Ratings

Financial Institutions Rating Methodology

Financial Institutions

Contacts

Marco Troiano, CFA
+39 02 3054 4993
m.troiano@scoperatings.com

Pauline Lambert
+44 203 9368 161
p.lambert@scoperatings.com

Carola Saldias
+39 02 3054 4991
c.saldias@scoperatings.com

Editorial note: This methodology was republished on 15 January 2025, with a minor update to the contacts section to ensure the information is current and accurate.

10 January 2025

Table of contents

Summary

This methodology replaces the version published on 6 February 2024 and includes editorial changes and clarifications that do not alter the content of the methodology.

In this update we have further specified the scope of application of the methodology to explicitly exclude asset management companies and funds, we have added the sources of information used for the derivation of this methodology and the limitations of the methodology.

We have also clarified some of the elements underpinning our assessment of the business model, and that the Step 2 of our analysis is driven by a mix of quantitative and qualitative factors. Editorial changes, aimed at improving readability, include the rearrangement of the methodology into six sections, each of which is further subdivided in chapters and paragraphs.

1. Scope of application

This rating methodology explains our approach to assigning credit ratings to financial institutions globally, including banks and a broad range of non-banking financial institutions. These include listed and unlisted credit institutions such as savings banks and cooperative groups; government-owned banks, retail and commercial banks, investment banks, specialised lenders, diversified credit institutions; other providers of financial services like mortgage institutions; non-bank lending institutions such as building societies, microfinance companies, leasing and factoring companies; and lending captives of car and other manufacturing companies. It is not intended to assign credit ratings to insurance companies, investment funds or asset management companies. For financial institutions that conform to our definition of a government-related entity, this methodology should be read in conjunction with our Government-Related Entities Rating Methodology.

The methodology is based on a transparent step-by-step approach. The first step, combining credit views on a financial institution's operating environment, business model and long-term sustainability, leads to the determination of an adjusted anchor assessment. We then refine this anchor with a compare-and-contrast analysis of financial performance, specifically earnings capacity and risk exposures, financial viability management, and additional factors when applicable. The third and final step of the analysis addresses external support, whenever applicable.

1.1 Rating framework

1.1.1 The issuer rating

Issuer ratings assigned on our long-term credit rating scale (see Credit Rating Definitions) are forward-looking opinions on the relative creditworthiness of an issuer's ability and willingness to repay its financial obligations with an original maturity of one year or more when due.

1.1.2 Long-term debt ratings and correlation with issuer rating

We rate each class of long-term debt based on: i) the issuer's credit strength as reflected by the issuer rating; and ii) the specific terms and conditions of the debt instrument itself. Consequently, long-term debt ratings are assigned as follows (see section 5 for more details):

- Higher than the issuer rating: certain classes of financial obligations benefitting from additional protection because they are secured by collateral and/or because of our expectation that they would otherwise be shielded from losses, even in a gone concern scenario. For example, this would be the case for covered bonds (see our Covered Bonds Rating Methodology).
- Same as the issuer rating: for categories of senior unsecured debt, depending on their seniority, as well as the regulatory and legal framework. For example, in the case of banks subject to resolution, preferred senior unsecured debt (or equivalents) would be rated at the same level as the issuer rating.
- Lower than the issuer rating: for capital instruments, subordinated debt and for categories of senior unsecured debt, depending on the ranking in the capital structure, debt-specific features as well as the regulatory and legal framework. For example, in the case of banks subject to resolution regimes, non-preferred senior unsecured debt, or structurally subordinated senior debt, would be rated at least one notch below the issuer rating.

1.1.3 Short-term debt ratings and correlation with issuer rating

Short-term debt ratings reflect an issuer's ability to repay debt with maturities typically up to 12 months – such as commercial papers, certificates of deposit and other short-term financial commitments.

Short-term debt ratings are derived from long-term debt ratings. The assessment is further informed by a review of an issuer's funding and liquidity profile – including the potential impact of changes in market sentiment and access to central bank funding in case of market disruptions. For institutions benefitting from access to central bank funding, we assign the highest possible short-term rating given the range indicated by the long-term rating, unless our analysis highlights specific weaknesses in the issuer's funding and liquidity profile.

The correlation between short-term and long-term ratings is detailed in our Credit Rating Definitions.

1.1.4 Local and foreign currency debt ratings

Unless otherwise specified, our issuer and debt ratings apply equally to liabilities in local and foreign currency.

For issuers located in countries assessed by Scope with a sovereign credit quality of BB+ and below (non-investment grade), we may assign both local and foreign currency ratings.

For issuers located in non-investment grade countries, transfer and convertibility risks could play a greater role in determining our local and foreign currency ratings compared to issuers located in investment-grade countries. Our local and foreign currency ratings may differ if we consider that there is a higher risk that debt denominated in non-domestic currencies will not be reimbursed. This rating differential would capture the risk that an issuer may be prevented from honouring its debt obligation in full and on time due to government-imposed restrictions on foreign-currency payments, leading to a higher risk of default on foreign-currency liabilities.

Conversely, we view transfer and convertibility risks as negligible in investment-grade countries and in the euro area. As a result, in these countries, there is no difference between local and foreign currency issuer and debt ratings.

Any rating differential between local and foreign currency ratings reflects our view of the likelihood of the government imposing capital controls, including restrictions on sourcing foreign currency or transfers of foreign currency to investors. In this case, we will typically cap foreign currency ratings at the level of the foreign currency rating of the sovereign in which the issuer is domiciled.

Conversely, if the issuer has earmarked adequate foreign currency reserves to repay outstanding foreign currency debt and these resources are sufficiently protected from capital controls (for example via accounts or assets outside the country of residence), we will not apply such a cap.

1.1.5 Regulatory action leading to non-payment of debt is a sector-specific consideration for regulated issuers

Because banks and some other financial institutions are regulated entities, investors may face the risk that issuers are either unable to or are prevented from meeting their financial commitments due to regulatory intervention. This can be in the form of: i) early supervisory intervention, e.g. to prevent payments on capital securities; ii) resolution-related debt bail-ins that affect liabilities eligible for bail-in; or iii) insolvency proceedings. Credit ratings must therefore assess the extent to which credit fundamentals and other factors evaluated in the rating process influence the likelihood of such an event, along with events that are common to other industry sectors.

Neither supervisory intervention-induced non-payment on capital securities, nor a resolution-induced bail-in of eligible liabilities, could be considered *de jure* defaults, although the impact for investors in these securities may result in the absence of timely payment.

Many jurisdictions have implemented resolution regimes to deal with large banks that are failing or likely to fail. Resolution measures apply when private-sector solutions or further supervisory actions are deemed unlikely to prevent failure and provided it is in the public interest for a failing bank not to be placed into insolvency. However, the actual implementation of resolution regimes differs across jurisdictions. For example, in the European Union, bank resolution measures not only apply to large systemic banks, but also to smaller institutions.

1.1.6 Issuers benefiting from a guarantee and/or government-related entity (GRE) status

Our Financial Institutions Rating Methodology describes how we assign ratings based on the analysis of standalone credit factors and applicable external support factors. In general, we do not perform a standalone analysis on financial institutions that benefit from an effective guarantee from a public sponsor or are assessed as being government-related entities. In such cases, we opt for a top-down approach as defined under our Government-Related Entities Rating methodology.

