NORTH Dakota | Securities
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Investor Advisory: Credit Ratings

With interest rates on the rise, more investors may be considering an investment in bonds or bond funds, and in researching alternatives or talking to a financial adviser, may have come across bond credit ratings. Credit ratings usually appear in the form of alphabetical letter grades (for example, 'AAA' and 'BBB') and are an estimate of the relative level of credit risk of a bond, company or government. Credit ratings are issued by third parties and are not an assessment by the issuer of the bond or by securities regulators.

Credit ratings can be useful when evaluating an investment. But when considering credit ratings, you should understand their limitations. You should not base your investment decision solely on a credit rating or treat a credit rating as if it were investment advice.

What is a Credit Rating?

A credit rating is an assessment of an entity's ability to pay its financial obligations. The ability to pay financial obligations is referred to as *creditworthiness*. Credit ratings apply to *debt* securities like bonds, notes, and other debt instruments (for example, some asset-backed securities). Credit ratings also are assigned to companies and governments. They do not apply to *equity* securities like common stock.

A *credit rating agency* assesses the creditworthiness of an entity that issues the bond, called an *obligor* or *issuer*. These include entities such as corporations, financial institutions, insurance companies, or municipalities.

Credit ratings generally reflect a relative ranking of credit risk. For example, an issuer or debt security with a high credit rating is assessed by the credit rating agency to have a lower likelihood of default (that is, not paying back its debt) than an issuer or debt security with a lower credit rating.

Credit rating agencies use rating scales, symbols, and definitions to express credit risk. Most use a scale of letters and/or numbers, and these symbols are defined by the particular credit rating agency issuing those ratings. A typical credit rating scale has a top rating of 'AAA' and may have a lowest rating of 'D' (indicating default).

Some credit rating agencies' scales distinguish between investment grade and non-investment grade (*i.e.*, "speculative" or "high yield") ratings and they draw this distinction between the 'BBB' and 'BB' rating categories - in other words, a rating that is 'BBB-' or higher is investment grade and a rating that is lower than 'BBB-' is non-investment grade.

What a Credit Rating is NOT

A credit rating does not reflect other types of risk, such as market or liquidity risks, which may also affect the value of a security. Nor does a credit rating consider the price at which the security is offered or sold. *You should not interpret a credit rating as investment advice and should not view it as a recommendation to buy, sell, or hold securities*.

A credit rating is not a guarantee that a financial obligation will be repaid. For example, a 'AAA' credit rating on a debt instrument does not mean the investor will always be paid – bonds rated at this level sometimes default.

About Credit Rating Agencies

Some credit rating agencies are registered with the SEC. Credit rating agencies registered with the SEC are referred to as *nationally recognized statistical rating organizations* ("NRSROs"). Generally speaking, the larger credit rating agencies issue credit ratings across industry sectors and around the world, while some smaller credit rating agencies focus on specific types of ratings. You can find out whether a credit rating agency is registered with the SEC by visiting the SEC's website at www.sec.gov/ocr. SEC registration is not an endorsement of a credit rating agency nor any credit rating issued.

Potential Conflicts of Interest in Credit Ratings

Many credit rating agencies—including the largest agencies—are paid by the obligors they rate or by the issuers of the securities they rate. This creates a potential conflict of interest in that the credit rating agency may be influenced to determine more favorable (*i.e.*, higher) ratings than warranted to retain the obligors or issuers as clients and to obtain new clients.

Alternatively, some credit rating agencies are paid by subscribers to their ratings services, which are usually investors. Investors' desire for low or high credit ratings, depending on their holdings and trading positions, may also present a conflict of interest.

Where Can You Find Credit Ratings and Related Information?

Many credit rating agencies make their ratings available to the public on their websites and with market data providers. Others require subscriptions to access their credit ratings. Your financial adviser may also have access to this information.

All NRSROs are required to provide on their public websites a description of their credit rating scales and definitions and the methodologies they use to determine their ratings. Credit rating agencies may require subscriptions or fees to obtain narrative reports containing credit analysis, although some credit rating agencies make these reports available for free.

Why Do Investors Use Credit Ratings?

When making investment decisions, credit ratings and any related rating and industry trend reports can be helpful tools, provided you use them appropriately. Credit ratings may offer an alternative point of view to your own financial analysis or that of your financial adviser.

Credit ratings may enable you to compare risks among investments in your portfolio. Considering the credit ratings of multiple credit rating agencies may be useful because they may offer diverse views on the creditworthiness of an investment.

In general, if you use credit ratings, they should be *in addition to*, and *not a replacement for*, your own research, analysis, and judgment to determine whether an investment best satisfies your needs. Remember that credit ratings address credit risk only. They do not address other risks such as liquidity risk, interest rate or market risk, or prepayment risk. The bottom line is that you should know what you are buying and only invest in what you understand.

Important Considerations

A credit rating is an assessment of the creditworthiness of a debt instrument or issuer, based on a credit rating agency's analytical models, assumptions, and expectations. While historical financial and operating experience and collateral performance may factor into the analysis, credit ratings are simply a prediction of the likelihood that a bond issuer will repay the obligation in the future. The predictions are based on the views of the credit rating agency, which may differ from your view and those of other industry participants.

Credit rating changes can happen at any time, without warning, and at any rating level. Some credit rating agencies provide rating "outlooks" and rating "watches" to formally alert investors about potential revisions to those ratings. Even still, these alerts may not precede every rating action.

You should understand the information that credit ratings are intended to convey and any limitations to the ratings. You should also evaluate the bond's prospectus or other documents that provide financial information, industry news and reports, and non-credit-related factors to determine whether an investment is suitable for you. Consider seeking professional advice, particularly if you have questions about analyzing the information.

For More Information Contact:

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