

Criteria | Financial Institutions | General:

Methodology For Assigning Financial Institution Resolution Counterparty Ratings

April 19, 2018

(Editor's Note: This article has been superseded by "Financial Institutions Rating Methodology," published Dec. 9, 2021, except in jurisdictions that require local registration.)

OVERVIEW AND SCOPE

1. S&P Global Ratings' criteria for resolution counterparty ratings (RCR) presents a new special-purpose rating type applicable to certain financial institutions subject to a bail-in resolution policy framework.
2. Publication of this criteria article follows our request for comment (RFC) titled "Request For Comment: Methodology For Assigning Financial Institution Resolution Counterparty Ratings," published on Jan. 31, 2017. For a comparison of the changes between the RFC and these criteria, see "RFC Process Summary: Methodology For Assigning Financial Institution Resolution Counterparty Ratings," published April 19, 2018. Upon publication of these criteria, we have included the rating definition of RCRs in "S&P Global Ratings Definitions," published Jan. 5, 2021. For guidance on how to apply these criteria, see "Guidance: Methodology For Assigning Financial Institution Resolution Counterparty Ratings," also published April 19, 2018.
3. These criteria are applicable to financial institutions globally that are likely to be subject to an effective bail-in resolution regime in the event of distress. These criteria are generally relevant for institutions where our criteria on additional loss-absorbing capacity (ALAC) are applicable (see "Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity," published on April 27, 2015), but may also be applicable to other financial institutions subject to resolution regimes. Insurance entities are not in scope of these criteria. Covered bonds are also not in scope; we use a different set of criteria to assign ratings to these instruments (see "Covered Bonds Criteria," published on Dec. 9, 2014).
4. The term "RCR liabilities" is used here to refer collectively to the relevant obligations of issuers that are within the scope of the criteria.
5. This paragraph has been deleted.
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ANALYTICAL CONTACTS

Alexandre Birry

London
+ 44 20 7176 7108
alexandre.birry
@spglobal.com

Richard Barnes

London
(44) 20-7176-7227
richard.barnes
@spglobal.com

Nicolas Malaterre

Paris
(33) 1-4420-7324
nicolas.malaterre
@spglobal.com

Stuart Plesser

New York
(1) 212-438-6870
stuart.plesser
@spglobal.com

Gavin J Gunning

Melbourne
(61) 3-9631-2092
gavin.gunning
@spglobal.com

Cynthia Cohen Freue

Buenos Aires
+54 (11) 4891-2161
cynthia.cohenfreue
@spglobal.com

See complete contact list at end of article.

METHODOLOGY

7. This methodology is a framework for assigning RCRs. An RCR is a forward-looking opinion of the relative default risk of certain senior financial institution liabilities that may be protected from default within an effective bail-in resolution process. The RCR is either aligned with the issuer credit rating (ICR) on a financial institution or set higher than the ICR, indicating our view of the default risk of RCR liabilities relative to the default risk represented by the ICR and associated senior liabilities.
8. An RCR addresses the likelihood of default, and does not provide an opinion on recovery prospects or expected loss following a default on some or all of a financial institution's liabilities that are addressed by the RCR. It applies the timeliness standards outlined in "S&P Global Ratings Definitions," published Jan. 5, 2021, for how a temporary moratorium tool declared as part of a resolution affects an RCR. RCRs are based on the long- and short-term global ratings scales. The short-term RCR on a financial institution is determined in reference to its long-term RCR, based on applicable mapping criteria (see "Methodology For Linking Long-Term And Short-Term Ratings," published April 7, 2017). RCRs are not assigned rating outlooks; the potential for changes would be noted as part of the general outlook statement for the ICR on a financial institution, particularly where an RCR may move in a different magnitude or different direction than the ICR. RCRs may be placed on CreditWatch where appropriate, using the same approach we use to place ICRs or debt issue ratings on CreditWatch.

