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The Implications Of The U.S. Debt Ceiling Standoff For Global Financial Institutions

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As the debate between Congress and the Administration over the federal budget continues and the issue of the U.S. debt ceiling remains unresolved, Standard & Poor's Ratings Services placed its 'AAA/A-1+' ratings on the United States of America on CreditWatch negative on July 14. (See "United States of America 'AAA/A-1+' Ratings Placed On CreditWatch Negative On Rising Risk Of Policy Stalemate," published on RatingsDirect on the Global Credit Portal.) Any deterioration in the credit quality of the U.S. likely would have broad implications for the financial markets. The severity of the impact would depend on the availability of liquidity, the conditions in the funding and equity markets, and the volatility of interest rates and spreads.

In light of this, we have considered three hypothetical scenarios that could emerge and have analyzed their potential impact on sectors in the financial services industry. (See "The U.S. Debt Ceiling Standoff Could Reverberate Around The Globe--With Or Without A Deal," published July 21, 2011.) We assessed the impact that each scenario could have as low, moderate, or high (see chart). The three scenarios are:

- Scenario 1: We affirm the 'AAA/A-1+' ratings on the U.S., remove them from CreditWatch, and assign a negative outlook.
- Scenario 2: We remove the ratings on the U.S. from CreditWatch, lower the long-term rating to 'AA+' with a negative outlook, and affirm the 'A-1+' short-term rating.
- Scenario 3: We revise the ratings on the U.S. to 'SD' (selective default) and then raise them to 'AA/A-1+' with a negative outlook a few weeks later. In this scenario, we would expect a systemic market disruption to follow the revision to 'SD', which would have a significant impact on ratings in the financial institutions sector. If a selective default occurs, but without a systemic market disruption, we would expect this scenario to have less of an impact on global financial institutions ratings.

Scenario Analysis

U.S. sovereign rating:	Scenario 1 AAA/Negative/A-1+	Scenario 2 AA+/Negative/A-1+	Scenario 3 SD
U.S.-based financial institutions sectors			
Funds	Low	Moderate	High
Insurance companies	Low	Low	High
Exchanges/clearinghouses	Low	Low	High
GSEs	Low	Low	High
Finance companies	Low	Low	High
Banks and broker/dealers	Low	Low	High
Alternative asset managers	Low	Low	Moderate
Traditional asset managers	Low	Low	High
Asia-Pacific region	Low	Low	Moderate
European banks	Low	Low	High
Europe, Middle East, Africa (Insurance)	Low	Low	High
Latin American region	Low	Low	Moderate

In our opinion, hypothetical scenarios 1 and 2 would have limited ratings implications for global financial services companies. We do not expect a systemic market disruption under these scenarios. In both, we would expect to take a few rating actions (including outlook revisions) on specific companies, mainly those with businesses, operating earnings, and assets that are largely U.S. based. We don't expect that a lack of liquidity would be a critical issue or that confidence-sensitive products would experience a run-on-the-bank type stress.

We expect that hypothetical scenario 3 could have the biggest impact on financial institutions and could lead to the largest number of ratings changes. This is primarily because we could envisage a systemic and global macroeconomic disruption. In this case, a lack of liquidity would become a critical issue, which could exacerbate cash payments related to confidence-sensitive products. This could look similar to the fall of 2008, when a complete loss of investor confidence and a massive flight to quality brought the global funding markets to a temporary stand-still. In the short term, this might lead to issuers' inability to roll over maturing debt and asset-backed securities and repo counterparties' reluctance to accept certain collateral. It could also trigger contingent liquidity requirements. The U.S. financial sectors that would be at the greatest risk would be those with business models that depend at least partially on short-term funding. These include banks, funds, finance companies, exchanges/clearinghouses, broker/dealers, and life insurers.

The Scenarios' Effects On Global Financial Institutions

U.S. funds

Money market funds issue and redeem shares at $1.00, provided that their marked-to-market net asset value (NAV) per share is between $0.995 and $1.005. Given this very small margin of error, deviations of greater than plus or minus 0.5% can create a situation in which a fund sells and redeems shares at a price other than $1.00, or, in other words, "breaks the buck." Should a market disruption caused by an 'SD' event lead to a decline in the prices of U.S. Treasury and government securities (and other short-term money market instruments), money market funds may experience a precipitous drop in their NAVs, increasing the likelihood of money funds breaking the buck. Principal stability fund ratings (PSFRs) are assigned to money market funds and address a fund's ability to maintain principal value. Therefore, a downward movement in a money fund's NAV could trigger a downgrade, including to 'Dm', if a fund has failed to maintain its principal value (i.e., $1.00 per share). PSFRs are closely linked to the short-term ratings on the U.S. government because a fund's investments should have a Standard & Poor's short-term rating of 'A-1+' or 'A-1' for the fund to be rated investment grade. A downgrade of the U.S. sovereign rating to below 'A-1+' would have significant implications for principal stability funds that invest a majority of their assets in U.S. government debt.

