How Management & Governance Risks And Opportunities Factor Into Global Corporate Ratings

November 7, 2018

Key Takeaways

- An assessment of management and governance is part of every corporate issuer rating.
- We find that events of mismanagement and poor governance contributed to severe multiple-notch downgrades.
- Notable cases of key personnel misconduct, bribery, data breaches, and corporate criminal behavior have been captured in our ratings analysis. We highlight some here.
- In total there were 262 instances over a two year period where we reassessed our M&G score. Over 60% related to a negative reassessment, while the rest were positive.

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S&P Global Ratings has completed a two-year review of how issues of management and governance (M&G) are reflected in our ratings. For that period, we found 77 cases where a revision of our view of management and governance factors led to rating changes, and a total of 262 cases where these factors were a part of the analysis and resulted in a change of our management and governance assessment.

We consider M&G factors explicitly in every corporate issuer credit rating. Our M&G criteria ("Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers," published Nov. 13, 2012) encompasses a range of factual and qualitative assessments that we apply and revise as necessary based in part on our in-person meetings with management as well as our understanding of how governance impacts credit quality more broadly.

This analysis looks at the universe of rated corporate entities and transitions of their M&G scores from July 2015 to August 2017. We have complemented the analysis of our scores with the application of a natural language processing technology highlighting some other notable instances of M&G factors considered elsewhere in the rating analysis. Finally, we have selected a number of past rating actions to illustrate our analysis of various governance factors.

This report is part of a series covering the impact of environmental, social, and governance (ESG) factors in our credit ratings. In October 2015, we published our first review of how environmental and climate factors affected our ratings between 2013 and 2015 (“How Environmental And Climate Risks Factor Into Global Corporate Ratings,” Oct. 21, 2015); last November we conducted our second (“How Environmental and Climate Risks and Opportunities Factor into Global

Corporate Ratings – An Update," Nov. 9, 2017). We then expanded the series to review social factors ("How Social Risks and Opportunities Factor Into Global Corporate Ratings," April 11, 2018). These reports showed that environmental and climate factors contributed more frequently than did social factors over the same period, and that while environmental and climate factors affected ratings in a nearly even split of negative to positive, social factors were overwhelmingly negative in terms of impact on credit quality. We will continue to track how we incorporate ESG risks and opportunities into our credit analysis, and we plan to further report on how those factors may affect entities' creditworthiness.

Governance: Notable Cases

Wynn Resorts Ltd.

On Jan. 26, 2018, The Wall Street Journal detailed allegations of a decades-long pattern of sexual misconduct by Wynn Resorts' founder, CEO, and chairman Steve Wynn. Mr. Wynn at the time owned 12% of the company and was a key qualifier on the company's gaming licenses. He denied the allegations, but regulators in Massachusetts and Nevada launched investigations to review the company and Steve Wynn's suitability as a gaming licensee.

We believe these events marked the first instance of the Me-Too movement directly affecting the CEO of a rated company or resulting in a rating action: on Jan. 30, after the WSJ article was published and before Steve Wynn's resignation, we revised the Wynn Resorts 'BB-' rating outlook to negative from stable because of the potential for impairment to Wynn Resorts' brand and its ability to maintain its gaming licenses. We also believed that reputational damage had the potential to hurt cash flows (especially in Las Vegas), particularly if companies elected to hold conventions and meetings elsewhere. Lastly, given uncertainty at the time around potential succession plans, we believed Wynn Resorts could incur additional leverage if it had to compensate Steve Wynn or buy out his ownership stake.

On Feb. 6, Steve Wynn resigned and Wynn Resorts appointed replacements, separating the CEO and chairman positions for the first time. It executed a separation agreement (which paid no severance) and negotiated an amendment to one of its bond indentures that would trigger a change in control if Steve Wynn were to sell his equity. Shortly thereafter, Steve Wynn sold all of his equity, eliminating one risk factor of our negative outlook.

Although the company and board made some imprudent statements that appeared deferential to the company's founder in the weeks following the allegations, they also acted fairly rapidly to distance themselves from Steve Wynn and to implement significant changes that regulators will likely view favorably, including adding three new female directors, significantly increasing female representation on the board to 40%. Additionally, by May 2018, 60% of the board that had been serving at the start of 2018 had resigned or announced plans to depart in 2019, reducing the median tenure on the board to less than three years from about eight years.

Despite all of these changes, our outlook remains negative because of continued uncertainty surrounding the outcomes of ongoing regulatory investigations. We believe management, board, and ownership changes since February reduce--but do not eliminate--the risks of an unfavorable outcome from these investigations. We believe the Massachusetts Gaming Commission will likely be the first regulatory body to conclude its investigation, as it expects to hold hearings in December.

Equifax Inc.

Equifax, a leading provider of consumer and commercial credit information, experienced a significant data breach in the summer of 2017. The intrusion started on May 13 and continued until the end of July, when the company discovered and subsequently terminated the unauthorized access. According to company releases, about 148 million Americans were impacted over the course of those six weeks, as well as thousands of U.K. and Canadian customers. Information stolen included names, addresses, social security numbers, and credit card information, as determined by third-party legal and cybersecurity experts retained by the firm in the wake of the incident.

