RESERVE BANK OF NEW ZEALAND

March 2010

Know your

CREDIT RATINGS

Credit Ratings

The Reserve Bank is responsible for the prudential regulation of non-bank deposit takers (NBDTs). This includes deposit taking finance companies, building societies and credit unions.

NBDTs are required to have a credit rating from an approved rating agency by 1 March 2010.

Credit ratings from approved rating agencies will play an important role in the new regulatory arrangements as they can be used to assist investors to make more informed investment decisions.

What are credit ratings?

- Credit ratings are alphabetical indicators of the confidence you can have in a company's ability to pay back (in full and on time) all the money they have promised you.
- Credit ratings are published by a credit ratings agency and are based on detailed research and analysis.

What do I need to know about credit ratings?

- Ratings can be used to help you make better investment decisions. They allow you to compare the financial strength of institutions where you can invest your savings.
- A poor credit rating indicates a higher risk that you will not get your money back as promised (this failure to repay investors in full and on time is known as 'default'). You should expect that a 'riskier' company will offer a higher interest rate to compensate you for the additional risk you are taking on. But a higher rating (eg, AAA) does not remove all risk – it could still default in the future. However, you can be more confident that a company with a strong credit rating is less likely to default than a poorly rated one.

What are the limitations of credit ratings?

- Ratings will not always predict default perfectly. Failure is a possible outcome for even a highly rated institution.
- They can be slow to react to changes in a company's risk profile. Agencies do not adjust their ratings frequently as they take a long term view of a company's risk.
- The accuracy of the information a ratings agency gets on a company is not independently checked by audit. The agency relies heavily on information provided by the company under review and, without an audit, ratings agencies will not necessarily detect misleading information that is provided by mistake or by fraud.

Don't confuse …

…the letters used in credit ratings with the old school grades.. While a 'B' grade may look good on a school report, a single 'B' credit rating actually indicates a company with a 1 in 5 chance of default over five years.

… the terms. A high credit rating reflects a low credit risk, and vice versa.

A standardised rating scale

This table maps the rating scales of the three main credit rating agencies. As you can see, their scales are similar. You can also see from the table how an AAA rated company has a much lower risk of default (1 in 600 over five years) compared with a B rated company (1 in 5 over five years).

	Strength	***S&P Scale***	***Moody's Scale***	***Fitch Scale***	***Approx. probability of default over five years****
Capacity to make timely payment	Extremely Strong	AAA	Aaa	AAA	1 in 600
	Very Strong	AA	Aa	AA	1 in 300
	Strong	A	A	A	1 in 150
	Adequate	BBB	Baa	BBB	1 in 30
Vulnerability to non payment	Less Vulnerable	BB	Ba	BB	1 in 10
	More Vulnerable	B	B	B	1 in 5
	Currently Vulnerable	CCC	Caa	CCC	1 in 2
	Currently Highly Vulnerable	CC		CC	
	Default	D	C	D	

** The approximate median likelihood that an investor will not receive repayment on a five-year investment on time and in full based upon historical default rates published by each agency.*

Source: Adapted from Reserve Bank of New Zealand Bulletin*, Vol. 71, No. 3, September 2008, p. 57.*

So what's the conclusion?

The benefits of credit ratings are that they are widely available, are a simple measure of risk, and allow easy comparison of companies that you are looking to invest your savings in.

You should also consider your own personal circumstances (eg, your age, family situation, etc.), your appetite for risk, your personal strategies for investing, and the prevailing market conditions.

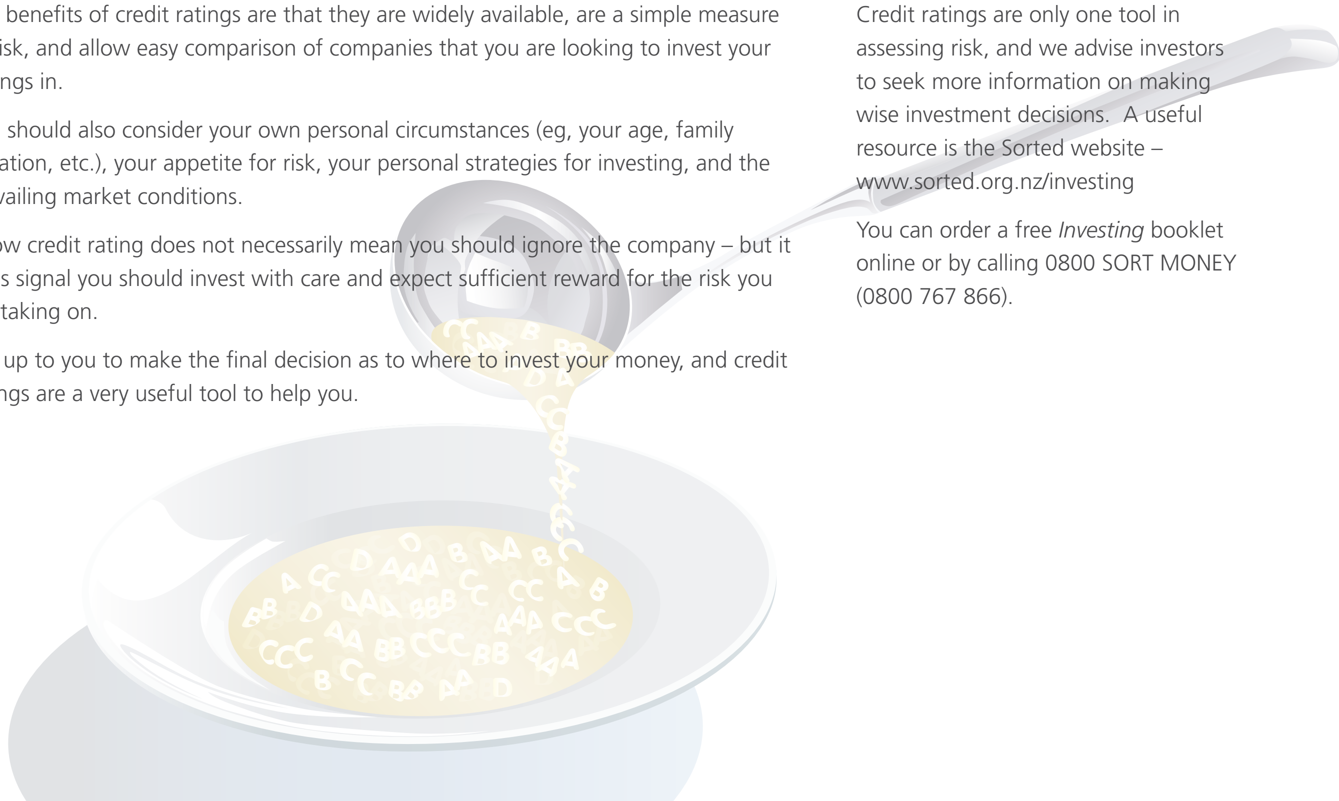
A low credit rating does not necessarily mean you should ignore the company – but it does signal you should invest with care and expect sufficient reward for the risk you are taking on.

It is up to you to make the final decision as to where to invest your money, and credit ratings are a very useful tool to help you.

More information

Credit ratings are only one tool in assessing risk, and we advise investors to seek more information on making wise investment decisions. A useful resource is the Sorted website – www.sorted.org.nz/investing

You can order a free *Investing* booklet online or by calling 0800 SORT MONEY (0800 767 866).



FOR MORE INFORMATION

Website: *www.rbnz.govt.nz*

Email: *rbnz_info@rbnz.co.nz*

Telephone: *64 4 472 2029*