Insurance companies

The sovereign local currency rating constrains the financial strength ratings on U.S. insurers because their businesses and assets are concentrated in the U.S., including a large proportion of U.S.-backed holdings. However, we expect that any changes to the U.S. sovereign credit rating would have a less direct and slower impact on global insurance companies with well-diversified assets outside the U.S.

U.S. clearinghouses and the central securities depository (CSD)

The sovereign rating also constrains the ratings on U.S. clearinghouses and CSD ratings because their clearing business is concentrated in the domestic market and is correlated with the U.S. economy.

U.S. government-supported entities (GSEs)

GSEs have a close tie to sovereign ratings because they are often partially or totally controlled by a government, and they help to implement policies or deliver key services to the population. Similarly, ratings on Temporary Liquidity Guarantee Programs (TLGP) debt have a close tie to the U.S. sovereign credit rating because the Federal Deposit Insurance Corp. (FDIC) guarantees this debt.

U.S. banks and broker/dealers

The impact that a change to the U.S. sovereign rating could have on banks and brokers/dealers ratings likely could depend on the confidence sensitivity of their funding profile and could be affected by their various indirect and direct exposures to U.S. Treasuries. Any rating actions on these companies likely could reflect the severity of any movement in short-term rates since these companies rely on the liquidity of the short-term funding markets.

U.S. traditional and alternative asset managers

We expect that short-term funding disruptions could have minimal ratings implications for traditional and alternative asset managers. Rather, these asset managers are more closely tied to the performance of the equity and fixed-income markets.

U.S. finance companies

The decreased viability of the wholesale funding market could hurt U.S. finance companies as economic and market factors reduce profitability, leading to liquidity concerns.

Europe

We would expect the impact on Europe's financial sector of scenario 3 to be reminiscent of the months following the 2008 failure of Lehman Bros. In contrast to that period, however, most European countries are in a far weaker fiscal position today and, thus, are less able to offer economic stimulus. Risk aversion would likely extend to the most confidence-sensitive issuers (banks), highly leveraged obligors in need of refinancing (leveraged buyouts and commercial mortgage-backed securities), and sovereigns that are already in the throes of serious fiscal adjustments. We believe, however, that all central banks in Europe would send strongly supportive signals to the banking sector to stave off panic.

Asia-Pacific

The region's financial sector might experience more pronounced funding difficulties in scenario 3. We think these could be associated with market disruptions that could result in costlier funding that could erode profits, while smaller market participants might experience difficulties in refinancing maturing debt. More exposed to a prolonged disruption could be Australian, Korean, and Japanese banks that have some dependence on offshore funding markets. Thus, the impact of a dislocation in global funding markets would be high. We believe that banks that have previously benefited from strong government support would receive support this time around as well. Asia-Pacific banks and insurers would also feel the impact on their marked-to-market assets on their balance sheets and pressure on market-dependent income. The overall impact would hurt earnings for some, and we couldn't rule out downgrades for smaller players.

It's also important to remember that China and Japan are large holders of U.S. debt securities. The immediate disruptions in global markets would be unlikely to cause a substantial hike in official interest rates in China and Japan--if authorities there moved quickly to maintain confidence. Both countries would likely experience repatriations of funds deployed abroad plus a flight to quality--which, to a degree, should help the largest banks (the expected recipients of such funds) deflect funding pressures.

Latin America

Finance companies are more sensitive than other companies in the region to liquidity shortages because of links to debt market funding requirements and our expectation that banks could close credit lines. Additionally, an economic impact similar to the one in 2008 and 2009 could hurt asset quality and profitability for some finance companies. The ratings on issuers in other sectors in Latin America are not directly tied to the U.S. sovereign rating, which we believe could help limit the number of rating actions.

Details Of Our Analysis

Scenarios 1 and 2

Under hypothetical scenario 1, where the U.S. rating is affirmed at 'AAA', ratings on financial institutions currently on CreditWatch would be removed from CreditWatch and affirmed, and their rating outlooks would mirror that of the sovereign. Thus, we believe the impact on ratings in all financial institutions sectors would be low.

