FitchRatings

Banks
Global

Exposure Draft: Bank Ex-Government Support Ratings Criteria

Effective from 20 February 2023 to 11 April 2023

Sector-Specific

Scope

In this Criteria Report, Fitch Ratings describes its approach to assigning and maintaining 'ex-government support', or 'xgs', ratings to certain bank (and some non-bank financial institution) issuers, and certain of their financial obligations. These ratings are assigned in addition to ratings assigned under the Bank and Non-Bank Financial Institutions Master Criteria.

Ex-government support ratings are only typically assigned to, and maintained on, issuers for which both of the following conditions apply: i) they are not rated as policy banks; and ii) their international ratings incorporate assumptions of government support, as reflected in Fitch's Government Support Ratings (GSRs) and, for subsidiaries of government-supported banks and banks supported by sub-national authorities, Shareholder Support Ratings (SSRs).

This Criteria Report applies to new and existing ratings and is applied in conjunction with the Bank and Non-Bank Financial Institutions Master Criteria reports.

Key Rating Drivers

Corresponding Underlying Rating: Each ex-government support rating corresponds to an existing underlying rating on the international scale. The underlying rating can be a Short- or Long-Term Issuer Default Rating (IDR), a Derivative Counterparty Rating, or a Short- or Long-Term Issue Rating. An 'xgs' suffix is added to the corresponding existing rating, e.g. 'AAA(xgs)'.

Relative Importance: A parent issuer's standalone risk profile, as reflected in a Viability Rating (VR) for banks and some NBFIs, is likely to be the most important driver of ex-government support ratings of parent issuers and, unless their own standalone risk profiles result in a higher rating, of rated subsidiaries.

VR Linkage for LT IDRs: In most cases, LT IDR (xgs) ratings are mapped to a bank's existing VR, which is an issuer-level rating that excludes assumptions of extraordinary government or shareholder support.

Subsidiary Ratings: A subsidiary issuer's ex-government support IDRs are determined by the higher of its VR or the level achieved based on shareholder support. Where the shareholder's rating incorporates government support, its LT IDR (xgs) rating is used as the anchor rating for notching subsidiary ratings.

Consistent Notching and IDR Reference Liabilities: The same notching approach is applied for ex-government support senior debt ratings, DCRs and IDRs as applied in relevant Master Criteria. We do not assign ex-government support ratings to subordinated or hybrid debt.

We apply the same default threshold as in relevant Master Criteria. Consistent with this, a bank may have failed under our Bank Rating Criteria and have a VR of 'f', but its ex-government support IDRs will only be at 'RD' or 'D' if it has also defaulted on a senior obligation to a third-party, non-government creditor. It will not be at 'RD' or 'D' if it has avoided default due to government support.

Short-Term Ratings: We apply the same Correspondence Table and cusp point approach for ex-government support Short-term Ratings as under relevant Master Criteria.

Click here for updated criteria

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Fitch invites feedback from market participants on this Exposure Draft. This criteria report is intended to be applied in conjunction with the Bank Rating Criteria report dated 8 September 2022 and the Non-Bank Financial Institutions Rating Criteria dated 31 January 2022).

Comments should be sent to criteria.feedback@fitchratings.com by 24 March 2023. Fitch does not intend to assign ex-government support ratings during the Exposure Draft period.

As this Exposure Draft contemplates a new rating scale, Fitch does not expect to assign any such ratings until such time as the comment period has concluded and the Exposure Draft has been converted to final criteria.

Fitch will publish on its website any written responses it receives, in full, including the names and addresses of such respondents, unless the response is clearly marked as confidential by the respondent.

Related Criteria

Bank Rating Criteria (September 2022)

Non-Bank Financial Institutions Criteria (January 2022)

Exposure-Draft: Non-Bank Financial Institutions Rating Criteria (February 2023)

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Summary of Proposed Key Changes and Expected Rating Impact

The key change proposed is to assign IDRs, DCRs and senior debt ratings that exclude government support to certain banks and NBFIs that i) are not rated as policy banks; and ii) whose ratings otherwise include assumptions of government support.

