

Request for comment:
Financial Institutions
Rating Methodology

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INTRODUCTION

1. Our financial institutions methodology describes the framework within which we assign credit ratings to financial institutions, as well as debt issued by rated entities. We define financial institutions as prudentially regulated banks and non-bank credit institutions with similar characteristics. Non-bank credit institutions face similar regulatory scrutiny as their bank counterparts, with the main differentiation being a lack of a banking licence for receiving deposits.
2. Our methodology is designed to be robust, continuous and systematic, and consequently lead to ratings that are relevant and comparable with other ratings that we assign, as outlined in *Rating Principles*. We assign long-term credit ratings on a scale comprising several categories ranging from 'AAA', reflecting the highest credit quality, to 'D', reflecting the lowest. We also assign short-term issuer ratings on a separate scale to indicate short-term credit quality.
3. For a full explanation and definition of our ratings and the rating process, see *Rating Principles* at www.nordiccreditrating.com.

FRAMEWORK OVERVIEW

Figure 1. Financial institutions rating framework



4. Our financial institutions ratings are forward-looking assessments that incorporate economic conditions, key risk appetite strategies and management, competitive position, and key earnings and loss performance indicators. The assessments are based on financial and non-financial information. Together, these qualitative and quantitative analyses result in an indicative credit assessment. The indicative credit assessment can be "notched" up or down to take into account adjustment factors. These adjustments are primarily based on comparisons with issuers rated at similar rating levels, but also reflect material risk, transitions or market impacts not otherwise captured in the indicative credit assessment. The addition of adjustment factors to the indicative credit assessment results in a standalone credit assessment. Lastly, we review support, whether credit implications arise from the ownership structure, or if sufficient bail-in-able instruments exist to warrant a higher long-term issuer rating to reflect capital structure protection. If required, we apply rating caps to reflect acute default risk associated with liquidity and/or regulatory intervention. We incorporate environmental, social, and governance factors into our analysis where relevant and material (see Appendix 3).
5. Our forward-looking assessments are supported by analysis of historical economic, sector-specific and issuer-specific information to which we add our own projections for each of the key components of the rating, on the basis of discussions with management, authorities and market participants. Our assessment of historical financial performance is based on publicly

available audited accounts. However, we can request further information from management if we deem it necessary.

6. The primary rating components are assessed by estimating, measuring or qualitatively scoring material subfactors, which are then weighted according to a pre-set system. Importantly, our final rating decision is a result of analytical judgment applied to each subfactor and rating component as decided in a formal rating committee.
7. We use economic data and indicators of the strength and flexibility of the issuer's domicile(s) to capture the cyclicity of the domestic operating environment and the strength and stability of national level institutions. While we focus on key national measures, we also consider the global economic cycle. When relevant, we consider specific risk factors related to a financial institution's region within a sovereign jurisdiction or sectoral concentrations among its customers. We also assess risk factors in cross-border exposures to reflect the operating environment accurately.
8. The main component of our analysis is our view of an issuer's risk appetite and management decisions that affect its ability to withstand economic cycles and periods of entity-specific stress without material deterioration of its solvency, funding and/or liquidity position. Key components of an issuer's risk appetite framework include its capital position and associated buffers to regulatory intervention, a fit-for-purpose and balanced funding profile, sufficient liquidity buffers and a robust risk management framework for key areas of risk, among which credit risk and related concentrations are often the most significant.
9. We believe that a financial institution's competitive position plays a material role in its ability to affect the market in which it operates. Key financial institutions in a given market could have increased pricing power and material influence that can support their ability to perform in line with their risk appetite without simply following the whims of the market or growing excessively to improve scale. We note, however, that magnitude is not always a recipe for success when markets are volatile or when scale equates to higher complexity or involvement in the riskier areas of financial services. In our assessment, we consider regional positioning, sectoral concentrations, and membership in financial services alliances, which could provide small institutions with some of the benefits of market-leading banks in terms of pricing, product range, influence and/or cost efficiency.
10. Finally, we review how a financial institution has performed and is likely to perform, given its risk appetite decisions, its balance sheet structure, the economic outlook, and its competitive position. Key areas of focus include earnings and loss performance – factors which can have a material influence on ability to repay creditors. Earnings indicators can indicate whether a given strategy and/or level of risk appetite is generating sufficient capital, meeting the owners' return expectations and/or providing a strong first line of defence against future downturns with stable risk-adjusted returns and cost efficiency. Loss performance indicators can indicate an issuer's ability to manage loan-loss provisions and Stage 3 loans, which in turn can support bottom line capital generation.