In scenario 2, reflecting the U.S. downgrade, we would downgrade the debt of Fannie Mae, Freddie Mac, the 'AAA' rated Federal Home Loan Banks, and the 'AAA' rated Federal Farm Credit System Banks to correspond with the U.S. sovereign rating. We would also lower the ratings on 'AAA' rated U.S. insurance groups, as per our criteria that correlates insurers' and sovereigns' ratings. In addition, we would lower the ratings on clearinghouses Fixed Income Clearing Corp., National Securities Clearing Corp., and Options Clearing Corp. as well as on The Depository Trust Co., a CSD. This reflects our view that their clearing businesses are concentrated in the domestic market and they are correlated with the U.S. economy. We assess the impact of this scenario as moderate for funds and low for all other financial institutions sectors.

Funds: On July 15, we placed 73 fund credit quality ratings (FCQRS) on CreditWatch negative following the sovereign CreditWatch placement. In scenario 1, we would affirm the 73 FCQRs and remove them from CreditWatch. In scenario 2, the ratings implications for FCQRs and PSFRs would vary. Scenario 2 would have an impact on funds with exposure to long-term U.S. Treasury and U.S. government securities, but not on funds with short-term investments. For FCQRs, we apply a lower credit score on investments in short-term (365 days or less) U.S. government securities than longer-term investments (more then 365 days). The 73 FCQRs that we placed on CreditWatch negative have significant exposures to U.S. Treasury and U.S. government securities that mature in more than 365 days. So in scenario 2, we would downgrade these 73 funds to reflect the lower long-term rating on the U.S.

Principal stability funds, on the other hand, seek to maintain stable and accumulating net asset values, and they invest in short-term debt instruments. As long as the short-term U.S. sovereign rating remains at 'A-1+', as we outline in scenario 2, we believe that lowering the long-term rating into the 'AA' category would not have an impact on the ratings on these funds because the credit quality of the U.S. would still meet the credit quality standards for all PSFR categories. (For details about our criteria, see "Methodology: Principal Stability Fund Ratings," published June 8, 2011.) Barring any potential price volatility associated with the lower long-term rating, the short-term rating on the U.S. government remaining at 'A-1+' would effectively be business as usual for the money market fund industry.

All other global financial services: In both of these hypothetical scenarios, we would expect there to be few rating actions (including outlook changes) on specific companies. In most cases, this would reflect that their businesses, operating earnings, and assets are largely U.S. based. In either instance, we don't expect liquidity to be a critical issue for companies. Furthermore, we do not expect the knock-on effects of the lower U.S. sovereign rating in scenario 2 to lead to additional downgrades immediately in the financial services industry. In both these scenarios, we would evaluate each company on a case-by-case basis, taking into account macroeconomic conditions and their own financial strength. If we do take rating actions, we could expect to downgrade companies that have a significant U.S. presence, with most of their business and assets in the U.S., or companies in Europe with sizable positive correlations to the U.S. insurance or banking sectors. We would expect to take fewer rating actions, and more slowly, on financial services companies in Asia-Pacific and Latin America--if indeed we took any.

Scenario 3

In our view, the impact is high for all sectors, except for alternative asset managers and in Asia-Pacific and Latin America, where the impact would be moderate.

U.S. insurance: We could consider placing our ratings on most U.S. insurers on CreditWatch negative (including bond insurers), but not necessarily lower any ratings immediately. We expect that any potential downgrades would occur within 90 days and would average no more than two notches. The most affected subsector of U.S. insurance, in this scenario, would likely be life insurance and multiline insurance--if life insurance is a significant part of the consolidated insurance operation. The impact likely would be smaller for most property/casualty, reinsurance, and heath insurers.

During the financial crisis of 2008-2009, holding company liquidity was, in some cases, insufficient to meet debt maturities. However, we believe the liabilities that would be most at risk in scenario 3 are institutional short-term operating leverage programs, including securities lending, repurchase agreements, dollar rolls (a type of repurchase agreement), and other short-term match-funded businesses that rely solely on the ability to access the short-term funding markets. Over the past two years, balances in these programs have declined because of tightening spreads. Longer-term institutional liabilities, such as global funding agreements, are primary cash flow matched and shorter-term put features are less prevalent now than they were in the late 1990s. Insurers offering variable annuity-guaranteed benefits would be most sensitive to equity market declines, resulting in reserve increases and declining capital bases. However, many of these variable annuity contracts have restrictive withdrawal rights, so declines in equity markets would be less of a risk if the market disruption is temporary.