1.1.7 Issuers benefitting from being part of a group

Financial institutions can have complex corporate structures. We consider the operational and legal/structural features of the underlying corporate structure on a case-by-case basis to determine the appropriate analytical approach. This is the starting point to determine whether a financial institution is analysed under a consolidated group approach, or alternatively on a standalone basis.

The identification of a group is not limited to a specific legal entity owning or controlling others but can also include a mutual or cooperative structure. For instance, there may be legal, contractual, regulatory, or governance considerations that indicate that the entities collectively form the equivalent of a group. Furthermore, the notion of a consolidated group for the purpose of this analysis does not necessarily coincide with accounting-specific consolidation.

For issuers that benefit from full support or high likelihood of support under exceptional circumstances due to their group membership, we apply a top-down approach, taking into consideration the creditworthiness of the group to which they belong (see section 4.9).

2. Key components

The key components for the assignment of an issuer rating are:

- Operating environment assessment
- Business model assessment
- Long-term sustainability assessment
- Earnings capacity and risk exposure assessment
- Financial viability management assessment
- Additional factors assessment (if applicable)
- External support assessment (if applicable)

2.1 Analytical process

To begin our analysis, we examine the range of data and information available, on both the macro and micro levels.

As indicated in sections 1.1.6 and 1.1.7, steps 1 and 2 may not be needed when we rate an issuer using a top-down approach (i.e., eligible government-related entities or subsidiaries).

2.1.1 Step 1: Initial mapping and adjusted anchor assessment

We arrive at an initial mapping based on a combined assessment of an issuer's operating environment and business model.

We further hone the initial mapping by analysing the long-term sustainability of the issuer's business in the context of a changing operating environment. This analysis is based on environmental, social and governance (ESG) considerations and given the anticipated transformational impacts of technology on the financial sector, how an issuer copes with digitalisation.

The adjusted anchor assessment is the end point of step 1 and is a notch-specific assessment.

2.1.2 Step 2: Determination of standalone credit assessment

We refine our adjusted anchor assessment by reviewing the issuer's financial performance:

- Earnings capacity and risk exposures: we assess the risk profile of the issuer, in particular asset quality, and the level of risk protection provided by the issuer's ability to generate adequate risk-adjusted returns that build buffers, from provisions to capital.
- Financial viability management: we assess to what extent an issuer operates at a sufficient distance from regulatory minimum requirements, or industry benchmarks, which are also de facto binding constraints for non- or less regulated entities, and therefore manage the risk of regulatory failure, or the equivalent market perception.
- Additional factors that are not necessarily already captured in the above steps. Temporary considerations that weigh positively or negatively on the issuer's creditworthiness could also be captured in this step.

Our analysis of earnings capacity and risk exposures and financial viability management is not based on pre-defined ratios, or pre-determined thresholds. The relevant indicators are assessed at individual bank level but are intended to be similar for peers operating in the same jurisdiction.

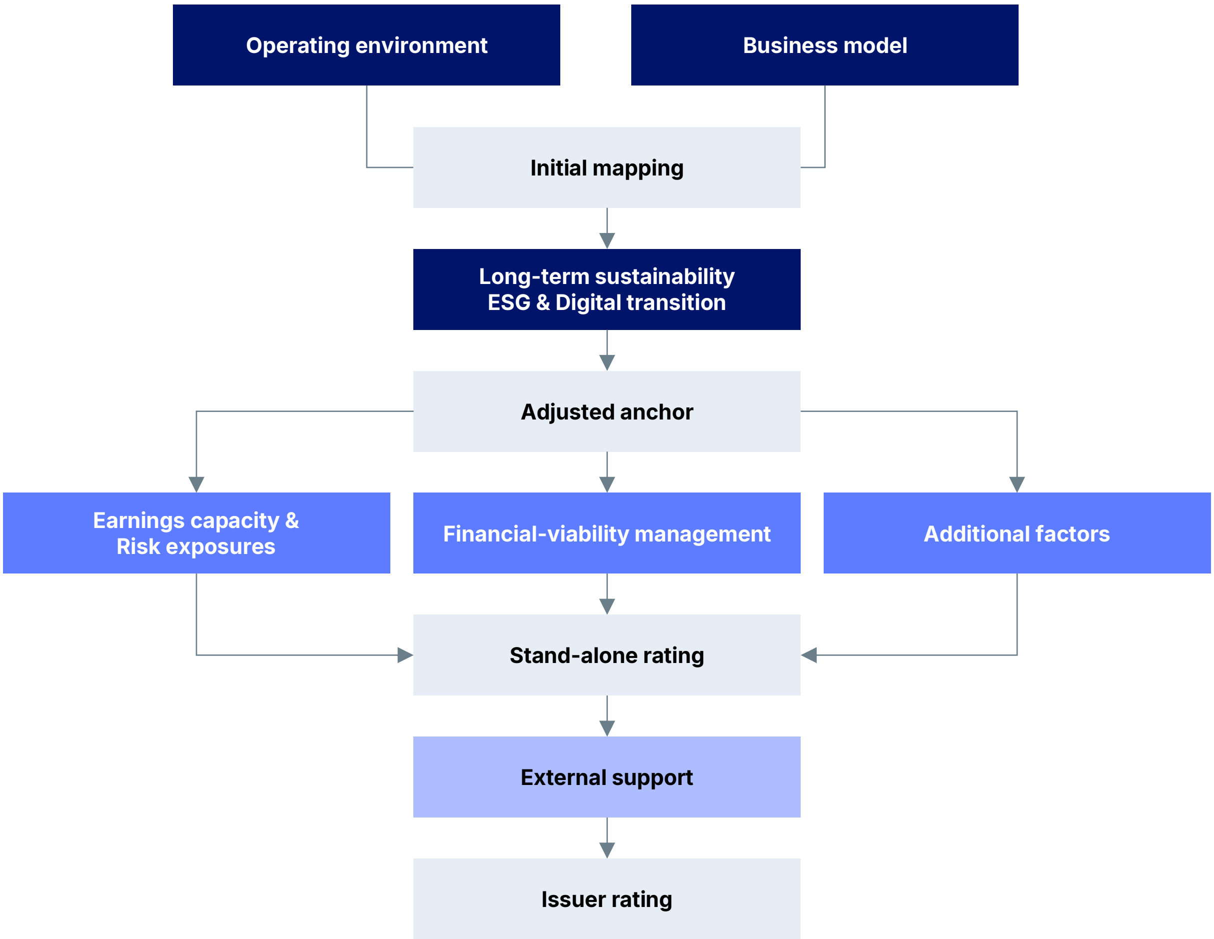
We incorporate elements of comparative analysis throughout our assessment. This reflects our belief that compare-and-contrast analysis and the identification of outliers can significantly add to our ability to spot potential credit problems early on.

2.1.3 Step 3: Integration of external support, if applicable

If appropriate, we complement our review of the issuer's standalone credit assessment with a review of potential external support.

The above-mentioned steps are detailed in the following sections.

Figure 1: Methodology outline and analytical framework



3. Information/Data sources

Key assumptions for this methodology are informed by discussions with external parties — such as issuers, institutional owners, regulators and governments — and Scope's analysis of financial and nonfinancial information, such as issuer financial statements and annual reports; bond documentation; and financial market, industry and economic data and history.

