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What's Happening With The Proposed U.S. Local Government Criteria? An Update On Feedback And Implementation

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Standard & Poor's Ratings Services would like to thank those who have provided feedback on our request for comment (RFC) on our proposed U.S. local government rating criteria.

Because of the importance and depth of the material, we actively reached out to a broad base of constituents to solicit reactions and feedback during the request-for-comment period. With our stated goal of transparency in developing criteria, we have synthesized the oral and written comments we received. Here, we will share some of those comments in an effort to apprise the market of many of the responses we have received. We are not in a position to comment on the final criteria. However, as we finalize the criteria, we currently expect to respond to these comments in one of three ways: by changing the criteria as we consider appropriate; by clarifying the original proposal where questions arose; or by leaving the proposals unchanged.

RFC-Related Outreach

We regularly interact with market participants to obtain feedback on our published criteria, ratings, and reports, and in certain cases request feedback on proposed criteria changes. Given the potential impact of the proposed criteria, we undertook a substantial effort to reach all types of constituents with an interest in U.S. local government ratings (investors, intermediaries, issuers, and so on) in a number of ways. We did this to raise awareness of the proposed criteria, to explain our goals, and to solicit feedback. In line with this effort, we populated a page on our public website (www.standardandpoors.com/pfcriteria) with the RFC and related articles. Our website contains supplemental resources, including videos, presentations, and a video of a case study--all intended to make it easier for our constituents to digest the many elements of the proposed criteria. We hosted roundtable discussions, one-on-one meetings, and hosted presentations so that our constituents had the opportunity to learn about the proposed criteria directly from our analysts and criteria officers and to address participants' questions and comments. Through these activities, we reached out to roughly 3,000 constituents.

We collected a large amount of informal feedback through these sessions in addition to the formal comments that were submitted directly to our CriteriaComments@StandardandPoor's.com email box.

Feedback Summary: Respondents liked transparency, had some concerns regarding the details

On March 6, 2012, Standard & Poor's published "Request for Comment: U.S. Local Governments: Methodology And Assumptions." At that time, we asked the public to respond to five specific questions and provide additional feedback as desired. The five questions were:

- Do you agree with our approach of using the same major factors to assign ratings to local and regional governments both inside and outside the U.S.?

- Do you agree with the underlying measures used to evaluate each factor? If not, how would you change the measures, and how would this change produce criteria more consistent with our ratings definitions (see "Understanding Standard & Poor’s Rating Definitions," published June 3, 2009)?
- Do you agree with the overriding factors that may cause a rating to differ from that resulting from the indicative rating?
- Are there other data sources that you believe should be considered before the criteria are implemented?
- Do you believe that the rating on the U.S. or the rating on a local government's state should cap the local government's rating?

Overall, investors appreciated the transparency afforded by the framework. The following highlights the major issues raised by respondents, organized by question.

Q1. Global Comparability: Do you agree with our approach of using the same major factors to assign ratings to local governments both inside and outside the U.S.?

Generally, respondents believed it was appropriate to use the same major factors to assign ratings to local governments both inside and outside the U.S. Additionally, there was general agreement about the seven factors Standard & Poor's proposed; however, respondents did not all agree on the appropriate weight for each factor. Some respondents were unsure of the proposed criteria's ability to address U.S.-specific issues.

Q2. The Seven Factors: Do you agree with the underlying measures?

The proposed criteria identify and assign weights to seven underlying factors. Respondents provided comments regarding each of these factors as well. Included is a summary of these comments grouped by factor.

Institutional framework (IF): Despite the fact that the formalization of this portion of our analysis is fairly new to readers of our criteria, there was relative agreement with inclusion of this factor. Mostly, respondents wanted to know if these scores would be available to the public and if the rationale behind the score would be clear. Regarding the predictability score and the revenue and expenditures score, respondents wondered if a municipality's IF score should be penalized if the state's changes were not detrimental to the municipality. Other comments included whether this score would recognize state enhancement programs or if states with lower ratings would have a more heavily weighted IF score.