Global insurance: The CreditWatch action could extend to non-U.S. insurance groups (including Canada and Bermuda) that have large U.S. operations or U.S. sovereign investment concentrations, although the non-U.S. business would mitigate the impact. The indirect impact outside the U.S. could be marginally more downgrades for insurers with large U.S. operations or exposure to U.S. sovereign investments, although these would probably average no more than one notch. The greatest impact for insurers in Eastern Europe/Middle East/Africa would be in terms of capital adequacy, rather than funding and liquidity. The substantial increase in interest rates and credit spreads would have adverse implications for marked-to-market balance sheets, and weak equity markets would compound this. However, regulatory forbearance could result in little intervention.

U.S. funds: We could consider placing our PSFRs and FCQRs on funds invested in U.S.-based issuers on CreditWatch negative given the uncertainty an 'SD' event would have on the U.S. financial system, investor behavior, and the ratings on issuers in other U.S. sectors (such as banks). Exposures to U.S.-based entities that could warrant a placement on CreditWatch negative include direct issuer exposure and counterparty transactions (such as repurchase agreements and swaps). The action would depend on whether we revise our rating on the U.S. to 'SD' and our prospective view of broader market volatility.

We currently rate 814 funds globally. We have PSFRs on 498 funds with approximately $2.5 trillion in assets and FCQR/FVRs (fund volatility ratings) on 316 funds with more than $400 billion. Of the 814 rated funds, approximately 550 are invested in U.S.-based issuers. We could place our ratings on these 550 funds on CreditWatch negative if we were to revise the U.S. rating to 'SD'.

With respect to Standard & Poor's PSFRs, an 'SD' event might cause a material deviation in these funds' NAV per share and could expose them to extraordinarily high redemption requests, which could exacerbate a declining NAV. For any PSFRs that we would place on CreditWatch negative, we would obtain the daily marked-to-market NAV per share and asset balances for the funds to determine the impact of the 'SD' rating action and whether a deterioration in the funds' NAV warrants rating actions. If a U.S. downgrade to 'SD' caused interest rates and credit spreads to significantly affect the prices of short-term investments and the marked-to-market NAVs of rated funds to drop below the stated bands for each rating category (for example, the minimum NAV for 'AAAm' is $0.9975), then we could take rating actions. For example, if we put our rating on a fund that invests 100% in U.S. Treasuries on CreditWatch negative, and over the course of a week we observed its NAV decrease to $0.9974 from $1.0000 because of widening credit spreads coupled with large redemptions, we would likely downgrade the fund to 'AAm' (NAV minimum $0.9970) and keep the rating on CreditWatch negative. Should an NAV drop below $0.995 (that is, break the buck) we would downgrade the fund to 'Dm' because the fund would have failed to maintain its principal value.

Many PSFRs that are currently limited to investments in U.S. Treasury and agency securities have been positioning themselves to deal with an 'SD' event by attempting to avoid securities that mature in early August 2011. These funds are also maintaining above-average amounts of overnight liquidity (i.e., 50% in overnight repo) and an overall shorter weighted-average maturity to minimize the impact that spread widening and redemptions would have on their NAVs. Although this strategy puts the funds in a better position to deal with an 'SD' event, the ambiguity regarding how the markets would react to such an event would warrant, in our opinion, placing the ratings on these funds on CreditWatch negative.

In this scenario, it's unlikely that we would initially place our ratings on CreditWatch negative for funds that hold only investments that mature in one business day with issuers or counterparties not on CreditWatch negative, as well as for funds that hold exclusively non-U.S. dollar-denominated investments. However, if the market impact of this scenario spreads beyond the U.S. and global issuers across Standard & Poor's rated universe experience rating actions, we could place our ratings on additional funds on CreditWatch negative.

It is important to note with respect to FVRs that if the 'SD' event caused a material loss in the underlying value of a rated fund's holdings and had a prolonged negative impact on the fund's total return profile, we could lower the FVR by one or more categories.

