Moody's Rating System Methodology

Introduction
Moody's Investors Service is a leading provider of credit ratings, research and risk analysis. Moody's ratings and analysis track debt covering more than 130 countries, 11,000 corporate issuers, 21,000 public finance issuers and 76,000 structured finance obligations.

Moody's Rating Scale
The rating scale, running from a high of Aaa to a low of C, comprises 21 notches. It is divided into two sections, investment grade and speculative grade. The lowest investment-grade rating is Baa3. The highest speculative-grade rating is Ba1.

Moody's Long-term Debt Ratings (maturities of one year or greater)

INVESTMENT GRADE
- Aaa – highest rating, representing minimum credit risk
- Aa1, Aa2, Aa3 – high-grade
- A1, A2, A3 – upper-medium grade
- Baa1, Baa2, Baa3 – medium grade

SPECULATIVE GRADE
- Ba1, Ba2, Ba3 – speculative elements
- B1, B2, B3 – subject to high credit risk
- Caa1, Caa2, Caa3 – bonds of poor standing
- Ca – highly speculative, or near default
- C – lowest rating, bonds typically in default, little prospect for recovery of principal or interest

Rating Methodology
Aberdeen City Council falls under Moody's rating methodology for regional and local governments (known to them as RLG's). Their methodology considers RLG ratings are comprised of 2 factors
- the government's Baseline Credit Assessment (BCA); and
- the likelihood of extraordinary support in the event of acute liquidity stress

Moody's uses a BCA scorecard, a matrix, and a support scorecard as part of their rating process. Once the standalone credit profile (BCA) of an RLG is assessed, they then incorporate an estimate of the likelihood of extraordinary support from a higher-tier government. The support scorecard uses a set of metrics which their rating committee uses to evaluate the likelihood & degree of support.

Baseline Credit Assessment
The steps taken by Moody's to determine a BCA for an RLG:-

a) Assess idiosyncratic risk score from scorecard
This score is assessed using four categories of metrics:-
- economic fundamentals (20%),
- institutional framework (20%),
- financial performance & debt profile (30%),
- governance & management (30%).

b) Assess systemic risk based on sovereign rating
Systemic risk of the RLG's operating environment and sovereign government bond rating.

c) Determine BCA score based on matrix combining 1) and 2)
This matrix provides consistency to the BCA making it comparable across countries.

d) Consider additional relevant factors and assign BCA
Events or particular circumstances which require to be factored into the BCA score (e.g. shrinking population, high debt ratios, history of default, political risk/interference etc).

Support Scorecard
This scorecard assesses the probability of extraordinary support from a higher-tier government. Support could take different forms, such as a one-time cash payment, facilitating negotiations with lenders etc.

When determining extraordinary support, Moody's account for:-
a) the supporting government's rating
b) an estimate of the default correlation between the 2 entities
c) an estimate of the likelihood of extraordinary government support

The estimate of the likelihood of extraordinary government support is determined by the following :-
a) Institutional framework
b) Legal requirements or barriers
c) Government policy stance
d) Degree of oversight
e) Reputation risk
f) Moral hazard
g) Historical behaviour