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Hybrid debt attack – for real, from Fitch

Tracy Alloway Author alerts Aug 20 2009 16:04

Woosh. That is the sound of a hybrid debt bomb being dropped on the European market, courtesy of ratings agency Fitch:

> **FITCH DOWNGRADES LLOYDS, RBS, ING, OTHER EU BANKS' HYBRIDS ON INCREASED RISK OF COUPON DEFERRAL**
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> Fitch Ratings-London-20 August 2009: **Fitch Ratings has downgraded the ratings of hybrid securities at Lloyds Banking Group plc (LBS), Royal Bank of Scotland Group plc (RBS), ING Group, Dexia Group, ABN Amro, SNS Bank, Fortis Bank Nederland and BPCE and certain related entities. The downgrade reflects increased risk of deferral of interest payments after the European Commission (the "Commission") clarified its stance on bank hybrid capital, and in particular the application of the concept of "burden-sharing"**. A full list of ratings actions is available at the end of this commentary.
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> **The Commission's recent statements confirm Fitch's view that government support for banks may not extend to holders of subordinated bank capital (see 4 February 2009 comment "Fitch Sees Elevated Risk of Bank Hybrid Coupon Deferral in 2009″ on www.fitchratings.com).** Fitch has already taken significant rating actions on the hybrid capital instruments of ailing banks within the EU and elsewhere. Nevertheless, in the light of the latest Commission statements, Fitch is applying additional guidelines in its ratings of hybrid capital instruments issued by EU financial institutions. These are outlined in a report published today, entitled "Burden Sharing and Bank Hybrid Capital within the EU." A second report; "UK Banks and State Aid: "A Burden Shared", which is also published today, discusses the implications for bondholders of UK banks that have received state aid.
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> In particular, Fitch would highlight that a bank that has received state aid and is subject to a name-specific restructuring process will likely have a hybrid capital

> rating in the 'BB' range or below, with most ratings on Rating Watch Negative (RWN), indicating the possibility of further downgrades. Banks which Fitch believes are subject to significant state aid beyond broad-based confidence building measures will likely have a hybrid capital rating in the 'B' range or below, and be on RWN. Fitch will apply these guidelines to banks where a formal state aid process has not yet been established, but where Fitch believes such a process is likely to arise.
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> "Although the concept of burden-sharing is implicit in EU state-aid rules, Fitch regards that the latest Commission communications on its application to hybrid capital to be a significant clarification," says Gerry Rawcliffe, Managing Director in Fitch's Financial Institutions rating group.
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> As well as the implications for coupon deferral under "burden-sharing," the possibility of asset sales, branch closures, commitments to capping market share and pricing have the potential to be a material issue for banks in receipt of state aid.
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> **"In Fitch's view, the capacity for the Commission to materially influence both the capital remuneration policy and the future shape of state-aided banks should not be under-estimated," says Rawcliffe.**
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> In Fitch's view, dated subordinated debt with no deferral features is unlikely to be affected by the Commission's "burden-sharing" concept. As such, Fitch will maintain its normal approach to rating such instruments, unless it believes there is heightened risk that a bank will be subject to state intervention under national bank resolution legislation such as the UK's Banking Act.
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> Banks that have benefited from broad industry-wide support measures, which themselves have been approved by the Commission, and which have not been subject to a name-specific process, are likely to be unaffected by the EC's recent statements. Fitch will continue to rate their hybrid capital instruments in line with existing criteria.

This is very similar to the thinking of Moody's, which announced in June that it too was considering altering its approach to assigning debt capital ratings. The ratings agencies have so far assumed hybrid or subordinated debt has implicit government support — but not not any longer, it seems.

Related links:
Hybrid debt attack! – FT Alphaville
Uncertainty grips hybrid debt owners – FT

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