Figure 2. Financial institutions rating factors and subfactors

Factors	Weighting	Subfactors	Impact	Selected metrics
Operating environment	20%	National banking environment	2.5–20%	Assessment of regulatory domicile
		Sector exposure assessment	0-17.5%	Sector risk and concentration
		Regional assessment	0-17.5%	Concentration and economic diversity
		Cross-border assessment	0-17.5%	Material cross-border exposures
Risk appetite	50%	Risk governance	7.5%	Risk governance track record Risk appetite framework
		Capital	17.5%	Regulatory capital & buffers Capital flexibility Additional loss absorption
		Funding & liquidity	15%	Fit-for-purpose funding sources Funding structure Liquidity buffers
		Credit and market risk	10%	Exposure characteristics Concentrations & collateral Trading book risk
Competitive position	15%	Competitive position	15%	Market shares in key businesses Business diversity Regional or sectoral roles Growth & pricing strategy
Performance indicators	15%	Earnings	7.5%	Revenue stability Cost efficiency Risk-adjusted return
		Loss performance	7.5%	Provision performance Non-performing loans Loss reserves
Indicative credit assessment				aa to b-
Adjustment factors				Peer comparisons Transitions Borderline assessments
Standalone credit assessment				aa to b-

Factors	Weighting	Subfactors	Impact	Selected metrics
Support				Ownership Capital structure protection Rating caps
Issuer assessment				aaa to b-
Issuer rating				AAA to D

NUMERICAL SCORING OF INDICATIVE CREDIT ASSESSMENT

- To arrive at the indicative credit assessment, we determine an initial assessment from 'aa' to 'b-' for each factor and subfactor (see Figure 2) following the guidelines described in this document.
- The weighted average score based on the factor weighting (see Figure 3) will be between 1 and 14 and translated into an indicative credit assessment (denoted with lower-case characters). For example, a weighted score of 7.2 would translate into a 'bbb' indicative credit assessment.

Figure 3. Indicative credit assessment conversion

Factor assessment	Weighted	Average	Score
aa	1.00	≤ x <	1.50
aa-	1.50	≤ x <	2.50
a+	2.50	≤ x <	3.50
a	3.50	≤ x <	4.50
a-	4.50	≤ x <	5.50
bbb+	5.50	≤ x <	6.50
bbb	6.50	≤ x <	7.50
bbb-	7.50	≤ x <	8.50
bb+	8.50	≤ x <	9.50
bb	9.50	≤ x <	10.50
bb-	10.50	≤ x <	11.50
b+	11.50	≤ x <	12.50
b	12.50	≤ x <	13.50
b-	13.50	≤ x <	14.00

- The indicative credit assessment is subject to additional considerations to determine the standalone credit assessment and the final issuer rating.