On Sept. 12, 2017, the company announced the immediate retirement of its CIO and Chief Security Officer followed by the retirement of its CEO on Sept. 26. It was revealed thereafter that some of the company's top executives sold approximately $2 million of company stock on Aug. 1 and 2, but were later cleared of wrongdoing by an internal independent investigation. Another employee was later charged with insider trading. As of this publication, the SEC has brought insider trading charges against two people who were employed by Equifax at the time of the discovery of the breach.

In response to these events we revised the 'BBB+' issuer credit rating outlook to negative, reflecting our uncertainty surrounding the eventual impact of this incident, as well as our opinion that the company's strong market position, large recurring revenue base, and strong cash flow generation would enable it to remediate the attack and mitigate the impact to its core business. With the considerable uncertainty at the time, including potential for impacts on strategy, substantial litigation, fines, and costs related to the incident, we expected leverage could remain elevated above 2x over the coming two years. We also felt the incident posed a reputational risk that could impact the company's other lines of business going forward.

Since the incident, the 'BBB+' rating remains unchanged, as does the negative outlook. We believe the company's strong market position, large recurring revenue base, and conservative financial policies will enable the company to remediate the attack and minimize the impact to its core business. However, ongoing litigation and regulatory reviews could result in substantial expenses and settlements, which could contribute to a downgrade if any of these factors should cause sustained net leverage in excess of 2x or free operating cash flow to debt sustained below 25%.

CBS Corp.

Recently, CBS engaged in litigation with National Amusements Inc. (NAI), which is 80% owned by Sumner Redstone and has twice attempted to push CBS and Viacom Inc. (its sister company that NAI also controls) to merge. The most recent merger attempt by NAI collapsed in May 2018 over disagreements between NAI's board and CBS's board regarding composition of the future management team of the combined entity. In order to avoid another attempt--one that could be a forced merger--CBS tried to issue a special dividend to reduce NAI's controlling ownership stake down to 19%. However, NAI countered this attempt by revising CBS's bylaws to require a super-majority to issue such a dividend. Both NAI and CBS (all of its independent board members and its management team) subsequently sued each other in Delaware court. The dispute has since been settled; both sides dropped their lawsuits, which cleared up some uncertainty, but not before it reflected poorly on the governance structures and systems that CBS had in place at the time.

In addition to these legal issues, CBS faced allegations of a culture of sexual harassment. Earlier this year, Charlie Rose, a key on-air personality, was fired after allegations of him committing sexual harassment emerged. This investigation was soon expanded to incorporate allegations of a culture of harassment at CBS News. More recently, the CEO of CBS, Les Moonves, was under investigation for allegations of sexual harassment, which came to light through two articles in the New Yorker magazine. Moonves stepped down from his position at CBS the day the second article was published. CBS stated Moonves would not receive any exit compensation pending an internal investigation (he could collect about $120 million if the investigation cleared him of any wrongdoing) and that the company would donate $20 million to organizations that support workplace equality for women, to be deducted from any severance that may be due to Moonves. The company also added six new independent members to its board of directors.

S&P Global Ratings responded to the NAI lawsuit in May 2018 by placing the company on CreditWatch negative due to operational and financial risks stemming from the possibility of protracted litigation. We believed the dispute evidenced weakness in CBS' corporate governance and so we revised our assessment of CBS' management and governance to fair from strong. Then in September we affirmed our CBS Corp. ratings with a negative outlook following the board and management changes in the wake of Moonves' resignation. The negative outlook reflects uncertainty around the final composition of the senior management team as the company needs to select both a permanent CEO and a new CFO (as of Oct. 25, CBS has an interim CEO and a newly promoted CFO). It also reflects the company's business strategy, operational capabilities, and financial policy, as well as how any changes could affect the company's operating and financial performance.

Siemens AG

For years, Siemens, one of Europe's largest technology conglomerates, was embroiled in a bribery scandal that came to light in November 2006. Several divisions were involved, including the telecommunications division paying $5 million in bribes to win a mobile phone contract in Bangladesh and a $40 million bribe payment to win a ~$1 billion contract in Argentina relating to producing national identity cards. Lax internal controls and a culture that did not frown upon this behavior contributed to the longevity and breadth of the problem. The company ended up paying over $1.5 billion in fines and expenses relating to the charges brought against it, the most notable in the U.S. and Germany.

While our management and governance criteria was not yet implemented, these issues and the resulting fines and expenses fall squarely into our assessment of governance. In our analysis, we look for regulatory and legal infractions, especially repeated or outside industry norms, as well the quality and comprehensiveness of internal controls, and the culture in which management promotes and incentivizes.

Following the scandal, Peter Löscher was appointed as CEO of the group, the first outside CEO appointment in the company's 171 year history. The company also replaced a significant amount of executives and named a general counsel with responsibility for compliance matters to the board.

In December 2006, we stated that while credit implications had not yet materialized, ratings could decline if the company's competitive position, strategic execution, or business or financial performance were weakened as a result of the scandal. In April 2007, we placed the Siemens ratings on CreditWatch negative following the resignation of Klaus Kleinfield, the CEO at the time. In June 2007 we took the company off CreditWatch negative and assigned a negative outlook, which was in part due the ongoing risks related to the scandal's investigations. Recently, the company has exhibited a far improved governance structure, a stable credit profile, and an 'A+'

issuer credit rating.