Identifying jurisdictions, liabilities, and issuers where an RCR is relevant

9. RCRs only apply to financial institutions operating in jurisdictions whose bail-in resolution framework is sufficiently effective, as defined in our ALAC criteria. Only these frameworks provide the necessary conditions for a likely successful bail-in resolution of certain entities, in our view, which may serve as a basis for differentiating between the default likelihood of RCR liabilities and that of other senior liabilities represented by the ICR, and thereby potentially assigning an RCR above the relevant ICR. When an entity operates in a jurisdiction whose bail-in resolution framework is sufficiently effective but the likelihood of default of RCR liabilities in our view will not improve, we do not assign an RCR higher than the relevant ICR. This would be the case, for example, where we believe that additional capacity, be it from the balance sheet or external sources, is insufficient to change the likelihood of default relative to the ICR.
10. Within jurisdictions that have sufficiently effective bail-in resolution frameworks, and where we have identified RCR liabilities meeting the conditions outlined in the following paragraphs, RCRs apply only to issuers that are likely to be subject to a resolution process were they to reach nonviability. This is because we expect that the base-case default risk scenario for that specific entity and relevant liabilities would be determined by the bail-in resolution of the institution, and that therefore the provisions of the resolution regime would likely be activated.
11. For each jurisdiction with a sufficiently effective bail-in resolution framework, we assess whether any senior liability categories may be protected from default by an effective bail-in process beyond the protection elements we measure in our ALAC analysis. The RCR addresses liabilities benefiting from such additional protection elements that provide for a credible and likely continuation for those types of obligations, without them defaulting in a bail-in resolution process.
12. For a senior liability category to be considered to be protected beyond what we address in our ALAC analysis, it must be likely to continue to perform on a complete and timely basis in the resolution scenario. We could consider this to be the case if:

- It is explicitly excluded by regulation from those liabilities that may be bailed in if the obligor enters a bail-in resolution, or
 - We believe the liabilities' resolution-driven default is unlikely because of all of the following: The type of liability is earmarked in the resolution framework for potential exclusion from bail-in at the discretion of the national regulator, other creditors in our view are unlikely to legally challenge such an exclusion (for example due to the "no creditor worse off" principle), and the type of liability meets at least one of the characteristics listed in the bullet points in the following paragraph.
13. The assessment of these characteristics typically takes into account how that liability type is either described in the legislation or regulations or viewed by the regulators:
- We view the continuity of the operations of that type of liability as critical for financial stability in that jurisdiction.
 - We believe the steps to carry out a bail-in of that type of liability would involve such high operational complexities that would make its bail-in unlikely in a reasonable time.
 - We consider that the performance of that type of liability is critical for the resolved entity to continue operating.
 - We believe the bail-in of that type of liability would not provide any economic benefit to the resolution or would even destroy value.
14. We follow a different approach for jurisdictions where we do not have sufficient visibility of the mechanisms that provide protection from default to certain senior liabilities beyond what we incorporate in our ALAC analysis or of the liabilities that these mechanisms are designed to protect, or of both. In these instances, for issuers that are likely to be subject to a resolution process were they to reach nonviability, we assign only issuer-level RCRs equalized with the ICRs.
15. Our RCR jurisdictional assessment encompasses relevant aspects of a country's resolution framework and the expected treatment of different liability categories within that framework.
16. In most cases, RCRs are assigned to rated operating entities of a financial group. Typically, a distinct RCR is assigned to each legal entity in the group when the resolution framework applicable to that entity and the resulting identification of RCR liabilities meet the conditions outlined above. Nonoperating holding companies (NOHCs) of financial groups would be eligible for an RCR if RCR liabilities are situated at the NOHC level and the bail-in resolution framework specifically provides the same conditions aimed at preserving those NOHC liabilities without a default through a resolution process as it does for operating entity liabilities.
17. A single RCR is assigned to a given legal entity, covering all its RCR liabilities. This is because the default risk of these liabilities depends on a common factor: the potential for a successful resolution process. If a specific bond has an issue credit rating and is also an RCR liability, the issue credit rating on the bond is assigned at the same level as the RCR for that issuer.

Determining uplift above the ICR

18. RCR uplift--the extent to which an RCR may be higher than the relevant ICR--primarily depends on the degree of visibility about:
- Possible resolution scenarios, and
 - Whether resolution authorities, in trying to preserve financial stability, are likely to succeed in resolving the entity so that RCR liabilities continue to perform on a complete and timely basis

as if the obligor was a going concern.

