

Rating Methodology of Creditreform Rating AG

# Government-Related Banks

Sub-Methodology of Bank Ratings

Neuss, April 2019  
Version 2.0

**Creditreform**   
**Rating**

## Table of Contents

<b>1</b>	<b>INTRODUCTION .....</b>	<b>2</b>
<b>2</b>	<b>SCOPE OF APPLICATION.....</b>	<b>2</b>
<b>3</b>	<b>RATING METHODOLOGY .....</b>	<b>3</b>
3.1	CRITERIA FOR THE ASSESSMENT OF GOVERNMENT-RELATION.....	3
3.2	CATEGORIZATION AS A GOVERNMENT-RELATED BANK .....	4

## 1 Introduction

Creditreform Rating AG (also referred to as "CRA") has been conducting ratings since its inception in 2000 and is a recognized European rating agency.

In order to enable interested parties, investors and the interested public to be able to understand a CRA rating judgement, the present complementary rating methodology (sub-methodology) "Government-Related Banks" is disclosed for the rating of government-related banks. It should also be noted that the sovereign rating is also taken into account in the application of this system. The rating methodology is updated when changes are made in the applicable classification system. Each rating carried out by CRA is based on established principles such as the rating process, basic procedures, fixed rating scales, and additions. This rating sub-system, the fundamentals, principles, and the code of conduct of the CRA are freely available on our website ([www.creditreform-rating.de](http://www.creditreform-rating.de)).

## 2 Scope of Application

The **sub-system for rating banks (bank rating) / government-related banks** of the CRA refers to specific banks, where the CRA ascribes a relation to the government or a local authority, e.g. a state, association of states, federal state, local government or another particular level of local administration, taking into account specific legal, regulatory and other relevant circumstances of a bank's country of domicile. The present rating system defines the supplementary methodological analysis framework for the implementation of a bank rating for government-related banks (sub-systematic). In principle, we consider a bank to be government-related within the framework of this system if the bank is largely under the influence of the state or a public authority and, in addition, there is a public interest in the business operations of the bank. In general, a bank can be identified as government-related to more than one government or local authority.

A government-related bank may benefit in times of economic and / or financial stress from extraordinary support from its responsible local authority if that local authority performs support measures for business development and / or business continuation, financing respectively punctual and complete servicing of its financial obligations. In particular, we understand extraordinary support to be the provision of funds, government guarantees, pledge declarations, assumption of liability, letters of comfort, nationalization, conversion of claims, transfer of financial obligations, or other support services that secure the banking business, although this enumeration is not exhaustive. We generally believe that the above-mentioned measures will have a positive impact on the bank's credit rating. However, it is not excluded in this context that a bank and its creditworthiness may suffer from being government-related if the bank is considered or classified as government-related.

### 3 Rating Methodology

Once a bank has been identified as government-related, it will first be subjected to a stand-alone rating according to our rating process described in the CRA Bank Rating System. We refer here to the mentioned document, which is available on the website of the CRA ([www.creditreform-rating.de](http://www.creditreform-rating.de)).

Following this, the extent of a bank's links to government is analyzed in greater detail in order to obtain an estimate of the effect of the government relation on the bank under view. The assessment of the respective local authority has an impact on the bank rating. We analyze the nature of the relation between a bank and its respective local authority and assess whether the local authority is willing and able to provide (financial) support and whether or not restrictions on support should be taken into account or assumed in individual cases.

#### 3.1 Criteria for the assessment of government relation

If the analysts or the rating committee have identified the bank under review as government-related, the degree of this relation is determined on the basis of two quantitative and two qualitative criteria. The CRA assesses the two quantitative criteria using five intensity levels (non-existent, low, moderate, high, very high) and the two qualitative criteria using four levels of intensity (low, moderate, high, very high).

##### A.1) Business share / equity share

In addition to the absolute amount of equity, the relative share ownership of a government / local authority is an essential criterion when assessing the government-relation of a bank. The assessment is based on the twin assumptions that the shareholders' impact on the decision-making processes is proportionate to the size of their shareholding (e.g. via voting power) and, on the other hand, that the economic or political interests of the local authority are increasing with the relative size of its shares.

##### A.2) Size and system relevance

The relative size and systemic importance of the bank is another indicator of the interest and willingness of a local authority to (financially) support and / or assume liability for the bank under review. Indicators of the relative size and systemic relevance of a bank are its total assets and the ratio of its total assets to the gross domestic product of the relevant government or local authorities.

##### B.1) Degree and extent of support with regard to financial obligations

We assume the highest level of support from a local authority to a bank if the local authority unconditionally guarantees the financial obligations of the bank or provides funds to it. Additionally,

a high degree and extent of (financial) support is assumed in particular when laws, regulations or other legally binding declarations exist which assume responsibility or obligate a local authority for the financial obligations of a bank.

In gradation to that, an increased level and extent to the (financial) support a bank is assumed if the failure of the bank may cause significant damage to the economy as whole, specific sectors of the economy, or private individuals, thus creating a public interest to (financially) support the bank or to protect it against default. We consider, for example, the importance of the banking services or their activities for maintaining the supply of the population, the economy or public organizations and institutions (inter alia in the areas of public services, education, health care, housing and national defense or raw material storage).

Our determinate degree of required support, respectively support-worthiness, and the expected scope and / or announced support is the relevant valuation variable at this analysis point. We also take into account whether and to what extent a local authority is capable of (financially) supporting a bank should the necessity arise.

#### B.2) Substitutability of the bank

We analyze to what extent the services of the bank may be substituted by other (government-related) banks. This degree of substitutability is determined based on a range of criteria including the number and size of the bank's competitors, the specific conditions on the market, as well as market entry barriers such as the timely implementation of the business model, capital requirements, or the necessary license.

### **3.2 Categorization as a government-related bank**

In case that CRA has identified the highest level of support under B.1), CRA assumes the highest degree of government-relation for the bank under review. In all other cases, CRA summarizes the characteristics obtained from the above-mentioned four different sub-categories into a single overall result. The overall result for assessing the relationship between the bank under review and the local authority has a significant impact on the bank rating. Accordingly, CRA assesses the level of interest on the part of the local authority in the bank under consideration, and the extent to which the local authority may be able to provide the bank with regular or extraordinary (financial) support. The default risk of the government-related bank will reflect this assessment and CRA's assessment of the local authorities own financial strength.

Taking into account the interests of the local authority (support willingness and capability), the degree of relation between the bank under view and the local authority determines the extent to which the previously performed (stand-alone) bank rating is affected. If the corresponding rating of the local authority exceeds the (stand-alone) bank rating, the rating of the bank can be notched up in the best case to the rating of the local authority. In case that CRA has identified a bank to

be government-related to more than one local authority or government, CRA uses the weighted assessment of the relevant authorities, whereby the weighting is dependent on the relative shareholdings of the relevant authorities. The extent of notching on the (stand-alone) determined bank rating depends on the creditworthiness and the relation in size between the local authority and bank under review. If the rating of the local authority is lower than the previously determined (stand-alone) bank rating, the rating of the bank may be notched down to the rating of the local authority in the worst-case scenario.

CRA shall be free to use other and / or additional criteria and analytical methods than those described above if it believes that such a strategy will lead to a more accurate assessment of a bank's government-relation and financial strength / creditworthiness. This can, for example, be induced by legal regulations or certain framework conditions. Whether or not a bank is categorized as government-related is ultimately decided by the rating committee. The deviation in individual cases is verified and approved by the rating committee and disclosed in the rating report under the "regulatory requirements" section.