Volkswagen AG

In September 2015, Volkswagen (VW) admitted to using sophisticated software to manipulate the results of emissions tests, allowing some diesel engine exhausts to pollute far more than allowed. The fallout has included millions of vehicles recalled, billions of dollars in fines, a U.S. federal indictment of the CEO of VW at the time, and the arrest the CEO of Audi, a subsidiary of VW.

The admission happened after a research group out of West Virginia University reported large discrepancies between the cars' laboratory test results and its emissions on the road, which caught the attention of the U.S. EPA. When probed by the EPA on the discrepancies, VW eventually admitted that software was programmed to discern when the vehicle was running on rollers, typical of a laboratory testing environment, and increased its control of emissions associated with its exhaust accordingly. According to the New York Times, VW has admitted in court documents that it "never expected anyone to test its cars on the road, where the illegal software would not work."

While ongoing legal and regulatory inquiries are trying to determine exactly who knew of this behavior within VW, it is clear that deficiencies in internal controls and a lack of compliance culture, both of which are explicitly included in our assessment of management and governance, were at play. We responded by downgrading VW to 'A-/A-2' from 'A/A-1', reflecting our assessment of material deficiencies in VW's M&G and general risk management framework. We believed VW's internal controls have been inadequate in preventing or identifying alleged illegal behavior in the U.S. and misconduct in other regions. We understood the software was installed in VW vehicles over a period of several years, in a number of vehicle brands and models, and appears to have been intended to deliberately mislead regulators, governments, and consumers. Our assessment of VW's risk management framework includes our view of VW's breach of U.S. environmental law and potential other laws outside the U.S., representing a significant reputational and financial risk to VW over the medium term. Therefore, we revised down our overall assessment of VW's management and governance to fair from satisfactory, which led us to include a one-notch negative adjustment to our initial analytical assessment (anchor) of VW's creditworthiness of 'a', which remained unchanged at the time.

In January 2017, the company reached a $4.3 settlement split between criminal charges with the U.S. DOJ and Civil Claims by the U.S. EPA. As part of the settlement, VW accepted that some of its employees engaged in criminal conduct. This had no rating or outlook impact, but as of the latest annual review we still view the company's governance as a weakness given the deficiencies in its risk management, internal controls, and the legal infractions that occurred with the diesel emissions issue. We also view VW's ownership structure as negatively influencing its corporate decision-making, with limited consideration given to minority shareholders. In particular, this reflects the continued disproportionate voting rights of Porsche Automobil Holding SE (Porsche SE) at 52.2%, held through only 30.8% of VW's subscribed capital, which gives Porsche SE full control of VW. Porsche SE is itself 100%-owned and controlled by members of the Porsche and Piech families. Without improvements in VW's M&G framework, a rating in the 'A' category is unlikely.

Yingde Gases Group Co. Ltd.

In early December 2016, Yingde (which, with its subsidiaries, produces, supplies, and distributes various industrial gas products to on-site and merchant customers in China), faced increased liquidity risks just after a shareholder dispute prevented it from issuing equity to its fourth-largest shareholder. If the share placement had gone through, Beijing OriginWater Technology Co. Ltd (OriginWater) would emerge as Yingde's largest shareholder, and as part of the deal, displace two founders of Yingde from the CEO/chairman and COO positions.

Soon after, on Dec. 14, 2016, Mr. Zhongguo Sun and Mr. Trevor Raymond Strutt, the former CEO and COO, respectively, issued an open letter to all shareholders stating that a previous appointment of new members on the board of directors was invalid, and requisitioned a shareholders' meeting to reverse these changes. Mr. Sun and Mr. Strutt also asserted that the proposed placing of 378 million shares of the company to OriginWater should trigger a general offer for all the shares in the company. They stated that this is because OriginWater and Xiangti Zhao (the newly appointed CEO, who was formerly an executive director and the second-largest shareholder) were acting in concert and would control 30% or more of voting rights of Yingde upon completion of the share placement.

Trading in Yingde's shares was briefly suspended on Dec. 15, the same day S&P Global Ratings downgraded the company to 'B-' from 'BB' and placed the ratings on CreditWatch negative.

The dispute raged on, and on Dec. 23 we downgraded the company again, to 'CCC-', due to the fact that the company had not yet secured cash to pay an offshore bank loan due less than two weeks later. We kept the ratings on CreditWatch with negative implications to reflect the imminent liquidity risk. We believed the legal actions had damaged the company's ability to access of funds for debt repayment in a timely manner, and that they could continue to weaken creditors' confidence in providing long-term funding.

On Jan. 5, 2017, we removed the CreditWatch placement and assigned a negative outlook because the imminent liquidity risk had eased. The issuer credit rating was still 'CCC-' because of ongoing liquidity pressure and refinancing risk for its substantial short-term debt maturities.

Soon after, three of the company's major shareholders, including two that were involved in a shareholder dispute, entered into a legally binding memorandum of understanding (MoU) with Hong Kong-based private equity firm PAG Asia Capital (PAG). PAG became the controlling shareholder in April 2017. Liquidity risk has since decreased further, operational and financial performance are strong, and the company's issuer credit rating is now 'B' with a stable outlook.

Governance In Ratings Processes

Our view on management and governance could significantly influence credit factors other than solely the M&G assessment, such as a company's competitive position, its credit metrics, and our view of its financial policy, each of which, on its own merits, can have direct impacts on the issuer rating.