We perform our credit analysis using qualitative and quantitative information, mostly from the public domain. In advanced economies, regulatory initiatives have contributed to a significant improvement in the quality, depth, and degree of standardisation of public disclosures on financial and non-financial information. Assessing the adequacy and completeness of the information available for the rating process is a prerequisite. We will consider limitations observed in available information, such as partial or delayed publication or limited access to audited accounts.

We primarily use audited annual statements, which we may supplement with other public or non-public information (when available).

4. The issuer rating

4.1 Operating environment

In this first stage, we assess whether the environment in which the issuer operates is supportive of banking and/or other financial activities or is in itself a source of risk to the performance of financial activities.

The starting point of our analysis is to identify and assess the main markets in which the issuer operates, within or beyond the borders of its country of domicile, in order to capture the local, regional, national or international characteristics of these markets. Two broad areas form the core of our operating environment assessment:

Economic assessment. The economic evaluation of an issuer's main markets underpins our fundamental assessment, providing the context for trends in an issuer's financial fundamentals. We focus on relative levels and structural, long-term economic dynamics, rather than short-term shifts in GDP, interest rates or cyclical indicators. For example, we look at GDP/capita and nominal GDP as measures for the wealth and size of the domestic economy, which tend to be quite stable at least in the short term rather than GDP growth.

Our economic assessment is de-linked from our view on a sovereign's debt-servicing capacity, though it may include considerations on the room for fiscal and monetary manoeuvre to counteract potential shocks. Understanding the phase of the business cycle in the various markets in which the issuer operates is crucial to interpreting its financial performance.

Soundness of the financial sector. We assess the soundness of the financial industry in terms of its operating performance, capitalisation, asset quality and funding, while also considering structural elements such as its competitive structure and the quality of the legal and regulatory oversight framework. Our assessment includes considerations around the degree of expected support by fiscal or monetary authorities, and the interlinkages between sovereign credit risk and financial stability. We examine the extent to which competitive pressure favours risk-taking strategies across the industry and whether the legal and regulatory frameworks are supportive of sound financial activities. An efficient legal system may facilitate such activities, or the regulator may have a record of and capacity for proactive and measured intervention to prevent default risk.

We summarise our view on the riskiness of an issuer's operating environment by assigning one of five qualifiers, further refined through a high or low modifier to a 10-degree scale ranging from Very supportive (high) to Very constraining (low) (**Figure 2**).

Figure 2: Operating environment assessment

Qualifiers	Typical characteristics (see Figure 4 below for mapping with business model assessment)
Very supportive	Highly diversified and wealthy economies, with well-developed capital markets and an outstanding record of resilience to economic shocks. Record of and/or high expectation of material government support to the economy in case of need. Legal and regulatory frameworks provide sufficiently predictable outcomes for the performance of financial activities and market players benefit from adequate pricing power thanks to a supportive and market-driven competitive landscape. No significant economic imbalances threaten financial stability.
Supportive	Diversified and wealthy economies, with developed capital markets and an adequate record of economic resilience to shocks. Record of and/or expectation of government support to the economy in case of need. Legal and regulatory frameworks support the performance of financial activities and market players benefit from adequate pricing power thanks to a supportive competitive landscape. Some of the best-performing emerging economies could be in this category.
Moderately supportive	Economies that are less diversified, show some level of vulnerability to shocks, or that are expected to experience bouts of volatility. Financial capacity from the government to support the economy in case of need exists but could be limited or restricted. Sufficiently advanced legal and regulatory systems support the performance of financial activities and market players benefit from a moderately supportive competitive landscape. Well-performing emerging markets could be in this category.
Constraining	Economies that have limited economic diversification and have a lower level of wealth. The high vulnerability to shocks and volatile economic cycles could negatively affect financial performance of the financial sector in the long run. Poor regulation, weak supervisory practices and aggressive price competition limit a fair and stable development of the financial sector.
Very constraining	Extremely volatile and weak economies that could experience very deep business cycles, periodic bouts of political instability, and prolonged periods of hyperinflation or deflation. Very weak legal systems, highly unstable regulatory environments, or unreliable supervisory systems that do not support for a fair and stable development of the financial sector.

Operating environment assessment for non-bank financial institutions

For non-bank lending institutions that are subject to less regulation and intensive supervision (or may even be completely non-regulated), we assess the extent to which this translates into heightened risk-taking practices across the sector. In such cases, our operating environment assessment may differentiate between banks and non-bank financial institutions.

Operating environment assessment for issuers operating across several jurisdictions

For issuers with material business activities spanning across several jurisdictions, the assessment will reflect a blended view of the different operating environments.

4.2 Business model

Our business model assessment examines the ability of an issuer's business to consistently deliver stable and solid risk adjusted performance.

Our assessment starts with a review of the issuer's business lines across geographies. Many large banking groups are universal in nature and their business model consists of a specific mix of different business lines, which can often be clustered into three categories: retail and commercial banking, wholesale and investment banking, and wealth and asset management. Alongside universal banks, more specialised business models exist, such as private banks, specialised lenders (mortgages, consumer, leasing etc.), specialised trading and/or investment banks.

The key drivers of our business model assessment include:

- **The issuer's market position and pricing power.** Dominance in a product segment in a market tends to correlate with higher pricing power. To assess an issuer's market position and pricing power, we analyse its size and market shares in its main countries of operations.
- **The degree of geographic and product diversification.** Revenue diversification is generally positive for a business model. Diversification, especially in lowly correlated markets or product segments, supports the resilience of financial performance against idiosyncratic shocks.

When relevant, we also consider additional factors, including, for example:

- **The overall risk-adjusted return profile of the business mix.** Some activities are inherently riskier than others due to the specific focus on certain products or client segments. We may adjust our business model assessment to reflect the risk return profile of the issuer's business model.
- **Volatile performance.** Highly volatile key performance indicators (KPIs) typically point to riskier business models. Similarly, activities that are structurally unable to generate enough revenue to cover their overall cost typically weigh down our business model assessment.
- **Implementation of medium-term strategy.** To ensure our business model assessments are forward-looking, we review the issuer's strategic direction and recent corporate activity (such as M&A, divestments) and adjust our business model assessment to incorporate its likely impact on the business model, when we expect this to be material. As well as the clarity and coherence of the strategy, we consider the execution record.
- **Niche players**. For issuers with a marked geographic or product focus, we would consider not only their overall market position, but also the positioning in a specified niche, if we consider this to be more representative of the actual competitive position and pricing power. The stability of an issuer's franchise, including its customer base, effectiveness of distribution and strong brand recognition can also inform our business model assessment.
- **Strategic partnerships.** For issuers that benefit from group membership, strategic alliances or strategic support from shareholders, we will reflect the increased ability to service clients coming from such associations.

We summarise our view on the issuer's business model by assigning one of five qualifiers, further refined through a high or low modifier to a ten-degree scale ranging from Very resilient (high) to Narrow (low) (**Figure 3**).