Ex-government support ratings are likely to be primarily of interest to banks incorporated in jurisdictions that allow the use of external ratings in regulatory capital requirements. New Basel rules (see Annex) coming into effect from January 2023, depending on the jurisdiction, require that where bank ratings are used in the 'External Credit Risk Assessment Approach' (ECRA), such ratings 'must not incorporate assumptions of implicit government support, unless the rating refers to a public bank owned by its government'[1].

Fitch believes that its existing bank rating types (notably the VR) serve users well when assessing an issuer's risk profile, excluding extraordinary support, and are well understood by the market and by users. No changes to existing ratings are proposed. At the same time, Fitch also believes that there is an opportunity to present users with specific 'ex-government support' ratings, addressing both long-term and short-term risk, and at both issuer and senior obligation level to make it as straightforward as possible for users with their implementation of new Basel rules, where this applies.

Fitch removed assumptions of government support from most of its developed-market banks' ratings following the 2008 global financial crisis, reflecting progress in bank resolution regimes intended to protect governments and taxpayers from the costs associated with bail-outs. Overall, only 6% of non-policy bank ratings (LT IDRs; 16% if adjusting for European co-operative and savings bank groups) are driven by expectations of government support, and it is to the substantial majority of this cohort that we propose to assign ex-government support ratings.

Regionally, this figure is 0% in North America, 4% in EMEA (driven by Middle Eastern banks; 19% if adjusting for European co-operative and savings bank groups), 5% in LatAm, and 33% in APAC (driven by several jurisdictions, including China and India). We anticipate that the majority of LT IDR (xgs) ratings would be assigned in line with a bank's existing VR, which is an issuer-level rating.

Exposure Draft Questions

Any feedback is sought on the content of this exposure draft, in particular, but not limited to:

Q1: Do users agree that the introduction of a specific ex-government support (xgs) rating, as set out in this Exposure Draft, would facilitate their implementation of the Basel rules?

This question is targeted at banks that expect to use external ratings in their capital calculations; however, feedback from other users is also welcome. It would be helpful if responses could state whether the feedback is from the perspective of a regulated bank implementing Basel rules.

Q2: Should Fitch take into account any other considerations when providing market participants with bank ratings that exclude government support?

Specifically, it would be helpful to receive any feedback on the extent to which users believe that they would find ex-government support ratings assigned to selected Non-Bank Financial Institutions useful. Please include reference to specific jurisdictions as the scope of application of the Basel rules can vary.

Comments should be sent to criteria.feedback@fitchratings.com by 24 March 2023. Fitch does not intend to assign ex-government support ratings during the Exposure Draft period.

Fitch will publish on its website any written responses it receives, in full, including the names and addresses of such respondents, unless the response is clearly marked as confidential by the respondent.