An effective management team may, in times of market duress, seek to balance the needs of debtholders with those of shareholders by making efforts to reduce leverage. By contrast, a management team could be excessively focused on pursuing debt-funded mergers and acquisitions (M&A); while growth is part of every company's strategy, it can become a governance issue if it involves excessive risk-taking or results from skewed management incentives causing a misalignment between management's interest and that of debt- or shareholders.

This illustrates another aspect of the governance analysis: while management can actively take actions that worsen credit quality, it can also fail to take actions that would support credit quality. This duality is part of the reason why management meetings, which are part of every rating, are of such importance. Management teams have a finite level of resources that can be dedicated to mitigating risk; our interactions with them indicate which are of the highest priority, and this selection can influence credit quality.

Relevance and definition

Sudden management and governance developments can often have an immediate or future impact on an issuer's creditworthiness, and weak policies or structures can often be red flags that herald adverse credit developments. Among actions and behaviors that could impact an M&G assessment are matters like:

- Executive/board and auditor departures and changes (particularly when sudden, unexpected, and repeated) can herald changes in strategic direction, indicate management dysfunction, or presage accounting, legal, or regulatory problems or operational underperformance.
- Delayed financial reporting or a qualified audit report can be a signal of underlying performance issues. Even if resolved, it often is accompanied by reduced access to capital.
- Lack of in-depth involvement by the board and/or its owners of management's strategic plans or complex areas of operations reduces their effectiveness to oversee risks.
- Badly-designed management compensation (with excessive focus on short-term results and pay-out) or ineffective compensation or audit committees can cause excessive risk-taking and/or damage the long-term sustainability of the company.
- The presence of activist investors. While their presence is not invariably negative for credit quality, they can also prompt or signal change in an issuer's strategic direction, risk appetite, and the potential for personnel changes to board and management, often at the expense of debtholders.

Our working definition for management and governance, as reflected in our M&G criteria, "encompasses the broad range of oversight and direction conducted by an enterprise's owners, board representatives, executives, and functional managers. Their strategic competence, operational effectiveness, and ability to manage risks shape an enterprise's competitiveness in the marketplace and credit profile.

"If an enterprise has the ability to manage important strategic and operating risks, then its management plays a positive role in determining its operational success. Alternatively, weak management with a flawed operating strategy or an inability to execute its business plan effectively is likely to substantially weaken an enterprise's credit profile."

Process and criteria

As shown in table 1, our M&G score is an amalgamation of assessments. We assess eight "Management" factors relating to strategy, risk management, and organizational effectiveness, each of which we score positive, neutral, or negative.

We also assess seven "Governance" factors, which are each scored as neutral or negative. In a circumstance when a governance deficiency or deficiencies impairs the ability of the enterprise to execute strategy or manage its risks, can be labelled severe.

These 15 factors are aggregated into the management and governance assessment, which can result in a strong, satisfactory, fair, or weak score. The result of the management and governance score, combined with certain anchor ratings, can result in increase on that rating of up to one notch, or a decrease of two or more notches, as shown in table 2. Sometimes these adjustments are only triggered if we feel we have not already captured the benefits of strong management and/or governance in the business risk profile or financial risk profile.

Each of the seven governance factors is primarily concerned with the structures and systems a company has in place that govern how it operates strategically (or not) given the various regulatory, political, economic, social, and natural environments it operates in. The governance systems are ultimately in place to guide, advise, and at times intervene in management's actions and planning to ensure the company's growth and longevity. Unlike the management factors that can be scored positively, governance factors are scored neutral or negative, and serve as an overarching scoring indicator when the two are combined. The rationale is that management cannot manage to optimum performance if the governance structures and systems are not in place that allow them to do so. This is reflected in the criteria, which caps the overall M&G Score at fair with just one governance negative subfactor, even if there are many positives among the management factors.

Table 1

Determining The Management And Governance Score For Corporate Enterprises

Management factors assessment

Strategy factors	Risk management factors	Org. effectiveness factors	Assessment
Strategic planning process	Comprehensiveness of risk management standards and tolerances	Management's operational effectiveness	Each element of the management assessment labelled one of...
Consistency of strategy with organizational capabilities and marketplace conditions		Management's expertise and experience	Positive
	Standards for operational performance		Neutral
Ability to track, adjust, and control execution of strategy		Management's depth and breadth	Negative

Governance factors assessment

Governance factors	Assessment
Board effectiveness	Each element of the governance assessment labelled one of...
Entrepreneurial or controlling ownership	
Management culture	Neutral
Regulatory, tax, or legal infractions	
Communication of messages	
Internal controls	Negative
Financial reporting and transparency	

Management and governance score aggregation

Management assessment		Governance assessment	Final score
5 or more positive **and** none negative	And	None negative	i. Strong
3 or more positive **and** none negative	And	None negative	ii. Satisfactory
All other combinations	Or	1 or more negative	iii. Fair
5 or more negative	And/or	1 or more severe	iv. Weak