Figure 3: Business model assessment

Qualifiers	Typical characteristics (see Figure 4 below for mapping with operating environment assessment)
Very resilient	Issuers with very strong and well-rounded business franchises, typically with a high degree of effective, well executed business and geographic diversification with adequate pricing power in several core markets and products. Leadership in domestic retail and commercial banking is often the anchor for the business model. KPIs are expected to remain very resilient and display very limited volatility even in stressed environments.
Resilient	Issuers in this category typically display a strong market position in their domestic retail and commercial market, where they may also be an important player in investment banking, insurance and wealth management. The domestic franchise is often complemented by some degree of international diversification. KPIs are expected to remain resilient and display low volatility through the business cycle.
Consistent	Issuers with a certain degree of revenue and earnings predictability, as is the case for most domestic retail and commercial banks. Regional franchises with strong local market positions or that focus on very low-risk customers or business lines can also be included in this category. Specialised lenders with well-established franchises or a high degree of geographic diversification can also be included in this category. KPIs are expected to display manageable volatility through the business cycle or in more stressed economic environments.
Focused	Issuers that operate on a small local scale and/or focus on a limited product range, making them more vulnerable to changes in the operating environment. This category also includes issuers with challenged franchises, and business models in need of reshaping. KPIs may display significant weaknesses or volatility through the business cycle or in more stressed economic environments.
Narrow	Business models with very high revenue volatility or a restricted revenue base, such as monoliners operating locally and lenders specialised in highly cyclical sectors or products with limited pricing power. A lack of business or geographic diversification limits the assessment.

4.3 Initial mapping

The combination of our operating environment and business model assessments provides the starting point for our rating process. Based on our qualitative assessment of these two factors, we arrive at an initial mapping assessment of the issuer (**Figure 4**).

Figure 4: Initial mapping table

		Operating Environment assessment									
		Very Supportive		Supportive		Moderately Supportive		Constraining		Very Constraining	
Business Model assessment		High	Low	High	Low	High	Low	High	Low	High	Low
Very resilient	High	a	a	a	a	a	a-	bbb+	bbb	bbb-	bb+
	Low	a	a	a	a	a-	bbb+	bbb	bbb-	bb+	bb
Resilient	High	a	a	a	a-	bbb+	bbb	bbb-	bb+	bb	bb-
	Low	a	a	a-	bbb+	bbb	bbb-	bb+	bb	bb-	b+
Consistent	High	a	a-	bbb+	bbb	bbb-	bb+	bb	bb-	b+	b
	Low	a-	bbb+	bbb	bbb-	bb+	bb	bb-	b+	b	b-
Focused	High	bbb+	bbb	bbb-	bb+	bb	bb-	b+	b	b-	b-
	Low	bbb	bbb-	bb+	bb	bb-	b+	b	b-	b-	b-
Narrow	High	bbb-	bb+	bb	bb-	b+	b	b-	b-	b-	b-
	Low	bb+	bb	bb-	b+	b	b-	b-	b-	b-	b-

4.4 Long term sustainability

From the initial mapping, we refine our view of the long-term sustainability of the business profile through an assessment of relevant environmental, social and governance (ESG) factors, with a specific focus on an issuer's preparedness for digital transition (D) – which we refer to as long-term sustainability (ESG-D).

Focus on ESG-D as source of credit risk. ESG-D encompasses a broad spectrum of topics. Our assessment, however, focuses on how ESG-D factors may impact an issuer's creditworthiness. Our approach takes into account the absolute level of sophistication of the issuer as well as the relative level of sophistication of the market(s) in which it operates. We aim to capture the extent to which proactive management of sustainability-related issues, including proper disclosures, reflects good risk management practices and provides a competitive edge in the market where the issuer operates, and therefore justifies a rating uplift. We also flag exceptionally weak ESG-D profiles, which we believe add to the risk profile of the issuer, justifying a downwards adjustment of the rating.

Materiality of ESG-D. To date, digitalisation and governance factors remain most relevant in the credit risk assessment of financial institutions. However, the importance of environmental and social factors is growing. Public and investor confidence are critical for financial institutions. Numerous ESG factors influence this perception, particularly those related to environment and social. These include an issuer's relationships with its various stakeholders, its management of human capital (e.g. employee welfare, skill development, diversity), its impact on the environment, and its role in environmental stewardship (i.e. support for sustainable growth and investment).

Our assessment of sustainability-related risks and opportunities is centred around the following elements:

Governance. We identify aspects of governance that may lead to higher credit risk, such as complexity in a group's ownership or corporate structure, a lack of independence among the board of directors, excessive power of (and reliance on) a key executive, or evidence of deficiencies in internal risk control and management. We also consider whether an issuer's business model is particularly exposed to litigation risk and the issuer's record on business conduct. Examples include incidents of product mis-selling, benchmark manipulation and money laundering. Misconduct can be a source of reputational and legal risk on top of regulatory fines. Remedial measures often involve direct costs and legal risks can represent a significant loss contingency.

Established financial institutions would in most cases display strong governance structures – at least on paper. Supervisory guidance, stock market governance codes and investor expectations have led to some convergence in the governance arrangements of larger institutions. As such, governance is unlikely to be a positive differentiating factor. Governance failures, on the other hand, are likely to drive credit differentiation. Small, unlisted or unregulated institutions are more likely to have weaker governance arrangements, partly due to a lower level of investor and supervisory scrutiny.

Digitalisation. To remain competitive, financial institutions need to make sufficient investments in their IT infrastructure, not only in client-facing functions but also in middle and back offices. We determine to what extent managing the digital transition is at the heart of strategic initiatives, or is a key component of the business model itself, whether a strong digital presence can be considered protective of established issuers, or whether digital transformation is shaping the competitive dynamic in the market the issuer operates in. Failure to keep up with evolving technologies and trends may not result in immediate losses but may jeopardise the business franchise in the long term. With financial services becoming increasingly digital, cyber risks are also becoming more prominent. This is no longer only an operational issue as failures in IT security, with respect to the loss of customer data, can lead to significant reputational damage and ultimately customer losses – affecting the longer-term sustainability of the business.

Environment. Our focus is on how an issuer addresses environmental issues from a risk management perspective, i.e. its efforts to identify risks and manage them. This is particularly the case when regulators have set expectations in this area. We look for evidence that an issuer is more exposed than peers to climate change risk, either in its credit portfolio or because of the nature of its business activities. A presence in multiple geographies typically constitutes a challenge given the heterogeneity of market and supervisory expectations, at least until a global standard emerges.

We also evaluate the availability and quality of disclosures on these risks and consider how an issuer is supporting sustainable growth and investment as this may be relevant for its stakeholders and represent a strategic business opportunity.

Social. Related factors impacting creditworthiness are often tilted to the downside and linked to governance issues. Issuers in the financial services industry are generally large employers with sizeable customer bases. The social repercussions of management actions may alter an issuer's reputation and constrain future growth prospects or the quality of its business franchise. Aggressive pricing, high remuneration policies or workforce adjustments tend to create more publicity than actions supporting social objectives. Governance models where customers have a significant influence on decision making tend to be more exposed to social risks.

Data limitations. We acknowledge the current constraints to peer comparisons, such as the level of industry disclosures, the ongoing development of standards, and the varying relevance of sustainability-related issues across geographies from a credit perspective. We also recognise that perceptions and expectations regarding ESG-D may vary across regions.

We expect the availability and quality of information to improve gradually and markedly as there is increasing demand from both supervisors and investors for ESG-related disclosures, transparency, and risk assessments. As supervisory expectations are further codified, financial institutions that cannot meet them face potential regulatory consequences and additional costs. In our assessment, we look for signs that management is aware of these expectations and is taking steps to meet them.

If needed, ESG-D factors may be further reflected in other steps of the rating process. Exceptionally strong (unlikely) or weak (more likely) ESG-D profiles, which warrant additional credit differentiation, could be reflected as additional factors (see Section 4.7).