[1] Source: Basel Committee Framework

Determination of Ex-Government Support Ratings

Rating	How the rating is determined		Examples
Long-Term IDR (xgs)	For non-subsidiary banks with a VR, the LT IDR (xgs) is assigned at the level of the VR. For non-subsidiary banks without a VR, a LT IDR (xgs) is not assigned. For subsidiary banks (for example, an international subsidiary of a government-supported bank), the starting point for assigning a LT IDR (xgs) will be the parent bank's LT IDR (xgs), from which the subsidiary's rating will be notched (or equalised) by considering shareholder support notching considerations as set out in the relevant Master Criteria. If a subsidiary bank has a VR, the LT IDR (xgs) will be assigned as the higher of the VR and the rating obtained by notching from the parent bank's LT IDR (xgs). Where relevant, Fitch will notch up the LT IDR (xgs) above the VR using the framework set out in the 'Assigning IDRs above VRs' section of the relevant Master Criteria. If a bank has failed and its VR is 'f', but has not defaulted on senior obligations to third-party, non-government creditors, its LT IDR (xgs) will not go to 'RD', even if it has avoided default only because it received extraordinary government support. Fitch may assign separate LT Foreign-Currency (FC) IDRs (xgs) and Local-Currency (LC) IDRs (xgs) using the same considerations for LT FC and LT LC IDRs that are set out in the relevant Master Criteria. Outlooks are not assigned to LT IDR (xgs) ratings.	a. b.	A bank has the following ratings: [VR: bbb; GSR: a; LT IDR: A]. The LT IDR (xgs) would be assigned at BBB(xgs) – i.e. the same level as the VR. A foreign subsidiary of a government-supported bank has the following ratings: [VR: *not assigned*; SSR: bbb-; LT IDR: BBB-]. The bank's parent has the following ratings: [VR: bb-; GSR: bbb-; LT IDR: BBB-]. Although the subsidiary does not have a GSR, it is rated based on shareholder support from its parent, whose LT IDR and other ratings incorporate assumptions of government support and the subsidiary's LT IDR has been equalised with that of its parent. In this case, the parent bank would be assigned a LT IDR (xgs) of 'BB-(xgs)' in line with its VR, and the subsidiary's LT IDR (xgs) would be assigned based on the relevant Master Criteria shareholder support notching and also be equalised with the parent's LT IDR (xgs) rating at 'BB-(xgs)'.
Derivative Counterparty Ratings (xgs)	The anchor rating for Derivative Counterparty Ratings (DCR) (xgs) will be a LT IDR (xgs) and the same notching will apply, as set out in the relevant Master Criteria.	c.	A bank has the following ratings: [LT IDR: A; DCR: A(dcr); LT IDR(xgs): BBB (xgs)]. Its DCR(xgs) will be assigned at 'BBB(xgs)(dcr)'.
Short-Term IDR (xgs)	For parent banks with a VR, the ST IDR (xgs) is assigned by applying the ST Rating Correspondence Table and the approach for 'Banks Whose IDRs Are Driven by VRs' in the Bank Rating Criteria to the bank's LT IDR (xgs). Consequently, a bank's Funding & Liquidity Key Rating Driver (KRD) score – which forms part of the overall VR assessment – will typically inform the choice between the higher or lower rating at cusp points. For subsidiary banks without a VR, the ST IDR (xgs) is assigned by first assigning a LT IDR (xgs) to the subsidiary, and then by applying the Rating Correspondence table to the bank's LT IDR (xgs) following the approach set out in the 'Banks with Support-Driven IDRs' section of the Bank Rating Criteria.	d.	A bank has the following ratings: [VR: bbb; GSR: bbb+; LT IDR: BBB+; ST IDR: F2]. Based on the VR of 'bbb', this bank would be assigned a LT IDR (xgs) of 'BBB(xgs)'. Under the Rating Correspondence Table in the Bank Rating Criteria, a LT IDR (xgs) of 'BBB(xgs)' could map to either 'F3(xgs)' or 'F2(xgs)'. The choice of ST IDR (xgs) would be informed by the issuer's Funding & Liquidity KRD score, as set out in the relevant Master Criteria. A minimum score of 'bbb+' would be needed for a ST IDR (xgs) of 'F2(xgs)'.
Long-Term Rating (xgs)	The anchor rating for assigning Long-Term Ratings (xgs) to senior obligations will be a LT IDR (xgs) and the same notching will apply as set out in the relevant Master Criteria. We do not assign Long-Term Ratings (xgs) to subordinated or hybrid securities	e.	A bank has a LT IDR of 'A', senior debt ratings of 'A' and a LT IDR (xgs) of 'BBB'. Its senior debt ratings are assigned Long-Term Ratings (xgs) of 'BBB(xgs)'.
Short-Term Rating (xgs)	As above, but mapped from the Long-Term Rating (xgs) of the corresponding obligation ratings.	f.	A bank has a Long-Term Rating (xgs) of 'BBB-(xgs)'. Using the correspondence table, this maps to a Short-Term Rating (xgs) of 'F3(xgs)'.
Branch ratings	An 'xgs' suffix may be applied to a branch rating. In these cases, it would reflect the main or ''head office' bank's equivalent 'xgs' rating subject to any country risk constraints, as set out in the relevant Master Criteria.	g.	A bank has a branch rating (LT IDR) of 'BBB' in a jurisdiction with a Country Ceiling of 'AA'. The main bank's VR is 'bb', its GSR is 'BBB' and its LT IDR is 'BBB'. The branch's LT IDR (xgs) would be assigned at 'BB(xgs)', in line with the main or 'head office' bank's LT IDR (xgs) of 'BB(xgs)'.