Table 2

Impact Of Management And Governance Factors On The Anchor

	Anchor Range			
	'a-' and higher	'bbb+' to 'bbb-'	'bb+' to 'bb-'	'b+' and lower
1 (Strong)	0 notches	0 notches	0,+1 notches (1)	0,+1 notches (1)
2 (Satisfactory)	0 notches	0 notches	0 notches	0 notches
3 (Fair)	-1 notches	0 notches	0 notches	0 notches
4 (Weak)	-2 or more	-2 or more	-1 or more notches (2)	-1 or more notches (2)

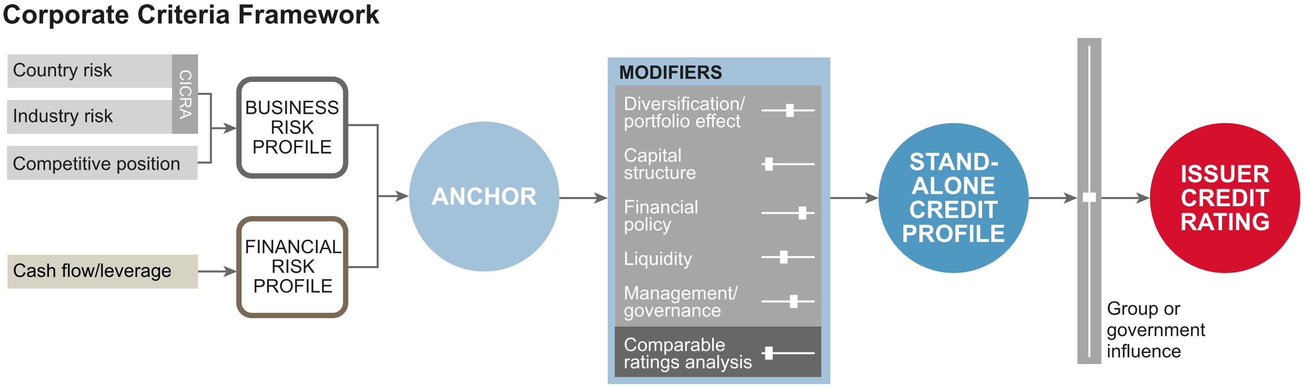
(1) This adjustment is one notch if we have not already captured benefits of strong management and governance in the analysis of the issuer's competitive position. (2) Number of notches depends upon the degree of negative effect to the enterprise's risk profile.

Board Effectiveness And Entrepreneurial Or Controlling Ownership

The role of a board of directors, especially its independent members, is important. When we assess director independence, our criteria emphasizes that it is not just the lack of these affiliations that makes a director independent, but whether the board's actions exhibit the kind of independent mindedness that make the board's oversight of management meaningful, both for the company and its investors.

When assessing entrepreneurial or controlling ownership in the context our credit ratings, it's essential to bear in mind that our M&G criteria neither exhort nor penalize ownership types, although the board is likely to operate differently between publicly listed companies (where owners are more distanced from management, requiring also a higher degree of public disclosure) and state-owned entities and private/family owned businesses. Consequently, ownership by a family, a private equity group, or with control layered through a partnership structure is not a negative factor.

Corporate Criteria Framework

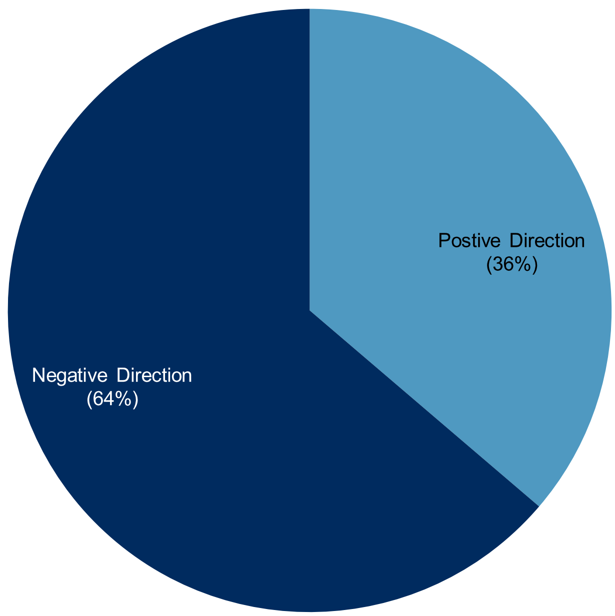


Study Results

Between July 2015 and August 2017 we changed the M&G assessment on an issuer 262 times. Of these, 95 (36%) were positive changes and 167 (64%) were negative changes.

Chart 1

Management And Governance Score Changes (Review Period)

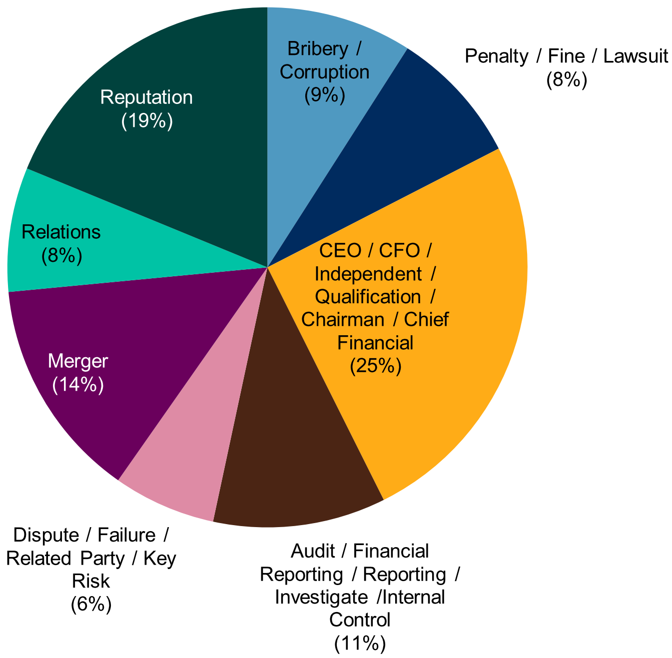


Keyword Review:

