An explanation of bond ratings

Bonds can complement an existing portfolio by adding diversification and help cushion it against major losses if the stock market drops.

While bonds are typically lower risk investments, there still remains an amount of risk associated with them.

The most common is **interest rate risk**. When interest rates rise, market values of outstanding bonds fall, and vice versa. Bondholders may have to sell existing bonds at a discount if they want to purchase new bonds. Another risk is **default risk**, the risk that the bond issuer will be unable to pay interest or principal.

Credit rating agencies were established to assess the default risk of certain bonds through the study of all information provided to the public, and to rate the bonds by assigning "grades" to the bonds and issuing company.

What does bond rating mean?

A bond rating is a grade given to bonds that indicates their credit quality. Independent rating services such as Standard & Poor's and Moody's provide these evaluations of a bond issuer's financial strength, or its ability to pay a bond's principal and interest in a timely fashion.

Bond ratings are expressed as letters ranging from "AAA", which is the highest grade, to "D", which is the lowest grade. Different rating services use the same letter grades, but use various combinations of upper- and lower-case letters and modifiers to differentiate themselves.

Standard & Poor's rates some 2,000 domestic and foreign companies; 8,000 municipal, state and supranational entities; and 1,300 commercial paper-issuing entities. Moody's rates 19,000 long-term debt issues; 28,000 municipals; and 2,000 commercial paper issuers.

Rating definition	S&P	Moody's
Highest quality and grade. Prime. Maximum safety. Bonds which are judged to be of the best quality. They carry the smallest degree of investment risk. The obligor's capacity to meet its financial commitment on the obligations is extremely strong.	AAA	Aaa
High quality. High grade. Bonds which are judged to be of high quality by all standards and only differ in small degree to the highest graded bonds. The obligor's capacity to meet its financial commitment on the obligations is very strong.	AA	Aa
Upper medium quality and grade. Bonds which possess many favorable investment attributes and are to be considered as upper-medium-grade obligations. They are somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher rated categories. However, the obligor's capacity to meet its financial commitment on the obligations is strong.	A	A

(continued)

Rating definition *(continued)*	S&P	Moody's
Medium grade. Bonds which are considered as medium-grade obligations (i.e., they are neither highly protected nor poorly secured). Interest payments and principal security appear adequate; however, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation.	BBB	Baa
Obligations rated "BB", "B", "CCC", "CC" and "C" are regarded as having significant speculative characteristics. "BB" rated bonds have the least degree of speculation and "C" the highest. While such obligations will likely have some quality and protective characteristics, they may be outweighed by large uncertainties or major exposures to adverse conditions.		
Somewhat speculative. Bonds which are less vulnerable to nonpayment than other speculative issues. However, they face major ongoing uncertainties or exposure to adverse business, financial, or economic conditions which could lead to the obligor's inadequate capacity to meet its financial commitment on the obligation.	BB	Ba
Low grade. Highly speculative. Bonds which are more vulnerable to nonpayment than obligations rated "BB/Ba," but the obligor currently has the capacity to meet its financial commitment on the obligation. Adverse business, financial, or economic conditions will likely impair the obligor's capacity or willingness to meet its financial commitment on the obligation.	B	B
Low grade. Default possible. Bonds which are of poor standing. Such issues may be in default or there may be present elements of danger with respect to principal or interest	CCC	Caa
Low grade. Extremely speculative. Bonds which are speculative in a high degree. Such issues are often in default or have other marked shortcomings.	CC	Ca
May be in default. Bonds which can be regarded as having extremely poor prospects of ever attaining any real investment standing. Bankruptcy petition has been filed or similar action has been taken, but payments on this obligation are being continued.	C	C
In default. Bonds which are considered to be in default. Payments on an obligation are not made on the date due even if the applicable grace period has not expired. Bankruptcy petition has been filed or similar action has been taken, and payments of an obligation are jeopardized.	D	D

Source: Bloomberg Finance L.P.

Call BMO for help

It's important to understand your investments. If you are considering investing in bonds, be sure to check out their ratings. This will be helpful in determining which bonds may be right for you and your situation.

For further information on retirement planning

We invite you to visit **mybmoretirement.com** or call the My BMO Retirement Line at **1-800-858-3829**.

BMO | Retirement Services