Source: Fitch Ratings

Rating Definitions

Definitions of the new ratings are provided below:

Rating	What the rating measures	When the rating can be assigned	Which rating scale is used
Long-Term IDR (xgs)	The entity's vulnerability to default on IDR reference obligations excluding assumptions of extraordinary government support. Government support is typically reflected in a GSR when coming directly from the sovereign, but may be reflected in an SSR in cases where Fitch expects the support to come from a sub-national authority, or via a parent whose ratings benefit from government support. See "IDRs: Reference Obligations and Types of Default" in our Bank Rating Criteria for additional clarifications on which senior obligations are reference liabilities for banks' IDRs, and how we define default.	To non-policy banks where the LT IDR relies on assumptions of extraordinary government support.	The 'AAA' scale with an '(xgs)' suffix (see Fitch's Rating Definitions).
DCR (xgs)	The entity's vulnerability to default on derivative contracts to third-party, non-government counterparties, excluding assumptions of extraordinary government support.	To entities where both a LT IDR (xgs) and a DCR are assigned.	The 'AAA' scale with '(xgs)(dcr)' suffixes (see Fitch's Rating Definitions).
Short-Term IDR (xgs)	The entity's vulnerability to default on senior financial obligations to third-party, non-government creditors in the short term, excluding assumptions of extraordinary government support.	To banks with a LT IDR (xgs)	Short-term rating scale with an '(xgs)' suffix (see Fitch's Rating Definitions).
Long-Term Rating (xgs)	Overall level of credit risk of senior obligations, including an assessment of both the level of default/non-performance risk and potential recoveries in case of default/non-performance, excluding assumptions of extraordinary government support.	Can be assigned to individual obligations or debt programmes with initial maturity of more than 13 months where a LT IDR (xgs) is assigned.	'AAA' scale with '(xgs)' suffix (see Fitch's Rating Definitions).
Short-Term Rating (xgs)	Only the default risk of the securities (not potential recoveries), excluding assumptions of extraordinary government support. Short-term deposit ratings can be notched up to reflect superior recovery prospects.	Can be assigned to individual obligations or debt programmes with initial maturity of less than 13 months where a LT IDR (xgs) is assigned.	Short-term rating scale with an '(xgs)' suffix (see Fitch's Rating Definitions).

Source: Fitch Ratings

Information Used to Analyse Banks

We use the same public (e.g. financial statements, transaction documents, presentations, regulatory filings) and non-public information to assign ex-government support ratings to banks and NBFIs as we use to assign the ratings under in relevant master criteria. See relevant master criteria for more details.

Criteria Disclosure

Fitch discloses information related to the extent and impact on ratings of government support on its website. Specifically, Fitch discloses whether a bank's Long-Term IDR and certain other bank ratings incorporate assumptions of extraordinary government support.

Where ratings are based on such support and Fitch has assigned a VR (i.e. which reflects a bank's standalone strength and does not reflect assumptions of extraordinary government support), this will also be disclosed. Fitch also discloses which banks are rated as policy banks under its Bank Rating Criteria.

Fitch includes VRs in its published Transition & Default Studies. These disclosures are intended, among other things, to help users with their preparations for the new Basel rules.

Surveillance

Analysts perform surveillance of information received or requested. Where a factor or trend could have an impact on the rating, Fitch will determine the appropriate course of action, which may be one of the following:

- The bank is taken to rating committee;
- The bank is issued with a request for additional specific information (Fitch may also place the entity on Rating Watch at this point); or
- Fitch may also conclude that no action is necessary.

There is no difference between new rating analysis and surveillance analysis.

Criteria Variations

Fitch's criteria are designed to be used in conjunction with experienced analytical judgement exercised through a committee process. The combination of transparent criteria, analytical judgement applied on a transaction-by-transaction or issuer-by-issuer basis, and full disclosure via rating commentary strengthens Fitch's rating process while assisting market participants in understanding the analysis behind Fitch's ratings.