In order to highlight how management and governance factors influence the ratings analysis, we did a keyword search of nearly 9,000 research updates in our review period, finding 298 examples of management and/or governance factors that were influential to the analysis despite not always leading to a direct change in the M&G score or any of its components.

Chart 2

Keyword Distribution



Auditing, reporting, accounting: In nearly 11% of these 298 cases there were issues of auditing, reporting, accounting, and/or investigations into these matters. For example, we removed CBL & Associates Properties Inc. from CreditWatch and affirmed the rating at 'BBB-' with a negative outlook after an investigation by the SEC and the company's independent investigation concluded that allegations of misrepresentation of financials were false. (See "Research Update: CBL & Associates Properties Ratings Affirmed, Off CreditWatch Neg Based On Closed SEC Investigation; Outlook Negative," Aug. 19, 2016.)

Another example is when we announced Akorn Inc. would remain on CreditWatch after the company announced delays in the filing of its financial statements and that it had dismissed its previous auditors (KPMG LLP) and retained BDO USA LLP to audit and restate its financials. At the time we stated "we could also take action if we believe that governance deficiencies are more severe than we thought, and warrant additional downgrades. Disclosures of additional weaknesses in internal controls, additional investigations from regulatory or other government institutions, or additional management departures could prompt such an action. The CreditWatch developing reflects prospects for restoration of the credit rating to 'B+' if the company files its delinquent financials by May 9, 2016. However, if the re-audit is delayed beyond that, we could lower the rating, possibly by multiple notches, suspend the rating, or withdraw the rating." (See "Research Update: Akorn Inc. 'B' Corporate Credit Rating And Debt Ratings Remain On CreditWatch With Developing Implications," Feb. 26, 2016.)

A few months later, in May, the company filed its SEC form 10-K and we revised the CreditWatch to positive from developing. (See “Research Update: Akorn Inc. CreditWatch Implications Revised To Positive From Developing On 10-K Filing,” May 11, 2016.) Shortly after, the company filed its 10-Q and we observed that the company "made progress in remediating material weaknesses in its internal controls," which led us to raise the issuer credit rating to 'B+' from 'B' and remove the rating from CreditWatch. (See “Research Update: Akorn Inc. Corporate Credit Rating Raised To 'B+' From 'B'; Stable Outlook,” May 19, 2016.)

Turnover: Just over 25% of the 298 examples stem from executive or board turnover. For example, in 2015 we placed Iconix Brand Group Inc. on CreditWatch negative following an announcement of an abrupt CEO departure, the same year the company's COO and CFO departed. We stated "Iconix Brand Group has had significant senior management turnover this year... The CreditWatch placement reflects that the sudden shift in management heightens the risk that operating performance will deteriorate because of corporate governance issues and management turnover." (See “Research Update: Iconix Brand Group Inc. 'B+' Corporate Credit Rating Placed On CreditWatch Negative On Announced Management Changes,” Aug. 7, 2015).

The next month, we downgraded the company to 'B' from 'B+', stating that "Iconix has filled the CFO position, has an interim CEO, and has eliminated the COO position, but this significant turnover in the executive suite, in our opinion, raises questions about the board's effectiveness in terms of oversight. Meanwhile, the unresolved SEC review raises questions about the adequacy of the company's internal control environment. Nevertheless, for now, we continue to assess Iconix's management and governance as fair, mainly because of the stability of the business. However, we could lower this assessment if management does not competently execute its current strategies or satisfactorily remedy the company's internal control deficiencies." (See “Research Update: Iconix Brand Group Inc. Downgraded To 'B' On Dimmer Performance Expectations; Off CreditWatch; Outlook Stable,” Sept. 16, 2015.)

Reputation: Examples that featured the word reputation made up nearly 19% of our findings. A corporation's ownership structure and its reaction to events and controversies can impact its reputation in market and may be relevant to the entity's credit quality. For example, in May 2017, we upgraded PG&E Corp. reflecting a gradual improvement in the company's business risk profile following the 2010 San Bruno gas transmission explosion. The company has since strategically implemented a multi-tier approach to rebuilding its reputation and reestablishing its credibility with all of its stakeholders. This includes demonstrating a safety culture with tangible results, focusing on the needs of its customers, resolving outstanding financial fines, penalties, and obligations to third parties, and issuing sufficient equity to maintain its regulated capital structure. (See "PG&E Corp. Upgraded To 'A-', Outlook Stable; Debt Ratings Also Raised," May 12, 2017.)

Multiple-Notch Downgrades

In numerous cases in which we downgraded issuer credit ratings multiple notches at once, governance deficiencies were a factor.

