



DBRS Criteria: Intrinsic and Support Assessments

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DBRS Criteria: Intrinsic and Support Assessments

As announced on February 11, 2009, DBRS has refined its support methodology for its bank ratings to enhance the transparency and clarity of the analytical process by introducing a floor rating concept for banking organizations that are considered critically important to the functioning of a country's financial markets. Although the overall support methodology is applied worldwide for all banks, the floor ratings will only apply in certain countries where it is deemed appropriate, based on government actions and the structure of the financial system. In addition to this refinement, some changes have been made in the description of the various support assessment categories to reflect the evolution of the application of this methodology.

Under this methodology, DBRS makes reference to intrinsic assessments and support assessments as the building blocks for bank credit ratings. For more clarity about support assessments, in 2006, DBRS introduced a simple four-notch scale from SA1 to SA4. To avoid the introduction of a lengthy parallel scale for intrinsic assessments, DBRS also then began to make direct reference to the rating equivalent of the intrinsic assessment in its analytical communications about the rated banks. For example, a bank with an intrinsic assessment equivalent to "A" and an SA2 support assessment could end up with an A (high) or higher rating. These two building blocks would be disclosed in our analysis.

INTRINSIC ASSESSMENTS

An intrinsic assessment reflects DBRS's opinion of a bank's intrinsic fundamentals – market position, franchise value, governance, ownership, management strength, strategy and its implementation, financial strength and earnings capacity as reflected in key ratios and qualitative parameters, risk profile and risk management (credit, market, liquidity, asset liability management, operational, etc.) – in terms of the strength and predictability of the operating and regulatory environment. Thus, the intrinsic assessment of a bank is the result of a comprehensive and multi-faceted analysis of its fundamentals, including both qualitative and quantitative elements. This assessment factors in explicit government support, such as programs to bolster capital or liquidity. DBRS does not limit this exercise to being a financial-ratio scorecard.

DBRS does not determine intrinsic assessment equivalents for subsidiaries whose business and financial viability depends on parent-company ownership and control, without which the subsidiary would not be able to function.

SUPPORT ASSESSMENTS

Support assessments reflect DBRS's opinion of the likelihood and predictability of timely explicit or implicit external support for a bank in case of need. This opinion is based on DBRS's analysis of the various forms of support coming from the bank's parent(s) or other controlling affiliates, be they private institutions (such as other banks, insurers or non-financial companies) or public bodies (such as local, regional, national or federal governments or related public-sector entities). DBRS's analysis also includes any implicit or partially explicit timely support likely to be provided to systemically important banks (SIBs), as discussed below.

In assigning support assessments, DBRS uses a scale with four categories:

SA1 – Reflecting very strong to good likelihood of and predictability of timely external support, ranging from an outright guarantee to ownership and control. The rating would be pegged to the guarantor's or parent's explicit or implied rating, being either at the same level or slightly lower, as follows:

- **Outright Guarantees or Their Equivalent:** Typically, there would be no notching between the guaranteed rating and the rating (or implied rating) of the guaranteeing body.



- **Ownership by and/or Strategic Control of the Parent Institution of a Financial Group:** Typically, there would be no notching or a one-notch difference (more rarely two). This would be a function of the strategic importance of the respective entity to the entire group, of the degree of group integration, of the entity's importance to the parent's overall brand and also of the intrinsic fundamentals of the parent itself.
- **Ownership by and/or Strategic Control of a Non-Financial Parent (Public Sector, Local or National Government or Private Sector):** The rating would also be pegged to the parent's explicit or implied rating, but in a looser relationship than in the case of entities that are members of a financial group. Typically, there would be up to a three-notch difference from the parent's rating (or implied rating).

SA2 – Reflecting the expectation of some form of systemic external support, ideally with a timeliness element in it. This would be the case with SIBs, which can be either national institutions or local and regional banks with an important local market position. In the latter category in particular, DBRS includes banks that belong to well-defined sectoral associations, such as savings banks or co-operative groups. In this case, DBRS would notch up from the level of the intrinsic assessment, typically by one notch. Financially weaker SIBs, for which a form of external support is more important, could benefit from a higher rating uplift. In considering the reliability of support in a country, DBRS considers the concentration in its banking sector, the extent of inter-connections between the state and its financial institutions, the history of predictable government intervention to support its SIBs and the infrequency of bank failures. There are cases, however, where an SA2 designation will provide no additional lift from the intrinsic assessment rating. These cases would typically include situations where the DBRS floor rating for a particular country has the added implication that support above the floor is less likely. It can also address situations where DBRS already incorporates some aspects of implicit support in the intrinsic assessment and it is not appropriate for the final rating to reflect additional lift from implicit support. In some cases, DBRS may also feel that the intrinsic assessment is at such a high level that including additional support because of the SA2 rating is simply not warranted. The support assessment-driven notching add-on is, however, applicable only to the extent that the rating (or the implied rating) of the supporting body is materially higher than the bank's intrinsic assessment equivalent.

SA3 – Reflecting no expectation of any form of timely external support. This would be the case with smaller credit institutions not affiliated with any cohesive sector and without a relevant national or local market position or with large and small institutions alike for which DBRS assumes that no form of timely support is likely. In this case, there would be no support assessment uplift built into the rating. This designation is also appropriate for banks in certain countries where support might be forthcoming, but where its timeliness and scale cannot be relied on sufficiently to raise the final rating above the intrinsic assessment.

SA4 – Reflecting the financial burden of a weaker parent, a situation that is the opposite of support enhancement. This would be the case of a bank with an intrinsic assessment equivalent that is higher than the explicit or implied rating of its parent (which typically is a non-financial entity). Depending on the level of the parent-company rating, degree of integration and credit ring-fencing (e.g., regulatory constraints), the bank's rating could be at the same level as the parent's or slightly higher (but typically not by more than one or two notches).