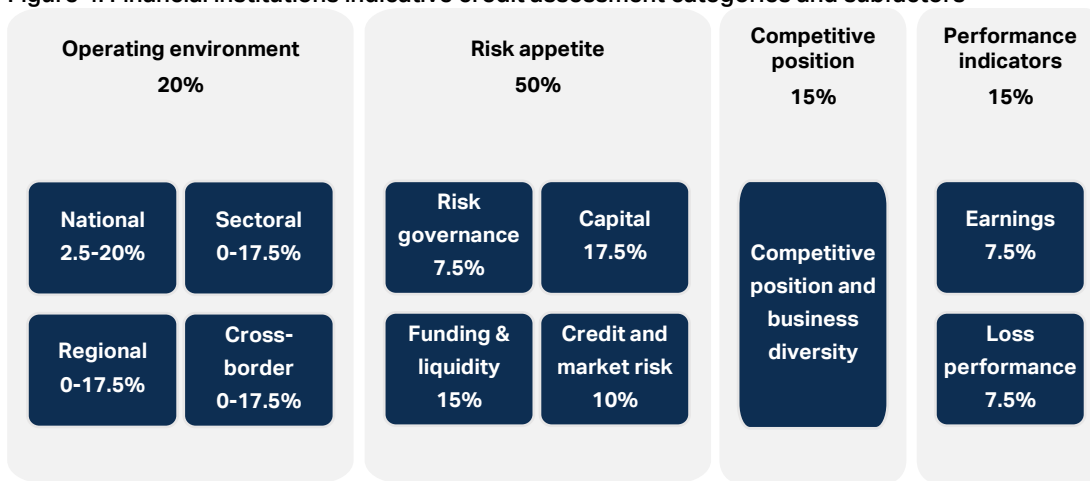
HIGHEST AND LOWEST RATINGS

- Our indicative or standalone credit assessments cannot result in the highest or lowest ratings on the rating scale. We believe that these rating levels should be reserved for entities characterised by special characteristics or situations. Consequently, we have specified criteria for what we expect at these rating levels (see Appendix 2).

INDICATIVE CREDIT ASSESSMENT COMPONENTS

- The following is a description of the key components of our indicative credit assessment of financial institutions. The scores for the primary factors are affected by subfactor scores, which combine to produce the indicative credit assessment (see Figure 4).

Figure 4. Financial institutions indicative credit assessment categories and subfactors



OPERATING ENVIRONMENT

16. As intermediators of capital, financial institutions are linked to the wider national or regional economy in which they operate and have a profound impact on key variables, such as growth, employment, and financial stability. Conversely, they are also highly affected by the overall strength and resilience of the national or local economy and trends associated with economic cycles. In addition, financial institutions are reliant on the strength of government bodies, either through regulation or the legal system, which enforce issuers' clients' obligations to fulfil legal financial contracts. Accordingly, we recognise that the operating environment is an important component in determining the creditworthiness of a financial institution.

17. Our analysis of the operating environment starts with the sovereign creditworthiness of the issuer's domicile. Accordingly, it reflects the strength and discipline of sovereign institutions, as well as providing an indication of key economic inputs such as GDP per capita, government indebtedness and political stability. From this starting point, we consider relative strengths and weaknesses in the sectors of the domestic and global economy that are particularly relevant for financial stability and prospects, as well as sustainability factors. We also look specifically at finance sector-related factors; credit growth related to GDP growth, the regulatory environment, profitability, and stable funding availability. Finally, we consider the risk in aggregate lending in the domestic finance system, and arrive at our national banking sector assessment.

18. For financial institutions with exposure profiles that differ materially or contain risk characteristics different from the national profile, we can include a sector exposure assessment in our view of the operating environment. In the case of institutions that have geographic or lending concentrations in a specific region of the sovereign jurisdiction or have material cross-border exposures, our view of the operating environment includes an assessment of these factors. The regional assessment is intended to capture both differences in economic factors in the region compared with the national economy, lending concentrations, and lack of diversity in the local economy. Our cross-border exposure assessment is akin to our sector exposure assessment, but we can also consider risk factors beyond sector-specific risk pertaining to operating in a given national-level jurisdiction. We find that financial institutions rarely have both significant regional concentrations in its jurisdiction of domicile and material cross-border exposures.

Figure 5. Operating environment factors

Factors	Weighting	Subfactors	Impact	Selected metrics
Operating environment	20%	National banking environment	2.5–20%	Assessment of regulatory domicile
		Sector exposure assessment	0–17.5%	Sector risk and concentration
		Regional assessment	0–17.5%	Concentration and economic diversity
		Cross-border assessment	0–17.5%	Material cross border exposures

