



## Base Rating Information

### **(1) TYPES OF RATING SCALES**

DBRS assigns ratings to a wide variety of securities, and apart from certain “Issuer Ratings”, the common denominator is the fact that in all cases, the issuer has a financial obligation to the security holder under certain circumstances. This normally occurs through some combination of maintaining interest or dividend payments and paying off the principal at a specified future date.

DBRS uses five distinct rating scales in providing ratings for short-term debt (including commercial paper), long-term debt (including bonds), preferred shares (Canadian scale only), claims paying ability, and income fund stability. Additionally, the DBRS Structured Finance uses a servicer evaluation scale for certain transactions.

### **(2) CHOICE OF RATING SCALE FOR HYBRIDS ISSUED IN CANADA**

DBRS is often faced with securities that are not truly debt or equity, but have varying degrees of both characteristics. In addition to assessing how to treat these securities from a balance sheet perspective, DBRS must also decide which scale to use when assigning ratings. Considerations include the legal status of the instrument (whether it is referred to as preferred), how the investment community perceives the security, whether distributions are dividends or interest, quarterly or semi-annual, tax treatment of those distributions, the relative ranking of the issue in relation to outstanding preferred share issues and their ranking in liquidation.

Preferred share ratings that use the long term debt rating scale will be heavily influenced by the ranking of these instruments relative to other outstanding or potentially outstanding securities. In that respect, rating decisions will use many of the same rating philosophies used in rating subordinated debt and other more deeply subordinated debt issues, such as hybrids.

It should be noted that the choice of rating scale used and the degree to which DBRS views the instrument as debt or equity in the capital structure are not the same issue. Those preferred instruments that are afforded a debt rating could still have varying degrees of equity allocated to them in the analysis.

For further information please refer to the DBRS methodology - Treatment of Preferred Shares and Hybrids.



### **(3) RATING SPECIFIC SECURITIES VERSUS CLASSES OF SECURITIES**

While DBRS will often assign a rating to a specific security, many of its ratings are assigned by classes of securities. In general, the DBRS rating process focuses first upon the overall strength of the issuer, answering the question, “What is the correct rating that should be assigned to the most senior unsecured debt of this entity?” Once this has been established, DBRS then considers the specific ranking and covenants of the issuer’s outstanding securities. In the case of a new issue, DBRS will typically specify the name of the security in our press release, and our reports often note the securities within the general text (i.e. “Senior Debentures, Class A, Series 1,2,4 and 8”). Many ratings are assigned to an overall general obligation, but also apply to all the securities that make up that obligation. This reflects the fact that ratings for the individual series within a general class are typically the same and that where there are exceptions that occur, these would be noted by DBRS.

### **(4) THE TREATMENT OF SHELF PROGRAMS**

A shelf program is a filing with applicable regulatory bodies to issue debt in the future.

When DBRS assigns a rating to a new shelf program, these ratings are focused on the ranking of debt being rated, with consideration for covenants. A DBRS rating on a shelf program should not be taken to mean that the rating has built in the expectation of the issuer using the entire program once it is established. Similar to ratings on other debt obligations, DBRS has expectations and understandings of the issuer’s debt targets. The use of shelf programs cannot be viewed in isolation, but is part of the issuer’s overall balance sheet management, including short-term debt usage, new long term issues, share buybacks and off balance sheet actions (including securitizations).

### **(5) NON-CREDIT RISKS**

In general, DBRS ratings are focused on providing a measure of the issuer’s ability to meet its obligations in a timely manner. However, there are numerous non credit risks that can impact the performance of security instruments, particularly securities that are longer term in nature. These non credit risks are not captured in the rating as they do not normally translate into any increase in the probability of default. Non credit risks include market risk, non-cumulative covenants and hybrid features.

#### ***Market Risk***

Market risk is present in every investment decision. Some securities carry more market risk than others. Regardless of the level, however, DBRS does not see market risk as part of the credit risk that is the focus of our ratings and as such, DBRS ratings are not impacted by market risk considerations and provide no opinion on such.



## ***Non-Cumulative Risk***

The risk with non-cumulative securities is essentially no different than with cumulative securities unless there is a default situation, in which case, the non-cumulative shares have the added risk of missing dividend payments that have no potential of being made up in the future. However, non-cumulative shares do not have a higher risk of default than do equivalently ranking cumulative shares of the same issuer. DBRS ratings are meant to provide a measure of default risk and therefore, ratings for equally ranking cumulative and non cumulative issues of the same issuer will be identical. Investors should be aware of the fact that DBRS ratings do not consider the additional potential risk of loss that exists with non-cumulative issues, if default should occur.

## ***Hybrid Instruments***

There are situations where securities carry unique covenants that can add a variety of risks that are not captured in the DBRS rating. Examples of these include the ability to defer payments and the ability to fulfill payment obligations using securities and not cash. By definition, hybrids are instruments that combine certain characteristics of debt and equity, however these characteristics do not normally cause any change in the likelihood of default. Investors should be aware that these covenants could lead to a variety of scenarios that impact performance and other factors, but DBRS does not see these considerations as part of credit risk and as such, DBRS ratings are not impacted by hybrid covenants and provide no opinion on such.