19. Subject to applicable conditions in the following paragraphs, RCR uplift is up to one notch if the ICR is between 'BBB-' and 'A+' (inclusive) or up to two notches if the ICR is between 'B-' and 'BB+' (inclusive). RCR uplift does not apply to financial institutions with ICRs in the 'AA' and 'AAA' rating categories.
20. RCR uplift is limited to one notch for issuers rated between 'BBB-' and 'A+' (inclusive) to reflect the uncertainty about how resolution may be handled in an extreme or severe stress scenario for issuers that are currently far from potential distress. For the same reason, we believe the incremental benefit to RCR liabilities is not commensurate with uplift for financial institutions with ICRs in the 'AA' and 'AAA' rating categories.
21. When we determine that RCR uplift is warranted for issuers rated between 'B-' and 'BB+' (inclusive), we typically apply two notches of RCR uplift unless situational factors contribute, in our view, to reduced visibility or likelihood of a successful resolution outcome, taking into account the evolving adequacy of the institution's loss-absorbing capacity relative to similarly rated peers and other relevant factors. We assign one notch of uplift if, despite the reduced visibility or likelihood of successful bail-in resolution, we believe there remains at least a moderate likelihood that the resolution process would preserve the institution's operational capacity.
22. For an issuer with an ICR of 'CCC+' or below, the RCR is set either:
 - Up to two notches above the ICR, similar to issuers rated between 'B-' and 'BB+' (inclusive) as described in the previous paragraph; or,
 - At the rating level consistent with the default risk of RCR liabilities, incorporating any additional short-term support (ASTS; see below) and taking into account the default scenario associated with the ICR according to the scenarios in "Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings," published on Oct. 1, 2012.
23. We use a different approach to determining RCR uplift for situations where the resolution framework establishes mechanisms of protection from bail-in for substantially all types of instruments that are not part of the total loss-absorbing capacity (TLAC) cushions (or similar regulatory concepts). In these cases, we assess whether the framework offers a comparable reduction in default risk relative to that of the RCR liabilities of entities operating in jurisdictions that have bail-in-able ICR level liabilities. This can for example occur when we believe other forms of support are available that result in a comparable reduction in default risk, such that an institution's ICR may be raised to a level consistent with the level of support the RCR implies. In such cases, the RCR on an institution is typically aligned with its ICR, and both ratings incorporate the same amount of uplift that would otherwise be applied only to the RCR. Otherwise, neither the ICR nor RCR would benefit from any RCR uplift.
24. If we believe an institution is approaching nonviability, and we expect the application of resolution measures in the near term, RCR uplift may exceed the limits outlined above to reflect our expectation of ASTS for the RCR liabilities. Our assessment of expected ASTS for these RCR liabilities is informed by the section "Additional short-term support for banks with high or moderate systemic importance" of "Banks: Rating Methodology And Assumptions," published Nov. 9, 2011 (the bank criteria), if the specific conditions in that section apply. Otherwise, our assessment is informed by our expectations regarding the likelihood of a bail-in resolution that would affect the default risk on the RCR liabilities. In such a scenario, the extent of RCR uplift for such expected near-term support is determined by our estimate of the combined impact of the support that will be made available to the RCR liabilities by the resolution authorities, including capital support from the activation of loss-absorbing capacity. This assessment of ASTS therefore

considers the potential impact of a resolution on the RCR liabilities even when there is no ASTS uplift for the ICR.

25. For all issuers, the RCR uplift is subject to the following conditions:
- An institution cannot benefit from RCR uplift if it is expected to be materially noncompliant with applicable regulatory requirements for bail-in-able debt cushions (for example, TLAC for some issuers; minimum requirement for own funds and eligible liabilities (MREL) for others).
 - An RCR is equalized to the ICR if we believe the bail-in resolution framework or the likely institution-specific resolution scenario we envisage does not support a clear expectation that the issuer's RCR liabilities will continue to perform beyond a default of other senior liabilities whose default risk is addressed by the ICR, including its senior unsecured debt. This could be the case if, for example, it is doubtful in our view that the resolution process would in practice preserve the bank's operational capacity.

Assigning RCRs to entities benefiting from group or government support

26. We typically do not assign RCRs to entities for which the expectation of external government support is incorporated into the ICR, except, for example, in the cases where we include additional short-term support. (We assess external government support under "Banks: Rating Methodology And Assumptions" or "Rating Government-Related Entities: Methodology And Assumptions," published on March 25, 2015.) When ratings are based on government support, even though an effective bail-in resolution framework may be in place, the default risk on senior liabilities (including RCR liabilities) is typically driven by the relevant support mechanism rather than by a bail-in resolution process activated by the relevant authorities.
27. We only assign an RCR to a subsidiary financial institution when we determine that the subsidiary's RCR liabilities have the potential to benefit from resolution powers being applied to either the group it belongs to, to the subsidiary itself, or to both.