Economy: A somewhat sizable number of comments addressed our use of the per capita income indicator and suggested the use of household income instead. Other respondents commented on the per capita income indicator regarding the transparency of the projections that Standard & Poor's will use to formulate the underlying metric. Respondents also noted that regions have different costs of living and some wondered whether the underlying metric should include some housing cost or cost of living comparisons. A smaller number of respondents suggested using local unemployment rather than county level unemployment.

Management: There were not many concerns expressed regarding the management factor, though some believed it was a subjective score and perhaps for that reason should not be weighted so heavily. Other comments questioned what impact this would have on our already existing Financial Management Assessment.

Budgetary flexibility: Overall there was agreement with the available fund balance metric to measure budgetary flexibility. Some respondents were a little unclear as to what would be considered available. We received comments that brought up the issue of the nominal size of the fund balance and whether that would have a rating impact. Additionally, some commenters believed our ranges required municipalities to carry too large a fund balance to receive credit and that municipalities with lower balances would be penalized.

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Budgetary performance: For the factor that measured performance, the concern most commonly expressed was how Standard & Poor's would handle years where expenditures spiked for reasons other than operations, such as one-time major capital expenditures, or one-time transfers. Additionally, some questioned the movement toward using total governmental funds, which our current criteria do not emphasize as greatly.

Liquidity: The large questions surrounding liquidity focused on how exactly we would calculate cash. For example, some wondered whether the liquidity score would take into account very liquid investments that may not show up as cash in an audit. Others were concerned about the possible inclusion of bond proceeds.

Debt: Many comments regarding the debt factor centered on the weighting of this factor and on contingent liabilities. Overall, commenters wanted to make sure the proposed criteria were appropriately considering contingent liabilities. Additionally, respondents brought up the complexity regarding pension and OPEB and highlighted their desire to have the liabilities considered in conjunction with management's ability to address the costs. Certain respondents were interested in how municipalities that issue debt for school districts would be treated and whether their debt ratios would be considered high in comparison to other municipalities. A couple of respondents wondered why we did not use per capita debt ratios and brought up the possibility of a low debt burden override.

Q3. Rating Changes and Volatility: Do you agree with the overriding factors that may cause a rating to differ from that resulting from the indicative rating?

Most respondents agreed with the use of overrides, recognizing that in certain situations specific factors can have a larger impact than would otherwise be indicated. The biggest concern regarding overrides was the increase in the volatility of our ratings when a cap was put in place and then subsequently removed. This was also related to how the caps and rating transitions would allow for the incorporation of trends in the underlying credit. A couple of respondents suggested additional overrides including one for a low debt burden or high market value per capita. While most agreed with the idea of the overrides, some respondents believed it could be too harsh and it would be more appropriate to take into account the municipality's willingness and ability to recover.

Q4. Sufficient Data: Are there other data sources that you believe should be considered before the criteria are implemented?

For the most part commenters agreed with the data we suggested using. Some noted a movement toward total government and total governmental funds. Many of the data comments concerned the underlying data for the economy factor and its adjustments. Some commented on cost of living data, though respondents did not provide uniformly available data sources alternatives. Another larger issue many respondents commented on was the per capita income projections used for the economy factor initial score. Concern was also expressed about the reliance on issuer provided financial projections. While respondents overall approved of forward looking ratings, there was some concern regarding how those projections would be made, used, and interpreted.

Q5. Sovereign or State Rating Cap: Do you believe that the rating on the U.S. or the rating on a local government's state should cap the local government's rating?

There was universal agreement that there should not be a sovereign or state rating cap for U.S. municipalities. However, some respondents questioned what an appropriate gap between these ratings would be.

The View From Here: How And When?

We understand that how we implement the new criteria is equally as important and interesting to investors, issuers, and other market constituents as is the finalized methodology. As we finalize the criteria, we currently expect to respond to these comments in one of three ways: by changing the criteria as we consider appropriate; by clarifying the original proposal where questions arose; or by leaving the proposals unchanged..

We are considering various options for the final implementation. In the interim, we continue to rate U.S. local governments according to our current methodology.