FLOOR RATINGS

A floor rating reflects DBRS's assessment of the intent and implementation of a government's policies to support any critically important banking organizations (CIBs) that come under pressure so as to maintain the CIB's position as an effective counterparty. The floor rating reflects DBRS's view that governments in certain countries stand ready to provide substantial support to their CIBs to keep them operating as fully functioning counterparties across the various segments of the capital markets. In effect, the intent of these policies and the related government actions can be taken to imply that there is a floor under the potential deterioration in the final ratings of CIBs. For CIBs whose ratings are higher than the floor, the existence of the floor rating clarifies the potential for downgrades in the ratings of these institutions. Specifically, if rating pressure occurs at a CIB, which has a DBRS floor rating in place, when the floor is reached, further weakening in the bank's intrinsic strength rating will not result in a concurrent downgrade of the final rating below the floor rating. Consequently, all ratings that are at the floor have a Stable trend.

The level of the floor rating reflects DBRS's assessment of the government's goals and the financial markets' demands. As the purpose of the support for CIBs is to ensure that financial markets are fully functioning, with these banks as active participants, the level of the floor is established by the creditworthiness that market participants demand. As essential counterparties, CIBs need to be perceived as reliable partners in undertaking a wide range of financial transactions, providing liquidity, offering deposits, acting as custodians and so forth. This perception reflects not only intrinsic strength, including explicit government support, but also the markets' expectation that more support would be forthcoming to ensure the continued creditworthiness of these institutions.

The floor level also reflects explicit and implicit government policies, including actions already taken, that demonstrate the willingness and ability of a government to provide the support that the markets demand. As a result, the floor rating applies, even if a CIB's intrinsic assessment falls more than two notches below the floor rating. DBRS anticipates that the gap between the floor rating and the intrinsic rating of a CIB can widen, but the gap cannot become too large. Otherwise, the market may become concerned that it is relying too much on implicit support. Consequently, DBRS expects that governments will provide explicit support to prevent this happening.

In general, DBRS will still apply its general policy of adding notches for support above the floor rating. For some countries, such as the United States, DBRS may not ascribe any uplift to ratings of CIBs whose intrinsic strength is higher than the floor. This difference would be based on DBRS's assessment that even with the existence of the floor, DBRS cannot reliably infer additional support to raise the final rating. To a certain degree, however, the existence of the floor imparts additional intrinsic strength by supporting these organizations' franchises.

EVALUATING APPLICABILITY TO COUNTRIES

A floor rating is likely to be appropriate for a country where there has been significant deterioration in one or more of the country's CIBs that has caused disruptions in its financial markets; where substantial explicit support is being provided to its CIBs; or where the government has made explicit statements or acted so that implicit support can be inferred for its CIBs. Accordingly, for such countries, CIBs can be identified and a floor rating established that helps clarify prospective rating actions for weakening institutions that are deemed to be underpinned by the floor.

If DBRS perceives that changes in policies or specific actions indicate that a government's willingness or ability to support these CIBs has changed, it would revisit the level established for the floor ratings or indeed the reliability of the floor itself.



SYSTEMICALLY IMPORTANT BANKS (SIBS)

DBRS's assessment process considers support more likely for what DBRS refers to as SIBs. The following types of credit institutions would fall into the SIB category:

- **Universal Banks and Large Predominantly Retail Banks:** These are institutions with a significant position in loan and deposits markets and in payment systems. The collapse of any one of them would cause material damage to the country's economy and probably social and political disruption as well. Likely forms of support would be open bank mergers with financially stronger peers or, in more severe circumstances, liquidity guarantees or solvency support (via new equity subscribed by existing or new shareholders or subordinated loans).
- **Regional and Local Retail Banks That Are Members of Specific Sectors – Primarily Groups of Co-Operative Banks and Savings Bank Associations:** The liquidation of any such bank would lead to business, financial, reputation and brand damage to the entire group or association. Likely forms of support would be merging the stressed entity with healthier peers in the same group or association or, in more severe circumstances, liquidity or solvency support by the group or association peers.

DBRS would not apply indiscriminately the SIB concept to all peer associations. In general, DBRS believes that, with a few exceptions, non-deposit-taking institutions would benefit from proportionately less institutional and systemic support than branch-based retail and commercial banks. DBRS also cites large providers of credits to important segments of a country's economy given the inherent difficulty of replacing them without a seriously disruptive effect on the economy.

DBRS believes that institutional support is more predictable, on a timely basis, in banking systems characterized by a higher degree of concentration, as the collapse of any credit institution would be a proportionately bigger blow for the system than in more fragmented markets.

Based on this analysis, which by its nature includes an inherent element of probability, DBRS would assign an SA2 qualifier to a bank with SIB characteristics. For a financially healthy bank, the uplift would be one or two notches above the intrinsic assessment equivalent. It would be higher for financially weaker institutions with a lower intrinsic assessment equivalent.

CRITICALLY IMPORTANT BANKING ORGANIZATIONS (CIBS)

CIBs will typically be banking organizations that have extensive involvement in a country's financial markets and perform critical roles in the flow of financial transactions. The loss of the market's confidence in a CIB's ability to perform as a counterparty could infect the market's perception of other participants and lead to the degradation in the functioning of the financial markets. These organizations are likely to be identified by significant participation in a range of financial markets or major market shares in key business lines that are essential to the functioning of financial markets, such as certain fiduciary activities. Accordingly, these banking organizations are a subset of SIBs that would be supported, with the specific goal of maintaining at a higher level of strength that would not permit them to be perceived to have fallen below the floor.

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