Factoring long term sustainability into the rating process

We summarise our view on an issuer's long-term sustainability by assigning one of five qualifiers, ranging from Best in class to Lagging (**Figure 5**). Based on the qualifier, the adjusted anchor assessment will benefit from a one-notch uplift, be unchanged, or be lowered by up to two notches.

Figure 5: Long-term sustainability assessment modifier

Qualifiers	Typical characteristics	Rating approach
Best in class	The issuer stands out as an early adopter of the most advanced industry sustainability-related standards or practices. The issuer's approach to long-term sustainability, including target setting and commitment to delivery, clearly enhances its credit standing.	+1 notch
Advanced	The issuer is effectively and proactively managing sustainability-related considerations and stands out as a frontrunner in at least one sustainability theme that enhances its credit standing.	+1 notch
Developing	The issuer is embracing changes in the ESG-D area, in line with peers. Progress made may be tangible but does not warrant further credit differentiation.	0
Constrained	The issuer is embracing changes to cope with stakeholder demand in relation to sustainability but needs to address some identified and manageable shortcomings that constrain our overall assessment.	0
Lagging	The issuer's management of material sustainability considerations displays significant shortcomings, which need to be addressed in the short term to catch up with evolving industry standards or market perception.	-1 or -2 notches

We then further refine our adjusted anchor assessment by analysing an issuer's financial profile, including earnings capacity, risk exposures and financial viability management.

4.5 Earnings capacity and risk exposures

Earnings, the first line of defence. An issuer's earnings capacity measures its ability to build and preserve economic value over time, as well as to create a sufficient level of risk protection – primarily in the form of credit provisions and equity capital. We view earnings primarily as an element of risk protection, as they are often an issuer's first line of defence against potential losses. Our assessment of an issuer's earnings capacity is a look-through approach of its earnings in light of its unique mix of risk exposures, which could be primarily credit risk, market risk or operational risk. Whereas our review of business models assesses the issuer's capacity to generate predictable and sustainable operating revenue, we focus here on an issuer's ability to generate sufficient income to: i) cover its operating costs; ii) absorb losses on an ongoing basis including exceptional losses or incremental losses through the cycle; and iii) generate profit above its capital needs to remunerate providers of equity capital.

Credit risk. For most financial institutions – in particular banks – asset quality is a key focus of risk analysis, as credit risk (encompassing both the lending and investment portfolios) is often the primary driver of losses. The quality of underwriting criteria and the permanence of effective protection mechanisms such as insurance or collateral may represent important mitigating factors. We focus on relevant exposures that are more cyclical and are most likely to suffer higher credit losses in a downturn. When problem loans arise, we assess the issuer's capacity to remedy them and its strategic approach to cleaning up the balance sheet.

Other risk exposures. Depending on the business model, market risk, in particular interest rate and foreign exchange risks, can be a relevant source of earnings and capital volatility for financial institutions with significant market activity, or material asset-liability mismatches. In some instances, concentrated exposure to individual risks can constrain an issuer rating.

Specialised lenders will often be exposed to specific risks arising from the peculiarities of their business models. Operational risk is especially relevant for issuers with complex operations and for activities structurally carrying low credit or market risk such as, for example, asset management or custody. We take into consideration the execution risk of specific material transactions (such as acquisitions or divestitures) or sizeable IT system migration processes, if this risk is not already sufficiently captured by our long-term sustainability assessment. Legal and litigation risks may be significant in some cases, limiting visibility on future earnings and capital trends. Other risks, inherent to a financial institution's business model, could be considered under this section.

Sovereign risks. For some financial institutions, and in particular those benefiting from effective supra-national support frameworks, such as banks in the euro area, we do not mechanistically link their overall creditworthiness to their respective sovereign. This reflects our view that there is a range of scenarios where banks may go through a sovereign default event without defaulting on their senior obligations.

When our bottom-up analysis indicates the potential for an issuer rating to be higher than the sovereign rating of the country in which the issuer is headquartered, we will systematically review its exposure to domestic sovereign bonds. When this exposure represents a material concentration (i.e. over 25% of Tier 1 capital), we review its risk characteristics and assess whether this is a driver for the assignment of the earnings capacity and risk exposure qualifier.

Focus on structural, rather than cyclical drivers. Our ratings provide a medium-to-long term view of an issuer's creditworthiness. This means that a temporary dip in earnings is not in itself a reason to downgrade the issuer rating. Conversely, a one-off boost to profitability would generally not warrant higher ratings. Disregarding temporary earnings spikes or dips should contribute to ratings stability and predictability over time. However, deeper cyclical fluctuations may inevitably indicate material changes in an issuer's financial fundamentals, which will be reflected in the ratings. Our assessments are geared toward future expected trends and developments.

No scorecard approach. Our analysis of earnings capacity and risk exposures does not hinge on the monitoring of a specific ratio, a pre-defined set of ratios, or pre-determined thresholds. The relevant indicators are assessed at individual bank level but are intended to be similar for peers operating in the same jurisdiction. We look at a broad range of measures, depending on the issuer's business model. For example, **Figure 6** illustrates the ratios that are typically reviewed for European banks.

Figure 6: Earnings capacity and risk exposure metrics, European banks

Earnings Capacity	Risk Exposures
Net interest margin	Non-performing loan ratio
Cost/ income ratio	Non-performing loans/ tangible equity and reserves
Pre-provision income/ risk-weighted assets	Coverage ratio
Return on assets	Cost of risk
Return on equity	

Peer based assessments. Our assessment of earnings capacity reflects the historical record and expected financial performance of the issuer. We look at changes in financial performance using a compare-and-contrast analysis, analysing the issuer's financial ratios relative to peers. As such, our assessment is not based on benchmarks – and we do not use pre-determined fixed thresholds for rating changes.

How we factor earnings capacity and risk exposures into the rating process

We summarise our views on earnings capacity in light of a financial institution's risk exposures by assigning a qualifier based on a five-degree scale ranging from Very supportive to Very constraining (**Figure 7**). A notching grade is attached to each qualifier, leading to an uplift or a lowering of the adjusted anchor from +2 notches to -2 notches.

Figure 7: Earnings capacity and risk exposure modifier

Qualifiers	Typical characteristics	Rating approach
Very supportive	Earnings capacity is highly stable through economic cycles and consistently supports the accumulation of loss absorption buffers. Provisioning and dividend distribution policies are conservative. There is no relevant concentration of risk exposures. Asset quality metrics and loss experience are better than peers. Risks are very low and well-managed, and unlikely to lead to losses capable of undermining the issuer's viability.	+2 notches
Supportive	Earnings capacity is stable through economic cycles and provides a strong buffer against losses. Asset quality metrics are relatively better or at least in line with peers. There is no relevant concentration of relatively high-risk exposures. Risks are well managed and are highly unlikely to lead to losses capable of undermining the issuer's viability.	+1 notch
Neutral	Earnings capacity may be variable over economic cycles but is sufficient to cover expected losses. Asset quality is in line with peers. Some risk concentration may exist but is not expected to be high or to generate high losses. Risks are unlikely to generate losses capable of undermining the issuer's viability.	0
Constraining	Earnings capacity is weak. Earnings and loss experience may show high volatility. Concentration risks require monitoring and can weigh on future performance. Asset quality metrics are below peers. Management is addressing risks, but these may still lead to material losses, putting pressure on the issuer's viability.	- 1 notch
Very constraining	Earnings capacity is very weak. Earnings and loss experience may show very high volatility. There are material concentration risks. Asset quality metrics are materially poorer than those of peers. Risk management is insufficient to build or rebuild loss absorption buffers, undermining the issuer's viability.	-2 notches

4.6 Financial viability management

Financial resource management a key driver of credit risk. We assess the way an issuer manages its financial resources, including its capital and funding. For banking institutions and other regulated financial institutions, our analysis acknowledges the need for institutions to continuously comply with regulatory requirements and supervisory expectations. For non-regulated issuers, regulatory ratios are typically not available. In these cases, our analysis will focus on measures that are commonly seen as industry benchmarks. For both banks and other financial institutions, we evaluate the stability and diversity of an issuer's funding structure as well as the management of structural mismatches from an asset and liability perspective.