19. In the case of issuers under severe distress, the operating environment assessment can be capped at 'b' to reflect that our assessment of their performance is entirely decoupled from our assessment of the domestic operating environment and/or our regional or cross-border assessment.
20. Weights for each factor are set on the basis of a qualitative and quantitative analysis, at intervals of 2.5% of the total weight. All issuers are scored on the national banking environment of their domicile to reflect the importance of regulatory oversight and domestic regulation, with a minimum weight of 2.5%. In the case of diverse institutions with sector and cross-border exposures similar to national averages, and without material regional concentrations, our operating environment assessment is in line with our national banking environment assessment. The other three factors are considered individually, with the weighting depending on the issuer's own profile.
21. We assign a sector exposure assessment and a regional assessment to reflect the risk profile of a financial institution's exposures or operating region on the basis of our view of how much of the operating environment risk is related to each of the four factors mentioned in the previous paragraph following the guidelines in the four sections below. For example, a particular region could be highly susceptible to commodity prices, have few large industries, or a small number of employers. When lending exposures are concentrated in specific sectors, important risk variables can be deemed to carry greater risk than national averages. Our cross-border assessment is primarily used to identify material differences in an issuer's cross-border exposures compared with those identified at national level.

NATIONAL BANKING ENVIRONMENT

(2.5–20% impact on indicative credit assessment)

22. Our assessment of the national banking environment is consistent for all financial institutions domiciled in the same sovereign jurisdiction. It reflects the institutional strength of the sovereign, economic stability, and finance-sector specific factors such as the regulatory environment, excess or stagnant credit growth, availability of stable funding, industry profitability, and risk in key areas of lending.
23. The starting point for our national banking environment is one rating grade below our credit assessment of the sovereign (see our *Sovereign Credit Assessment Methodology*), with a maximum starting point of 'a'. Our sovereign credit analysis combines factors such as institutional strength, fiscal responsibility, monetary policy, current account position, GDP per capita and other economic indicators. We believe that a creditworthy sovereign with strong ability to provide liquidity support and/or fiscal stimulus and a track record of stability creates an optimal support infrastructure for financial institutions.
24. The stability and prospects of a national banking environment can be dependent on factors other than those that impact sovereign creditworthiness. We also focus on the regulatory environment, excess credit growth in the finance system, industry profitability, and funding availability.
25. The regulatory environment is fundamental in providing a solid and sustainable foundation for financial institutions to operate. This foundation is improved by strong regulation, in our view. We also consider the ability of supervisory authorities to enforce regulation as well as

the prudence of regulatory oversight and requirements. Unpredictable regulatory oversight can be detrimental.

26. We consider credit growth in relation to GDP growth, to monitor for excess growth. We consider that high credit growth without high output growth can be an indicator of future unsustainable debt levels. We also consider the availability of stable funding markets and credit growth in relation to available stable funding. The definition of stable funding sources can differ by jurisdiction, but generally includes retail and corporate deposits as well as established and liquid domestic covered bond markets.
27. In addition, we consider the overall profitability in the domestic financial services sector, i.e. financial institutions' ability to cover real or potential losses and accumulate capital. In some instances, strong profitability can offset weaknesses in other areas. Finally, our assessment takes into consideration a jurisdiction's aggregate lending profile as an indicator of potential risk to domestic financial-sector stability given historical and expected cash flow volatility, collateral value stability and liquidity, and the cyclical nature of relevant sub-sectors. We assess exposure classes individually in each jurisdiction, as risk characteristics can differ across territories. In instances where sustainability-related risks are not sufficiently captured in our assessment of other factors, we can make additional adjustments to our final assessment.
28. Where material cross-border operations exist, typically accounting for more than 25% of an issuer's private-sector credit exposure, we can apply an exposure-weighted average of our national banking environment assessments for jurisdictions where an issuer has operations. We can capture the risk profile of the international exposures of institutions with niche lending profiles in our sector exposure and/or cross-border assessment.
29. We calibrate from the sovereign strength starting point to reflect each risk factor (see Appendix 1.)

