria may be modified where appropriate as required by local laws and precedents.

Guarantees

A financial guarantee is a contract under which a guarantor agrees to become responsible for the obligations of a principal debtor to a third-party creditor. Of the three forms of explicit support DBRS considers (i.e., guarantees, keepwell agreements and comfort letters), guarantees are preferred as they create a legally enforceable obligation on the part of the guarantor to pay the subsidiary's debt. This legally enforceable obligation of the guarantor may allow DBRS to rate the subsidiary at the same level as the guarantor, effectively relying on the rating of the stronger entity.

DBRS recognizes that each financial guarantee is unique and drafted to address specific circumstances. Therefore, while DBRS generally expects guarantees to display the following characteristics, each guarantee is reviewed on a case-by-case basis:

- The guarantee is an absolute, direct, irrevocable and unconditional obligation of the guarantor.
- The guarantee will not terminate until full payment of sum due. DBRS will consider language that allows the guarantor to terminate the guarantee only if the rating of the supported entity would not be negatively affected by such termination.
- The guarantee ranks senior to or *pari passu* with the guarantor's senior unsecured obligations.¹
- The guarantor waives all defences that would otherwise be available to guarantors and waives the enforceability or pursuit of the underlying obligation against the principal debtor.

1. On occasion, a guarantor will provide a guarantee that will rank equally with its subordinate debt. In these circumstances, any reliance of the guarantor's rating will be at the subordinate debt level.



- The guarantor waives all rights of subrogation, reimbursement, contribution, indemnified offset or participation against the principal debtor until the guaranteed obligations are paid in full.
- The trustee, on behalf of bondholders, is a party to the guarantee and the guarantee states that the guarantee is enforceable by the trustee on behalf of bondholders.
- The guarantee is binding on successors and assigns of the guarantor.
- A statement that the guarantor has received good and valuable consideration.
- The guarantee may not be amended or modified without the written consent of the third-party creditor relying on the guarantee.

In order to be satisfied that a guarantee incorporates these features, DBRS generally requires an opinion from counsel for the guarantor stating that the guarantee is an irrevocable and unconditional obligation of the guarantor, ranking equally with the senior unsecured debt of the guarantor, which is enforceable by the trustee on behalf of bondholders against the guarantor. If the guarantor is located in a jurisdiction other than the jurisdiction of the guarantee, DBRS will generally require an opinion that a judgment obtained under the guarantee is enforceable against the guarantor in the guarantor's jurisdiction.

DBRS recognizes that each guarantee is unique and drafted to address specific circumstances. Guarantees are therefore examined on a case-by-case basis.

Keepwell Agreements

Keepwell agreements between a parent company and subsidiary typically contain provisions whereby the parent agrees to maintain a given level of equity in the subsidiary or agrees to ensure that certain financial ratios are maintained by the subsidiary. Unlike a guarantee, a keepwell agreement does not create a legal obligation on the part of a parent to honour a subsidiary's debts and is therefore less likely to support full reliance on the parent's rating.

However, to the extent that a keepwell agreement contains obligations that are material to the financial strength of the subsidiary and provided that the agreement contains language to the effect that the obligations of the parent are enforceable by the trustee on behalf of bondholders, keepwell agreements are considered by DBRS and may result in support for a subsidiary's rating.

International Financial Institutions

DBRS also receives, from time to time, for rating purposes support agreements with respect to domestic financial institutions from foreign parents and affiliates. These agreements typically contain provisions that the parent will ensure that its domestic subsidiary will at all times satisfy regulatory capital requirements, along with a promise to provide any liquidity necessary to fulfil obligations to depositors or policyholders. A number of factors may allow DBRS to place greater weight on these agreements than it would for keepwell agreements for non-financial institution issuers, including the following:

- (1) The fact that, for a highly rated financial institution, allowing a subsidiary to fail could have severe ramifications on the entity's other operations.
- (2) Domestic financial institutions that are large borrowers need to take great care to maintain depositor and investor confidence.
- (3) Domestic financial institutions are regulated by authorities that closely monitor their financial health.



Comfort Letters

Unlike a guarantee or a keepwell agreement, a comfort letter is not a contractual agreement. As its name suggests, it is a letter that may be provided to creditors of a subsidiary borrower by the subsidiary's parent company. Comfort letters typically address the parent's current policies and intentions with respect to the subsidiary.

Comfort letters are the least preferred method of offering explicit support for a rating as jurisprudence suggests they are unenforceable and provide no legal basis on which a creditor can pursue a parent company to recover defaulted obligations of a subsidiary. Notwithstanding the lack of a legal obligation, reputation and commercial considerations may lead a parent to honour a subsidiary's debt. It is these factors that DBRS assesses when considering a comfort letter for ratings purposes.

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