Looking at financial viability through the prism of regulatory metrics. Banking is a regulated business. Compliance with regulatory requirements is a prerequisite for banks to continue operating, often referred to as a 'licence-to-operate risk' or failure risk. With the increased sophistication of regulatory frameworks, maintaining a sufficient distance to regulatory minimums has become a source of complexity for banks, an important driver of their medium-term strategies and a confidence-sensitive issue, attracting both management and investor attention. Maintaining a sufficient distance to minimum regulatory requirements often drives strategy, e.g. capital allocation if capital resources are scarce or regulatory requirements are high. The need to comply with a variety of requirements can also significantly hamper the ability of a bank's management to implement its strategy. The consequences of not complying with a regulatory minimum requirement is not always clear, with some regulatory breaches having more severe implications than others.

Acknowledging the complexity of financial viability management. A well-defined regulatory regime could be amended at discretion to adapt to changing operating conditions in a pragmatic manner and with little advance notice. We aim to identify requirements that are critical to a bank's viability and, under stressed conditions, scrutinised by market participants, potentially exacerbating default risk. National discretion or regulatory forbearance may ease the challenge of complying with regulatory requirements for some banks, and less so for others. While looser regulatory requirements may facilitate management's ability to execute its medium-term strategy, they could also foster an aggressive risk appetite or insufficient protection against risk, which we would capture in our analysis of key risk exposures. Funding stability is a highly confidence-sensitive issue, and we consider that the analysis of funding adequacy is less easily performed through the prism of regulatory compliance. There is a diversity of funding sources from one country to another, and from one business model to another.

No scorecard approach. We do not set prescriptive, pre-defined thresholds above minimum requirements that we consider appropriate for an issuer's business. Our assessment does not hinge on the monitoring of a specific ratio, a pre-defined set of ratios, or pre-determined thresholds. The relevant indicators are assessed at individual issuer level but are intended to be similar for peers operating in the same jurisdiction. For example, **Figure 8** illustrates the ratios that are typically reviewed for European banks.

Figure 8: Financial viability management metrics, European banks

Capital	Funding and liquidity
CET1 ratio	Net stable funding ratio
Tier 1 ratio	Liquidity coverage ratio
Total capital ratio	Loan/deposit ratio
Leverage ratio	
Asset risk intensity	

Quality review. Our assessment incorporates qualitative considerations on the different metrics, including their composition, stability and any imminent risks. For example, we may penalise issuers with very low risk asset intensity, when we consider this is not fully capturing the underlying risks of the balance sheet.

Forward looking view. Our assessment incorporates our expectations on how capital, funding and liquidity metrics will evolve over time. This view is informed by management expectations and guidance, as well as by our expectations around future profitability, asset growth, and upcoming regulatory changes. For example, a bank with very high capital buffers will not receive any rating uplift if we expect such excess capital to only be a temporary feature based on the bank's growth and distribution plans.

Asymmetric approach to capital excesses and deficits. In general, we do not expect excessively large buffers to remain a permanent feature. Consequently, we do not give additional weight to buffers that are significantly above the regulatory minimum. We consider a maximum two-notch uplift to strike a balance between a degree of conservatism and balance sheet optimisation considerations. In contrast, our assessments may penalise by 5 downward notches financial profiles that place an institution's financial or regulatory viability at risk.

Factoring financial viability management into our rating process

We summarise our views on financial viability management by assigning a qualifier based on a six-degree scale ranging from Ample to At risk. A notching grade is attached to each qualifier, leading to an uplift or a lowering of the adjusted anchor assessment from +2 notches to -5 notches (**Figure 8**).

Figure 9: Financial viability management modifier

Qualifiers	Typical characteristics	Rating approach
Ample	We consider that the issuer's management effectively and consistently maintains an ample buffer to relevant regulatory requirements, and we expect it to continue to do so. We expect the issuer's financial viability to prove resilient to tail-risk events.	+2 notches
Comfortable	We consider that the issuer's management effectively maintains a comfortable buffer to relevant regulatory requirements, and we expect it to largely continue to do so. We expect the issuer's financial viability to prove largely resilient to tail-risk events.	+1 notch
Adequate	Financial viability management provides some buffer and, under a base case scenario, should not imminently push any metric close to minimum requirements or jeopardise the issuer's financial viability.	0
Limited	We consider that the issuer's management of its financial resources, intentionally or not, puts pressure on its ability to conduct its medium-term strategy independently and free of regulatory or financial viability considerations.	-1 notch
Stretched	We consider that the issuer's management of its financial resources is too aggressive or that compliance with minimum regulatory requirements is stretched, which hampers management's ability to drive business strategies.	-2 or- 3 notches
At risk	We consider that the issuer's compliance with minimum regulatory requirements is too stretched and puts its regulatory and financial viability at risk.	-4 or- 5 notches

4.7 Additional factors

This final step captures credit strengths and weaknesses that were not already captured or insufficiently captured earlier in the rating process. We intend to make limited use of this additional step.

This step can reflect transitory situations, such as restructuring measures that have not been fully implemented, events leading to changes in ownership or M&A transactions. The full execution of these strategic moves often entails transition risks, which may temporarily but materially constrain or support an issuer's creditworthiness. By isolating analytical factors under this category, we explicitly signal their material but transitory nature and the possibility that they could eventually be incorporated elsewhere in the rating process.

This step also captures specific business model characteristics and risks relating to non-bank lending institutions and more generally, narrower business models exposed to specific risks and/or with a high dependency on one specific factor, leading to a material concentration risk that may not otherwise be reflected or only be insufficiently captured in other parts of this methodology.

Figure 10: Additional factors

Qualifiers	Typical characteristics	Rating approach
Significant upside factor	We consider that a qualified rating factor, or set of factors, not already captured in the rating process, provides a significant uplift to the issuer's creditworthiness.	+2 notches
Material upside factor	We consider that a qualified rating factor, or set of factors, not already captured in the rating process, provides a material uplift to the issuer's creditworthiness.	+1 notch
Neutral factor	We consider that the previous steps in the rating process adequately reflect the issuer's creditworthiness.	0
Material downside factor	We consider that a qualified rating factor, or set of factors, not already captured in the rating process materially weighs on the issuer's creditworthiness.	-1 notch
Significant downside factor	We consider that a qualified rating factor, or set of factors, not already captured in the rating process, significantly weighs on the issuer's creditworthiness.	-2 notches

4.8 Standalone rating

The standalone rating, resulting from the refinement of the adjusted anchor assessment in step 2, represents the intrinsic credit strength of the issuer, irrespective of any expectation of extraordinary external support.