Figure 6. National scoring and notching guidelines

Risk factors	-	Subscore	+
Sovereign strength		'a' to 'b'	
Economic adjustments	4		4
Credit growth	2		2
Regulatory environment	2		2
Profitability	2		2
Funding availability	2		2
Exposure assessment	2		2
Sustainability	2		0
National banking environment		'aa' to 'b-'	

SECTOR EXPOSURE ASSESSMENT

(0–17.5% impact on indicative credit assessment)

30. We consider whether the risk profile of a financial institution's sector exposure differs materially from the national profile and notch up or down from our assessment of the national banking environment. We also consider whether an issuer's sector exposure has a similar risk profile to the domestic average, or if it lends to a sub-sector that has different risk characteristics from the overall sector.
31. Typically, negative adjustments apply to issuers materially overexposed to volatile industries, while positive adjustments are possible for an exceptionally stable exposure profile. We expect pronounced differences in scoring for institutions with high exposure to volatile industries affected by globally determined prices. In addition, we can adjust to reflect higher risk associated with consumer finance lending which is generally highly sensitive to economic cycles. We can also consider differences in the level of regulation for specific sectors and borrower types.
32. Our guidelines for weighting individual risk exposures (see Figure 7) specify 25% intervals, although we can apply weights at intervals of 12.5%, resulting in middle-ground weighting of 37.5% or 62.5%, tail-end weighting of 12.5% or top-end weighting of 87.5%.

Figure 7. Individual exposure assessment weighting guidelines

	25%	50%	75%
Sector exposure factors	Loan exposures are to sectors that we expect to perform in line with the domestic economy, with highly similar risk factors to the domestic average.	Loan exposures are to sectors that we largely expect to perform in line with the domestic economy, with similar risk factors to the domestic average.	Loan exposures are to sectors that primarily have idiosyncratic risk drivers compared with the domestic average, that are countercyclical or face high volatility.

REGIONAL ASSESSMENT

(0–17.5% impact on indicative credit assessment)

33. For issuers with material concentrations in one or several regions we assign a regional assessment score to capture differences between the local and national operating environment. Our regional assessment is characterised by notches from the national banking environment score, and reflects differences in local and national economic factors, regional growth prospects, economic diversity, and other variations. High economic concentration, which is common in small and/or rural regions, is likely to weigh heavily on our assessment.
34. Our regional assessment takes into consideration local growth projections and employment to assess long-term prospects for financial institutions. It also takes into consideration industry-specific or single-name lending concentrations, or reliance on volatile industries, which can result in high-risk operating conditions for issuers with a presence in the same jurisdiction. While some regions outperform national averages, we do not adjust our view of the local operating environment upwards in view of limits associated with regional lending concentrations.

Figure 8. Guidelines on regional assessment, indicating notches below the national assessment

Subfactors	0	1-2	3-4	5-7	8 and above
Regional factors	Regions with similar economic characteristics to the domestic economy. Typically linked with major metropolitan areas.	Regions with sufficient sector and economic diversity, with some weak economic factors. Typically with strong ties to major metropolitan areas.	Regions with modest diversity and/or economic factors. Typically with mid-sized or university cities.	Regions with low diversity and/or weaker economic conditions than national averages.	Regions with negligible diversity and/or significantly weaker economic conditions than national averages.

35. Our guidelines for weighting the regional assessment specify 25% intervals, although we can apply weights at intervals of 12.5%, resulting in middle-ground weighting of 37.5% or 62.5%, tail-end weighting of 12.5% or top-end weighting of 87.5%.

Figure 9. Regional assessment weighting guidelines

Subfactors	25%	50%	75%
Regional factors	Exposure to multiple regions, that individually or jointly have economic characteristics similar to the domestic economic environment.	Exposure to one region with economic characteristics similar to the domestic economic environment. Exposure to multiple regions with differing characteristics to the domestic economy.	Primary exposure to region(s) with economic characteristics largely different from the domestic economic environment.

CROSS-BORDER ASSESSMENT

(0–17.5% impact on indicative credit assessment)

36. For issuers with modest cross-border operations (typically less than 25% of private-sector credit exposure), we use our cross-border factor to identify positive or negative differences in credit quality from the domestic national assessment. For example, exposures in a jurisdiction facing rapidly rising unemployment, or intense economic volatility are likely to carry higher risk, regardless of sector. Similarly, weak regulation, such as poor debtor protection, or high political risk might not increase the risk to all sectors but are nonetheless not sector-exclusive. Cross-border exposures can be immaterial or not carry materially different risk levels from those determined by the combined national, regional and/or sectoral assessment. In such cases, we can opt not to make any cross-border adjustments.

