

Rating Methodology of Creditreform Rating AG

# Government-Related Banks

Sub-Methodology of Bank Ratings

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## 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 understand a CRA rating assessment, this supplementary rating methodology (sub-methodology) "Government-Related Banks" is disclosed for the rating of government-related banks. If an issuer is found government related according to the following sub-methodology, the sovereign rating is taken into account in the application of this system. Each rating carried out by CRA is based on established principles such as the rating process, basic procedures, and fixed rating scales. This rating sub-methodology, and the CRA Code of Conduct can be freely accessed on our website ([www.creditreform-rating.de](http://www.creditreform-rating.de)).

## 2 Scope of Application

This **sub-methodology for rating government-related banks** refers to specific banks that CRA considers to be related to a government or 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. Together with the CRA methodology "Bank Ratings", this sub-methodology provides the analytical framework for rating government-related banks. Under this sub-methodology, we principally consider a bank government-related 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 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, in this context, it cannot be ruled out that a bank's creditworthiness may suffer from being government-related.

### **3 Rating Methodology**

Initially, a standalone rating for a bank is conducted according to the process outlined in CRA's "Bank Ratings" methodology. This methodology, along with others, can be accessed on our website ([www.creditreform-rating.de](http://www.creditreform-rating.de)). Examining government relatedness is an integral part of the rating process, whether or not this sub-methodology is ultimately applied.

Subsequently, we investigate potential connections between the bank and the government to evaluate the influence of government relatedness on the bank under review. The credit assessment of the respective local authority impacts the bank's rating. We analyze the relationship between a bank and its corresponding local authority, determining the local authority's willingness and ability to provide financial support. Additionally, we assess if any limitations on support should be considered or presumed in specific cases.

#### **3.1 Criteria for the assessment of government relatedness**

When analysts or the rating committee considers a bank to be classified as government-related, the degree is assessed using a combination of two quantitative and two qualitative criteria. CRA evaluates each criterion across four intensity-levels, namely low, moderate, high, and very high.

##### **3.1.1 Degree and extent of support with regard to financial obligations**

The highest level of support from a local authority to a bank is assumed 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, thereby creating a public interest to (financially) support the bank or to protect it against default. Factors considered include, 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 defence or raw material storage).

The determined degree of required support, respectively support-worthiness, and the expected scope and / or announced support is the relevant valuation variable at this analysis point. The extent to which a local authority is capable of financially supporting a bank if necessary is also considered.

### 3.1.2 Substitutability of the bank

We analyse 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.

### 3.1.3 Business share / equity share

Besides the absolute amount of equity, the relative share ownership of a government or local authority is an essential criterion assessing a bank's government relatedness. 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.

### 3.1.4 Size and systemic importance

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.

### 3.2 Categorization as a government-related bank

In case that CRA has identified the highest level of support under 3.1.1, CRA assumes the highest degree of government-relatedness 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. In cases where the corresponding rating of the local authority exceeds the (stand-alone) bank rating, the bank's rating may be notched up to match that of the local authority in the most favourable scenario. 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. In case 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 most unfavourable scenario.

CRA reserves the right to employ supplementary and/or additional criteria and analytical methods beyond those described above if it leads to a more precise assessment of a bank's government-relatedness and financial strength / creditworthiness. Such deviations may be induced by legal regulations or framework conditions. The classification of a bank as government-related is ultimately subject to a rating committee and the deviation in individual cases is shown in the corresponding rating report.