4.9 External support

We incorporate ongoing operational support (ordinary support) in the standalone analysis. For instance, stable distribution agreements with shareholders could boost our assessment of an issuer's business model; risk-sharing or buyback agreements could boost our assessment of asset quality; and the existence of standby funding commitments could boost our assessment of financial viability.

Beyond the analysis of these intrinsic rating factors, external support notches can be appropriate if we assess that an issuer is likely to benefit from an external source of support under exceptional circumstances. Our assessment of external support focuses on both the ability and the willingness to support the issuer under exceptional circumstances such as financial distress.

Sources of support may take different forms, such as:

- Government support, for entities qualifying as government-related entities and for which we apply a bottom-up approach (see our Government Related Entities Rating Methodology)
- State support: as resolution regimes have been implemented in various jurisdictions and in particular across Europe and in the US, timely external state support for banks in distress (bail-out) has become less likely. We therefore believe that bank ratings cannot generally be boosted by the expectation of extraordinary state support in those jurisdictions. Our rating may incorporate the possibility of state support for banks domiciled in jurisdictions without resolution regimes if the systemic importance of those entities indicates a significant likelihood of extraordinary state support. The expectation of state support will be assessed considering the specific characteristics and systemic importance of the issuer, the characteristics of the legal and regulatory framework, including the record of government interventions in the sector, as well as the creditworthiness of the potential source of support.
- Parental support, either from a single owner, in the case of subsidiaries, or from several owners in the case of joint-ventures or other forms of joint ownerships.
- Other forms of group membership such as joint liability schemes or solidarity mechanisms: in many countries, financial services are provided by members of associations, through the amalgamation of joint liabilities or solidarity mechanisms. If there are mutual support mechanisms or cross-guarantees within a group of entities, as in the case of certain cooperative or savings bank groups, expectation of support may provide an uplift the issuer rating beyond standalone factors.

The expectation of support, assuming the source of support has the capacity to provide support, depends on:

- The source of support being more creditworthy than the issuer.
- The absence of legal impediments, regulatory limitations or other constraining factors that would prevent the supporting entity from providing support to the issuer, for instance in case of international groups facing transfer or convertibility risks. Such a limitation would likely weigh on the possibility of providing rating uplifts.

4.9.1 Factoring in external support for members of a group

We summarise our views on the likelihood of external support for members of a group by assigning a qualifier based on a four-degree scale ranging from No support to Full support (**Figure 11**). The rating approach remains conditional upon the absence of other constraints (external to the group) as highlighted above.

Figure 11: Group support for members

Likelihood of support	Typical group membership characteristics	Rating approach
Full support	The issuer benefits from an implicit guarantee or legal commitments or a record of support that confirms the likelihood of effective and timely support. The activities of the issuer are fully aligned with the strategic goals of the source of support. The issuer is fully integrated operationally with the source of support. A no-support decision would be highly detrimental to the source of support in terms of financial, reputational or franchise developments, potentially threatening its own credit standing. An issuer only established to perform a specific function, such as providing funding, would qualify for this category.	Aligned with credit strength of the source of support
High support	Activities are of high strategic importance and in line with the source of support's strategic direction. The issuer is largely integrated to the source of support from an operational standpoint. The financial, reputational and strategic downside from a no-support decision could be material.	One notch below the credit strength of the source of support
Moderate support	The source of support is under no obligation to support the issuer. However, the financial, reputational and strategic downside from a no-support decision could be material. The issuer is of strategic relevance and benefits from some degree of operational integration.	Bottom-up approach: up to maximum 1 notch below credit strength of supporting entity
No support	The third party is under no obligation, explicit or implicit, to support the issuer, and there is no record of support actions. The financial, reputational, and strategic downside from a no-support decision is very limited. The degree of operational integration is limited. This may be due to external constraining factors such as ring-fencing. The entity is strictly separated from the assets of the group.	No uplift

Group rating approach. For highly cohesive groups that prepare consolidated financial statements and share significant functions, we apply a consolidated group rating approach, where we align the rating of core member institutions with the combined credit strength of the group, unless our analysis indicates that the different entities of the group have significantly different risk profiles. The regulator's view of the cohesiveness of such groups would be a key element informing our decision on which rating approach to pursue. For example, a consolidated group rating approach would typically apply for banks belonging to officially recognised European institutional protection schemes.

Rating above the parent. An issuer could be rated higher than its parent (or the relevant source of support) based on its standalone credit fundamentals. Typically, the rating difference would be one notch, but it could be wider if, for instance, a financially healthy subsidiary has a ring-fenced structure or benefits from other forms of credit enhancement.

4.9.2 Assessing the creditworthiness of the source of support

To determine whether the source of support is more creditworthy than the issuer, and therefore able to provide support, we may rely on different credit assessments depending on the degree of control it has over the issuer. Support may be provided by a single entity or jointly by several entities, which would require an estimate of their average credit strength where appropriate.

Figure 12: Guidelines for assessing the credit strength of parental support

<table>
<tr><th colspan="2"></th><th colspan="2">Expected support*</th></tr>
<tr><th colspan="2"></th><th>Full or high support</th><th>Moderate support</th></tr>
<tr><td rowspan="3">Ownership stake</td><td>50%-100%</td><td rowspan="3">Public or private rating by Scope</td><td>Public or private rating by Scope</td></tr>
<tr><td>15%-50%</td><td>Credit estimate</td></tr>
<tr><td>0 - 15%</td><td>Not performed</td></tr>
</table>

*As indicated in Figure 11

5. Ratings on debt instruments

While the issuer rating does not automatically equate to specific ratings on an individual security, it is the starting point for assigning credit ratings to various classes of liabilities. The ratings on individual securities normally reflect their ranking in the issuer's capital structure, with the most senior unsecured bonds typically rated in line with the issuer rating. Other considerations, such as the expectation of a different treatment of a liability class due to financial stability or political considerations may also inform the final rating, depending on the jurisdiction.

Figure 13: Typical notching structure for classes of bank debt securities

Typical notching structure for classes of bank debt securities	
Senior Secured debt (e.g. covered bonds)	X+1 to X+9
Deposits (preferred)	X+1
Issuer rating	X
Senior unsecured debt	X
Senior unsecured (subordinated) debt	X-1
Subordinated debt	X-2
Tier 2 debt	X-3
Additional Tier 1 debt	X-5

Deposit ratings are either aligned with the issuer rating or are rated one notch above. Specifically, deposits can be rated one notch above the issuer rating if they are considered to be more protected than senior unsecured debt. This is the case in countries with a depositor preference regime.

Senior unsecured debt ratings are aligned with the issuer rating. However, senior unsecured debt is rated one notch below the issuer rating if it is issued as statutorily non preferred, structurally subordinated, or otherwise subordinated to other senior unsecured debt.

Subordinated debt is rated two notches below the issuer rating.

Banks' capital structures typically also include Tier 2 and Additional Tier 1 securities. Our approach to rating these securities reflects their role in strengthening banks' capital positions, including their loss absorption features. The methodology applies solely to Basel III/CRR-CRD compliant capital securities and does not apply to hybrid securities issued before the global financial crisis.

Tier 2 debt is rated at least three notches below the issuer rating, reflecting its loss absorbing features and junior status in the priority of claims. Tier 2 securities can be written down or converted into equity as part of early regulatory intervention or when an issuer has reached the point of non-viability (PONV). In a resolution bail-in scenario, Tier 2 securities are considered capital securities and rank below subordinated and senior debt.