In cases of fraud, falsification, or misrepresentation of financial data (often coupled with other governance deficiencies like management/director exodus), there is an increased likelihood of severe impact on the issuer credit rating. For example, in October 2015 we lowered the issuer rating on Globo PLC by five notches because "the confirmed falsification of data and the misrepresentation of the company's financial situation by Globo's CEO, as well as the resignation of the company's executive directors, cast doubt over the company's true financial position as well as its operational continuity." (See "U.K. Mobile Software Firm Globo Rating Lowered To 'CCC' And Placed On CreditWatch Negative On False Accounting," Oct. 30, 2015.) About two weeks later, after the company had been notified by a creditor of events of default, it entered administration and we lowered the issuer credit rating to 'D' and subsequently withdrew the rating. (See "U.K. Mobile Software Firm Globo Downgraded To 'D' After Going Into Administration; Rating Subsequently Withdrawn," Nov. 6, 2015.)

In other cases, our analysis of precarious management scenarios have given insight into upcoming headwinds to an issuer's credit quality. For example, in August 2015 we downgraded Town Sports International Holdings Inc. to 'B-' from 'B', noting the "significant execution risk associated with the HVLP club conversion, the company's high fixed-cost base, and its very low reported EBITDA margin, which we believe heighten the vulnerability of operations to strategic and management missteps." (See "Town Sports International Holdings Inc. Downgraded To 'B-' On Weak Operating Performance; Outlook Negative," Aug. 6, 2015.) In March of the following year we downgraded the company five more notches, to 'SD', after it repurchased $30 million in face value of a subsidiary's term loan at a significant discount to par. (See "Town Sports International Holdings Inc. Rating Lowered To 'SD'; Term Loan Rating Lowered To 'D'," March 8, 2016). The company has since reduced its execution risks and the rating currently stands at 'B-'. (See "Town Sports International Holdings Inc. Upgraded To 'B-' From 'CCC+' Due To Improved Performance; Outlook Stable," April 16, 2018.)

Further Case Studies:

Dole Food Co. Inc.

- Date: May 15, 2017
- Action: CreditWatch placement
- Rating after the action: B-/Watch Pos/ --

In April 2017, Dole announced it intends to complete an initial public offering (IPO) and use the proceeds primarily to repay existing debt. We believe that if the company raises about $300 million and applies it towards debt repayment, debt to EBITDA could fall below 5x. Also, the potential for adding independent board members and increased regulatory oversight as a public company could reduce M&G risk. We placed all ratings on Dole on CreditWatch with positive implications.

We subsequently raised the rating to 'B' after an Ireland-based produce company bought a large stake in Dole, addressing M&G deficiencies without an IPO.

China Hongqiao Group Ltd.

- Date: July 24, 2017
- Action: Downgrade
- Rating after the action: B/Watch Neg/ --

In our view, frequent auditor changes and prolonged delays in the publication of its annual report revealed the company's deficiencies in its internal control. We also view the delayed response to allegations by short sellers of accounting improprieties as a less-than-favorable sign of the company's transparency. The company eventually did publish its financial reports and the rating now stands at 'B+' with a stable outlook.

Mingfa Group (International) Co. Ltd.

- Date: April 6, 2016
- Action: Downgrade, CreditWatch placement
- Rating after the action: CCC+/Watch Neg/ --

We downgraded the company to 'CCC+' from 'B-' and revised our M&G assessment of Mingfa to weak from fair to mainly reflect our concerns over the lack of transparency in the company's financial reporting, weak internal controls, and less independent board and management. Mingfa had released its annual report a few days earlier but the auditor did not express an audit opinion, having not been able to obtain sufficient evidence for the nature and commercial substance of certain transactions. We subsequently took the rating off CreditWatch, but suspended the rating the following year because of a lack information.

The Scotts Miracle-Gro Co.

- Date: Oct. 7 2015
- Action: Downgrade
- Rating after the action: BB/Stable/--

The downgrade reflected a more-aggressive financial policy, but the M&G score reflected risks associated with a domineering CEO, as evidenced by significant top management turnover in the last several years. The rating still stands at 'BB' with a negative outlook.

MDC Partners Inc.

- Date: July 24, 2015
- Action: Upgrade
- Rating after the action: B+/Stable/--

The upgrade followed MDC's addressing the SEC's inquiries into its travel and entertainment expense reimbursement practices. Its founder, chairman, and CEO retired, and would reimburse the company an additional $12.5 million ($1.9 million in improper payments and the clawback of $10.6 million in retention payments) above the previously disclosed $8.6 million payment that he had already made. The company also announced that it was restructuring its board of directors (by reducing the number of management directors to one and adding more independent directors) and modifying its executive compensation practices. We viewed these actions, along with the announced resignation of the former chief accounting officer, as a partial remedy to its governance deficiencies and revised our assessment of MDC's M&G to fair from weak, thereby lifting a negative one-notch modifier to our 'b' anchor rating. We subsequently lowered the rating back to 'B' because below-expectations performance led to cash flow concerns. The outlook remains stable.

Sistema (PJSFC)

- Date: July 24, 2015
- Action: Outlook revised to stable
- Rating after the action: BB/Stable/--

Sistema's management and governance practices were characterized by an autonomous management team, well-defined risk management, and the fact that a majority of its directors were independent. These strengths were partly offset by Sistema's continued reliance on Vladimir Yevtushenkov, its key shareholder, who faced criminal proceedings at the time. We subsequently lowered the rating to 'B+' with a stable outlook.