A rating committee may adjust the application of these criteria to reflect the risks of a specific transaction or entity. Such adjustments are called variations. All variations will be disclosed in the respective rating action commentaries, including their impact on the rating where appropriate.

A variation can be approved by a rating committee where the risk, feature, or other factors relevant to the assignment of a rating and the methodology applied to it are both included within the scope of the criteria, but where the analysis described in the criteria requires modification to address factors specific to the particular transaction or entity.

Limitations

Ratings, including Rating Watches, assigned by Fitch are subject to the limitations specified in Fitch's Rating Definitions.

They are available at https://www.fitchratings.com/site/definitions.

Ex-government support ratings are limited with respect to unforeseen events, which are excluded from ratings until they become explicit or defined. Event risks can be externally triggered – such as a change in law, a natural disaster, a political shock, an ownership change or a cyber-attack – or internally triggered, such as a change in policy on capitalisation, a major acquisition, fraud or other material operational/regulatory/litigation risk event, or a management or strategic restructuring.

Information Used to Derive Criteria

The key rating assumptions for the criteria are informed by discussions with external parties, such as issuers, institutional owners, supervisors and governments, and Fitch's analysis of financial and non-financial information, such as issuer financial statements and annual reports, bond documentation and financial market, industry, academic and economic data, research and history.

Rating Assumption Sensitivity

Fitch's opinions are forward-looking and include Fitch's views of likely performance. Bank and non-bank financial institution ratings, which influence ex-government support ratings, are subject to positive or negative adjustment based on actual or projected financial and operational performance. The list below includes a non-exhaustive list of the primary assumption sensitivities, or shifts in KRDs, that can influence the ratings. Further detail can be found in relevant master criteria.

Risks to an Entity's Standalone Strength: Including operating environment risk, business risk, financial risk, event risk.

Support Change Risk: A change in extraordinary support likely to be available to an issuer, for example due to a change in ownership or developments in bank resolution frameworks. In the event bank resolution frameworks result in extraordinary government support no longer being factored into ratings, an issuer's ex-government support ratings would likely be withdrawn.

Instrument-Specific Risks: Issue-level ratings may be sensitive to changes in a bank's issuer-level ratings, performance risk relative to the risk captured in issuer-level ratings, and changes in default risk or recovery prospects for the instrument, for example as a function of its seniority, volume (or expected volume) of pari passu liabilities or the volume (or expected volume) and relative ranking of other liability layers.

Event risk and changes in support can often have more material implications for bank ratings than other risks outlined above.

Annex 1 – Basel Rules

Under the 'External Credit Risk Assessment' (ECRA) approach, banks assign to their rated bank exposures the "base" risk weights determined by the external ratings according to the table below. Such ratings must not incorporate assumptions of implicit government support, unless the rating refers to a public bank owned by its government. Banks are also expected to perform due diligence on the external ratings and to assign a higher risk if warranted.

Risk Weight Table for Bank Exposures
External Credit Risk Assessment Approach

External rating of counterparty	AAA to AA–	A+ to A–	BBB+ to BBB–	BB+ to B–	Below B–
"Base" risk weight	20	30	50	100	150
Risk weight for short-term exposures	20	20	20	50	150

Source: Fitch Ratings, Basel Committee, 'Calculation of RWA for credit risk (CRE20)', effective 1 January 2023

Banks operating in jurisdictions that do not allow the use of ratings are expected to use the Standardised Credit Risk Assessment (SCRA) approach, which also applies to unrated bank exposures in jurisdictions that apply the ECRA.

Risk Weight Table for Bank Exposures
Standardised Credit Risk Assessment Approach

Credit risk assessment of counterparty (%)	Grade A	Grade B	Grade C
"Base" risk weight	40	75	150
Risk weight for short-term exposures	20	50	150

Source: Fitch Ratings Basel Committee, 'Calculation of RWA for credit risk (CRE20)', effective 1 January 2023

Implementation timing and details will vary in different jurisdictions, including the scope of application of the Basel rules and the scope of external ratings recognised in each jurisdiction.

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