When rating specific Tier 2 securities, there may be a further notching beyond the minimum three notches. This would be the case when we see additional risk factors that may be security-specific or issuer-specific. For example, the notching on a Tier 2 security may widen as an issuer's fundamentals deteriorate towards the PONV. Depending on the severity of the capital need and the amount of capital resources available, Tier 2 securities may be converted or written down.

Additional Tier 1 debt (AT1) is rated at least five notches below the issuer rating, reflecting its loss absorbing features and deeply subordinated status in the priority of claims. More specifically, investors are subject to coupon-cancellation risks in the following situations: i) the issuer lacks available distributable items; ii) the issuer has breached its combined buffer requirement (CBR); and iii) the issuer utilises its discretion not to pay. Further, AT1 securities may be written down or converted into equity when the issuer's common equity Tier 1 capital ratio breaches the specified trigger or when the issuer has reached the PONV.

When rating specific AT1 securities, there may be further notching beyond the minimum five notches. This may be the case when we see additional risk factors. These may be security- or issuer-specific, such as a narrower distance to the maximum distributable amount level compared to peers, the existence of high triggers for write-down, or material earnings volatility due to an issuer's higher risk business model.

Our ratings do not take into account whether AT1 securities will be called by the issuer, or the interest reset rate, although these are important considerations for investors.

Covered bonds are part of the general on-balance sheet funding of a bank, as further confirmed during the great financial crisis, when covered bonds managed to keep many banks afloat. Our rating approach for covered bonds therefore reflects our view that:

i) The issuer rating is the fundamental anchor point for covered bond analysis.

ii) The combination of legal and resolution frameworks is the most important element supporting the covered bond rating.

iii) The cover pool represents a second recourse after a chain of events affecting the issuer. It is limited but provides additional security and stability to the covered bond rating.

The introduction of resolution/bail-in regimes in several markets, e.g. the Bank Recovery and Resolution Directive in the EU, has had significant implications that are reflected in our separate methodology for covered bond ratings. The former base case for covered bond analysis – in which the cover pool becomes the sole source of repayment upon the insolvency of the issuer – has become unlikely in a resolution regime. For more details, see our Covered Bond Rating Methodology[1].

[1] Available on www.scoperatings.com.

6. Other considerations

6.1 Bank holding companies/non-operating holding companies

For European financial institutions with a holding company structure, we consider the credit fundamentals of the entire group, i.e. on a consolidated group basis, when assigning an issuer rating to the holding company. This is in line with the regulatory approach followed in Europe and reflects the inherent connection and interdependence among group constituents.

Where the credit risk profile of the holding company is not essentially related to the performance of the consolidated group (e.g. due to material additional leverage or large equity investments), the rating of the holding company could be notched down relative to the group to reflect a potentially higher credit risk.

For debt issued by the various operating and non-operating entities of a group (including the holding company), this will be rated according to their ranking in the creditor hierarchy and within the context of the group's liability structure. For instance, we would typically rate senior debt issued by a holding company one notch below senior debt issued by the main operating bank as the holding company debt has a lower ranking in the context of the group's liability structure.

6.2 Branches issuing debt

We may assign issuer ratings to the local or foreign branches of a financial institution. A key attribute of a branch is that it has no separate legal existence compared to the reference issuer (generally identified as the head office).

A branch located in the same country of operation as the issuer's head office would be rated at the same level. The issuer rating of a foreign branch will be rated lower than the issuer rating of the reference issuer in case of specific country characteristics limiting the ability of the reference issuer to repay its debt obligations via foreign branches in a timely manner. We consider this unlikely for branches in investment-grade countries.

When we consider that there is no such limitation, we will assign debt ratings to debt instruments issued by branches of a financial institution without necessarily assigning an issuer rating to the branch.

6.3 Low issuer ratings

For banks subject to resolution with very low issuer ratings, typically in the B range and below, the likelihood of preferred senior debt (or equivalent) being bailed in would be higher. In these cases, we may notch down all senior unsecured debt ratings from the respective issuer rating to reflect the expectation of heightened bail-in risk for these securities.

6.4 Banks under regulatory intervention

For banks undergoing a resolution process or equivalent regulatory action, we would take a view on the likelihood of a successful intervention returning the bank to the market as a going concern, as well as the credit strength of the resulting institution, which would be captured by a new issuer rating level. Securities not bailed in as part of the process will be notched off the new issuer rating level.

6.5 Impact of coupon cancellation on AT1 ratings: no automatic downgrade

The terms and conditions of AT1 securities allow for coupon payment discretion. Consequently, an issuer who does not pay does not breach any regulatory or contractual obligations and would therefore not be considered in default.

In this scenario, we would evaluate the reasons for the coupon cancellation and assess whether this is a temporary or more permanent change in the issuer's ability to make distributions. If the reason for the coupon cancellation were a one-off event, which does not impair the issuer's future capacity to make payments, we may not change the rating on the AT1 security. More specifically, we will not automatically consider such an event to be a default.

However, if coupon cancellation were due to negative credit developments, such as a permanent deterioration in the issuer's earnings capacity or capital position that is unlikely to be promptly restored, this would lead to a downgrade of the issuer rating and, potentially, a concomitant widening of the notching gap for the AT1 security rating.

6.6 Impact of write-down or conversion on capital securities ratings

The terms of certain capital securities allow for write-down or conversion under certain conditions. In such a scenario, investors would experience a material loss on their principal investment. A write-down is also possible upon regulatory intervention.

If a capital security is converted into equity, we would downgrade to default status and withdraw the credit rating. Similarly, when a capital security is written down permanently, it ceases to exist. We would also downgrade to default status and withdraw the credit rating.

If a capital instrument is written down temporarily, we continue to rate it as it remains outstanding. The rating on the temporarily written-down security would be kept at D. We would then monitor and modify the rating as appropriate – for example, as the likelihood of coupon payment or write-up evolves.

6.7 Key limits and uncertainties of this methodology

This methodology is designed to be applicable to a broad range of financial institutions globally. We believe that the key drivers of credit risk for financial institutions, as described in **Section 2 Key components** are indeed universal. However, information availability and disclosures will inevitably vary across business models and jurisdictions, requiring Scope's analysts to apply judgement in identifying appropriate metrics when analysing individual credits. For example, disclosure heterogeneity limits our ability to quantitatively benchmark issuers on long term sustainability issues, our assessment having to rely on qualitative assessments to a greater extent.

Our aim is to capture all relevant credit drivers in the methodological framework, but we acknowledge the impossibility to foresee any potential source of risk ex-ante. For this reason, **Section 4.7 Additional factors** is designed to capture credit strengths and weaknesses that were not already captured or insufficiently captured earlier in the rating process.

Our ratings incorporate both the historical track record of an issuer and its expected financial performance. However, for some issuers, a long track record of audited financial accounts may not exist. For example, this is typically the case with newly established institutions. In these cases, our analysis will rely more heavily on projections and expectations. For issuers participating in the rating process, our assessments will be informed by management discussions or other confidential information. Neither past results nor management or Scope's analysts' expectations are guarantees of future performance.

Scope Ratings GmbH

Lennéstraße 5
D-10785 Berlin
scoperatings.com

Phone: +49 30 27891-0
Fax: +49 30 27891-100
info@scoperatings.com

in
Bloomberg: RESP SCOP
Scope contacts

Disclaimer