Innovation Ventures LLC

- Date: April 12, 2016
- Action: Upgrade
- Rating after the action: B/Stable/--

The upgrade was based on credit metrics, but our assessment that Innovation had weak M&G practices was based on the absence of a board of directors and that substantially all management and governance decisions rested with the CEO of the company. We subsequently upgraded the company another notch based on changes in its financial policies, and withdrew the rating at the company's request.

Chobani Global Holdings, LLC

- Date: Sept. 22, 2016
- Action: Rating Assigned
- Rating after the action: B/Stable/--

Our "fair" assessment of Chobani's M&G reflected, among other things, its concentrated ownership by founder Hamdi Ulukaya and TPG Capital. The five-member board composition reflected this and included one independent director and another independent spot yet to be filled. This initial M&G assessment was also based on our belief that TPG and Ulukaya have established an effective working relationship, as evidenced by the teamwork required to turn the company from negative EBITDA to over $100 million. We had a favorable view of the division of labor between the founder's role to advance research and development and also act as "the face" of Chobani for marketing purposes, and the delegation of corporate operations to Kevin Burns (former partner at TPG Capital). That division in our view has been vital to the company's turnaround. The new management's depth and breadth was a concern but had a wide range of experience. In 2018 we revised the outlook to negative on weaker-than-expected earnings.

Mylan N.V.

- Date: Sept. 29, 2016

- Action: Affirmed
- Rating after the action: BBB-/Stable/--

Our revision of Mylan's M&G score to satisfactory from strong was based on our view that the company's strategic execution was under pressure and may not be as reliable as we once believed. Management had taken excessive price increases (about 500% since 2007) on life-saving EpiPen, an injector used to treat severe allergic reactions, and recently raised prices once again at a time when consumers were also facing higher co-payments and high-deductible plans, making EpiPen in some cases unaffordable. It was also a time when the pharmaceutical industry is under high scrutiny for its pricing practices, given the U.S. presidential election. We subsequently assigned an 'A-3' commercial paper rating. The long-term rating stands at 'BBB-' with a stable outlook, and the M&G score stands at satisfactory.

Carnival Corp.

- Date: Oct. 13, 2016
- Action: Upgrade
- Rating after the action: A-/Stable/A-2

The rating action reflected our opinion that Carnival had implemented sufficient risk mitigation and safety measures following multiple ship fires and other accidents, and that these measures would lessen (although not eliminate) the likelihood and severity of future potential damaging events on ships, which should limit cash flow volatility from these types of incidents in the event they occur.

Carnival also hired a chief maritime officer to oversee functions relating to guest safety and security, among others. We believed these changes increased accountability and aligned incentives in a way that would allow Carnival to better manage the impacts of these risks in future periods. As a result, we revised our M&G assessment to satisfactory from fair.

M&G outside the U.S.

We recently published sector- and geography-based thematic pieces on management and governance (see "Rebuilding Governance Will Be Instrumental To Recovery In Brazil's Engineering And Construction Industry," June 6, 2018, and "Japanese Corporations' Management And Governance Gains Importance In Rating Analysis As More Issues Emerge," May 16, 2018).

Methodology

The keyword review involved using natural language processing tools to search through the nearly 9,000 research updates posted to the Capital IQ platform to identify particular words relating to management and/or governance factors.

We excluded incidents that had the search word incorporated in a name of an issuer but were not part of the ratings analysis. We also excluded results if the word turned up in a context that other than a management or governance risk factor. We excluded the words "management" and "governance" because they appear in the criteria's name. We used this to illustrate notable examples where M&G plays a vital role in a ratings analysis but was not captured through a change the modifier, as allowed for by the criteria. Management and governance factors are assessed in every ratings analysis, and we believe the words used in the search turned back a majority of these instances, but acknowledge there may be instances which did not turn up in this search. Since what constitutes an M&G factor is debatable, we acknowledge there may be instances in which we excluded an analysis that others believe should be included, and vice versa.

Keyword list

- audit
- bribery
- ceo
- cfo
- chairman
- chief financial
- chief operating
- corruption
- culture
- dispute
- divestment
- execution of strategy
- failure
- financial reporting
- fine
- independent
- internal control
- investigate
- investigation
- key risk
- lawsuit
- merger
- non-financial
- penalty
- principal risk
- qualification
- related party
- relations
- reporting
- reputation

Related Research And Criteria

- How Environmental, Social, And Governance Factors Help Shape The Ratings On Governments, Insurers, And Financial Institutions, Oct. 23, 2018
- Through The ESG Lens: How Environmental, Social, And Governance Factors Are Incorporated Into U.S. Public Finance Ratings, Oct. 10, 2018
- S&P Global Ratings' Proposal For Environmental, Social, And Governance (ESG) Evaluations, Sept. 24, 2018
- How Social Risks and Opportunities Factor Into Global Corporate Ratings, April 11, 2018
- Credit FAQ: How Does S&P Global Ratings Incorporate Environmental, Social, And Governance Risks Into Its Ratings Analysis, Nov. 21, 2017
- How Environmental And Climate Risks And Opportunities Factor Into Global Corporate Ratings - An Update, Nov. 9, 2017
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

This report does not constitute a rating action.

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