Treatment of foreign and local currency RCRs, RCRs above the sovereign rating, and branches

28. We typically assign the same RCR level to foreign currency RCR liabilities as we do for local currency RCR liabilities, since liabilities subject to foreign law are usually not at a greater risk of loss from actions of foreign authorities than of domestic authorities in a resolution scenario. RCRs are generally based on the foreign currency ICR in the event an institution has a different (typically higher) local currency ICR. A distinct local currency RCR may be assigned if there is sufficient visibility that the default risk of local currency RCR liabilities is lower than the default risk of liabilities rated at the local currency ICR level.
29. An RCR can be up to two notches above the foreign currency sovereign rating on the institution's country of domicile if we expect RCR liabilities to avoid default under the applicable sovereign stress test, as described in "Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions," published Nov. 19, 2013. This assessment considers the likelihood of an orderly bail-in resolution, as well as of related supranational institutional arrangements supporting financial system stability. For cases in which the sovereign foreign currency rating is 'B-' and below, the limits of table 2 in "Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions" apply to RCRs.
30. We follow the same approach to assigning an RCR for a branch as we do to assigning an ICR to a branch (see "Assessing Bank Branch Creditworthiness," published on Oct. 14, 2013).

REVISIONS AND UPDATES

This article was originally published on April 19, 2018. These criteria became effective on April 19, 2018.

Changes introduced after original publication

- On Aug. 12, 2019, we republished this criteria article to make nonmaterial changes. In paragraph 15, we removed noncriteria content related to published research on individual banks. In addition, we deleted paragraphs 5 and 6, which were related to the initial publication of the criteria. We also updated the contact information and the "Related Publications" section.
- On March 25, 2020, we republished this criteria article to make nonmaterial changes to update references to related criteria.
- On March 23, 2021, we republished this criteria article to make nonmaterial changes. We updated references to related criteria and research. In addition, we deleted text related to the initial publication of the criteria.

RELATED PUBLICATIONS

Related Criteria

- Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Assessing Bank Branch Creditworthiness, Oct. 14, 2013
- Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011

Related Research

- S&P Global Ratings Definitions, Jan. 5, 2021
- RFC Process Summary: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- How S&P Global Ratings Proposes To Introduce Resolution Counterparty Ratings On Financial Institutions, Jan. 31, 2017

Related Guidance

- Guidance: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018

These criteria represent the specific application of fundamental principles that define credit risk and ratings opinions. Their use is determined by issuer- or issue-specific attributes as well as S&P Global Ratings assessment of the credit and, if applicable, structural risks for a given issuer or issue rating. Methodology and assumptions may change from time to time as a result of market and economic conditions, issuer- or issue-specific factors, or new empirical evidence that would affect our credit judgment.

Contact List

ANALYTICAL CONTACTS

Alexandre Birry
London
+ 44 20 7176 7108
alexandre.birry@spglobal.com

ANALYTICAL CONTACTS

Richard Barnes
London
(44) 20-7176-7227
richard.barnes@spglobal.com

ANALYTICAL CONTACTS

Nicolas Malaterre
Paris
(33) 1-4420-7324
nicolas.malaterre@spglobal.com

ANALYTICAL CONTACTS

Stuart Plesser
New York
(1) 212-438-6870
stuart.plesser@spglobal.com

ANALYTICAL CONTACTS

Gavin J Gunning
Melbourne
(61) 3-9631-2092
gavin.gunning@spglobal.com

ANALYTICAL CONTACTS

Cynthia Cohen Freue
Buenos Aires
+54 (11) 4891-2161
cynthia.cohenfreue@spglobal.com

ANALYTICAL CONTACTS

Michelle M Brennan
London
(44) 20-7176-7205
michelle.brennan@spglobal.com

CRITERIA CONTACTS

Steven Ader
New York
(1) 212-438-1447
steven.ader@spglobal.com

CRITERIA CONTACTS

Nik Khakee
New York
(1) 212-438-2473
nik.khakee@spglobal.com

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