U.S. banks and broker/dealers: In this scenario, we could place the ratings on confidence-sensitive banks and broker/dealers (for example, those that rely on short-term funding markets) on CreditWatch negative. We could also lower the ratings on debt issued by financial institutions and guaranteed by the FDIC through its TLGP to the senior unsecured rating on each issuing entity. Short-term funding markets would likely seize, and brokers could struggle to pass daily liquidity tests. U.S. Treasuries used as collateral could fall in value, leading to margin calls. Banks would likely struggle to borrow in the interbank market. Falling equity markets and a rise in interest rates could affect the value of balance sheet assets for big banks and broker/dealers. Banks and brokers may also have to pay out redemptions on sponsored funds, which may further deplete cash reserves, and honor drawdowns on committed credit lines, which would further pressure liquidity. Questions about the viability of deposit insurance could lead to runs on banks if the rating on the U.S. remains at 'SD' for several weeks. In response, banks would likely stop uncommitted lending, which could include consumer lending, to conserve liquidity.

U.S. GSEs: We could lower our debt ratings on Fannie Mae and Freddie Mac to 'C'--our lowest issue-level rating--to reflect our view of their significant risk of a near-term payment default. We could also lower our rating on the Federal Home Loan Bank System's (FHLB) debt to the lowest system bank's stand-alone credit profile (because of their joint and several liability) and place the ratings on CreditWatch negative. In addition, we could lower our ratings on the Federal Farm Credit System's debt to its stand-alone credit profile and place the ratings on CreditWatch negative. Furthermore, we could downgrade individual banks in the FHLB and Farm Credit systems to their unsupported stand-alone credit profiles and place the ratings on the banks on CreditWatch negative. The weakening dollar and wider spreads would likely have a significant impact on the funding costs of the GSEs, while the longer-term economic malaise could hurt their operations. Questions about the U.S.' ability to support Fannie Mae and Freddie Mac could have the greatest impact on their funding costs.

As the U.S. sovereign rating rebounds, assuming the U.S. government reiterates its support of Fannie Mae and Freddie Mac, we would equalize the ratings on the GSEs' debt with the sovereign rating. We would also likely raise the FHLB and Farm Credit debt ratings back to the sovereign level, and we would reevaluate system banks to determine stand-alone credit profiles and levels of support.

U.S. exchanges, clearinghouses, and central securities depository: We believe the impact on the industry could be high, especially if the rating on the U.S. remains at 'SD' for an extended period. As a result, we could keep our ratings on Fixed Income Clearing Corp. (FICC), National Securities Clearing Corp. (NSCC), Options Clearing Corp. (OCC), and The Depository Trust Corp. (DTC) on CreditWatch negative. We do not expect that we would revise our ratings on these four entities to 'SD' because we would expect that the sovereign 'SD' designation would be short term and that these four financial institutions would continue to meet their clearing and settlement obligations during that time, barring a meltdown of the entire U.S. financial system.

We understand the four 'AAA' rated entities and the clearinghouse units of CME Group are taking precautionary measures to protect their financial safeguard systems in the event of broad market disruptions. They are preparing to increase margin and guaranty fund requirements, possibly impose additional intraday margin calls, and curtail risk exposures at member firms experiencing financial duress. In addition, they are conducting "war games," in which they practice closing out positions of large members. Such actions would not be new--they did the same during the 2008-2009 global credit crisis. (During that time, we maintained the ratings on the three rated U.S. clearinghouses and DTC because they fulfilled their clearing and settlement obligations as expected.)

U.S. finance companies: In general, wholesale funding market disruptions pose the biggest risks to finance companies because most finance companies do not have access to deposits. The immediate issue would be a deterioration in economic and market conditions that affects profitability and could lead to higher cash needs. Factors that could lead to an increase in delinquencies for balance sheet-intensive companies, such as rising unemployment or decreased demand for financial services companies, could pose the most immediate risks. We also think companies that hold assets that need to be marked to market on a regular basis would face substantial difficulties, especially companies in commercial real estate, which, in our opinion, remain under significant pressure.

U.S. traditional asset managers: Our immediate response could include placing our ratings on asset managers with significant business managing money market funds on CreditWatch negative until we have a better understanding of the impact of any potential redemption activity that could result from an 'SD' event. If the U.S. sovereign ratings remained at 'SD' for an extended period, that could lead to significant redemption activity out of money market funds. In addition, a stock market drop could cause managed asset balances to decline across our rated universe because of both redemptions and market depreciation. In the longer term, depending on the severity and duration of the stock market shock, we might need to take negative rating actions on some of the more highly leveraged asset managers if their financial metrics weakened because of a reduction in assets under management, which could adversely affect cash flow from operations.

U.S. alternative asset managers: We believe that the biggest risk for alternative asset managers would be managing short-term liquidity, consistent with the 2008-2009 financial crisis. We rate a small number of alternative asset managers relative to the industry, and we believe that we could take a few rating actions in the short term. Any rating action would be the indirect result of liquidity issues arising from margin calls triggered by poor performance and asset value declines, coupled with redemption requests from investors at hedge funds. We could experience a bifurcation of alternative managers into those that benefit from the market disruption and those that have to deal with asset value declines, margin calls, and capital outflows. This scenario likely would have a bigger impact on hedge funds than private equity managers, at least in the short term. We could consider rating actions in the case of a broad decline in asset values because many managers generate their revenues based on assets under management.

Europe: For European financial institutions, we expect that the impact could be significant and possibly reminiscent of the months following the 2008 failure of Lehman Bros. In contrast with that period, however, most European countries are now in much weaker fiscal positions and are no longer able to offer economic stimulus. Risk aversion would likely extend to the most confidence-sensitive issuers (banks), highly leveraged obligors in need of refinancing (leveraged buyouts and commercial mortgage-backed securities), and sovereigns that are already in the midst of serious fiscal adjustments.

We would also expect that central banks in Europe would send strongly supportive signals to the banking sector to stave off any signs of panic. We believe European banks should be able to withstand this short-term market disruption assuming central banks would remain supportive. We also believe that central banks would continue to accept U.S. government debt as collateral under these extreme circumstances, although the European Central Bank has publicly indicated that it would not accept defaulted securities as collateral. Finally, in our view, authorities would do everything to ensure that payment systems would remain open. We believe that we could place our ratings on a few of the largest European banks on CreditWatch negative because of broad market disruptions affecting predominantly confidence-sensitive wholesale funded banks with large trading operations, or banks that have significant exposure to the U.S. sovereign or significant U.S. operations. This scenario likely would have a smaller impact on retail banks and local players, which investors would likely consider safer. We doubt that European banks would face a run-on-the-bank scenario and would expect governments to take actions to confirm that deposits would remain safe.

Asia-Pacific: Across Asia-Pacific, the potential adverse market impact--including dislocation in the funding markets and a disruption of capital flows--would be more important than the direct financial impact associated with a U.S. downgrade or default. We expect that the currently robust economic growth outlook for Asia-Pacific, the strong domestic savings rates, and the healthy household and corporate sectors would mitigate the pressure on the ratings on strong financial institutions. However, this scenario could result in a small number of negative actions on sovereign ratings in Asia-Pacific.

China and Japan are large holders of U.S. debt securities. The immediate disruptions in global markets would be unlikely to cause a substantial hike in official interest rates in China and Japan if the authorities responded quickly. Both countries could see repatriations of funds deployed abroad and a flight to quality. These factors likely could somewhat alleviate the funding pressures for the largest banks (the expected recipients of the funds). Smaller institutions could suffer if governments didn't provide explicit support for them, as was the case during 2008-2009, but we believe the support would be forthcoming. The yen and the yuan would experience sharp upward pressures, with the Japanese currency likely to see more upward movement (because of its open capital account) and more tolerance for appreciations than China. We could expect China to launch another credit-driven stimulus package to keep growth above 6%, while the Japanese government, with weaker control over its economy and high debt, would unlikely to be able to maintain positive growth. Korean banks are still significant borrowers from abroad, so the sovereign's domestic monetary conditions could tighten.

The Asia-Pacific financial sector might experience more pronounced funding difficulties associated with market disruptions, resulting in higher funding costs that reduce profits, while smaller market participants could face some difficulties in refinancing their maturing debt. Australian, Korean, and Japanese banks would be more exposed to a prolonged disruption because they depend somewhat on offshore funding markets. As such, the impact of a dislocation in global funding markets could be high. These banks have previously benefited from strong government support, which we expect would be available. Asia-Pacific banks and insurers would also feel the impact on their marked-to-market assets on their balance sheets and pressure on market-dependent income. Overall, this scenario would weaken earnings for some, and it could lead to downgrades for the smaller financial institutions in the region.

Latin America: We could downgrade Argentinean funds that have significant exposure to U.S. Treasury securities. The impact on Latin American banks would have to be worse than the 2008-2009 downturn, when few banks suffered, and we don't expect a liquidity crisis. The impact would be moderate for the region's exchanges and clearinghouses and low for insurance companies, but could occur if there is exposure to U.S. business or assets.

The odds that scenario 3 will occur are still low, in our opinion. This makes sense, given that the consequences would be so wide ranging.

Related Research And Criteria

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