RISK APPETITE

37. The most influential factor in our assessment of a financial institution is the issuer's risk appetite framework and management's decisions about capitalisation, funding profile, liquidity buffers and risk-taking that affect its ability to withstand economic downturns and periods of entity-specific stress without defaulting on obligations or facing regulatory intervention.
38. While risk appetite accounts for 50% of the indicative credit assessment, it is divided into four subcategories: capital, funding and liquidity, risk governance, and credit and market risk.

Figure 10. Risk appetite subfactors and impact on indicative credit assessment

Factors	Weighting	Subfactors	Impact	Selected metrics
Risk appetite	50%	Risk governance	7.5%	Risk governance track record Risk appetite framework
		Capital	17.5%	Regulatory capital & buffers Capital flexibility Additional loss absorption
		Funding & liquidity	15%	Fit-for-purpose funding sources Funding structure Liquidity buffers
		Credit and market risk	10%	Exposure characteristics Concentrations & collateral Trading book risk

39. Taken together, the risk appetite assessment takes into consideration an issuer's risk-based decision-making that drives the current and future status of the balance sheet. To make a forward-looking assessment of risk appetite, we discuss with management future targets, budgets, growth objectives and market dynamics. We do not accept a financial institution's financial budgets and issuing plans as definitive but incorporate them as we make our own projections and incorporate predictable future events where appropriate.

RISK GOVERNANCE

(7.5% impact on indicative credit assessment)

40. The strength of risk management in a financial institution's decision-making is a key determinant of whether an issuer is sufficiently prepared to withstand a downturn. A financial institution at which top-level management decisions and limit-setting drive decision-making is generally well positioned to avoid risk-related problems and respond quickly to a deteriorating operating environment.
41. In our view, a robust risk appetite framework should include clearly defined risk limits and specific expectations of the board, management and internal auditors' roles and responsibilities. In addition, the risk appetite framework should be in line with the strategy, capitalisation and finance strategy of the financial institution. Management should be

adequately informed about the risk undertaken by the financial institution itself and promote a culture in line with the risk management framework.

- 42. The risk appetite framework should take into consideration all material risk and define clear limits and statements of risk appetite so that management can implement the financial institution's business strategy. We expect effective risk appetite frameworks to be implemented iteratively and consistently. An effective risk appetite framework should be backward- and forward-looking, focus on known areas of concern, and take into account potential regulation and areas of risk.
- 43. We expect the risk appetite framework to include a combination of qualitative statements as well as quantitative measures expressed relative to earnings, capital, risk measures, liquidity and other relevant areas. A thorough risk appetite framework should also address areas where risk can be difficult to quantify, such as reputation and conduct, related-party lending, cyber activities, corporate responsibility, money laundering, and corruption.
- 44. Risk appetite frameworks can take different forms depending on the size and complexity of the financial institution. In complex financial groups they can cover enterprise risk management systems, while in smaller operations exposure to different types of risk can be limited. For this reason, we apply a degree of proportionality in our analysis, taking into consideration an issuer's scale and level of organisational complexity. In all cases, we expect management to identify and quantify its level of risk tolerance and ensure adequate risk management controls and reporting are in place for all relevant forms of risk regardless of the organisation's size and complexity. We also consider the benefits of banking alliances and other forms of cooperation and information exchange that improve an issuer's risk management capacity and ability to manage growing regulatory and compliance requirements.

Figure 11. Risk governance scoring guidelines

Subfactors	aa	a	bbb	bb	b
Risk governance	The risk appetite framework and risk governance are perceived to be exceptional. Risk resources are proportionate and adequate given the risk profile.	The risk appetite framework and risk governance are perceived to be strong. Risk resources are proportionate and adequate given the risk profile.	The risk appetite framework and risk governance are adequate, but some features are less appropriate for the risk profile. Risk resources are limited or reflect key person risk but are generally proportionate and adequate given the risk profile.	Multiple features of the risk appetite framework and risk governance are deemed weak or less appropriate for the risk profile. Risk resources might not be proportionate nor adequate given the risk profile.	Material weaknesses in risk governance exist. Risk resources are neither proportionate nor adequate given the risk profile.

- 45. In general, large and/or complex financial institutions have more significant and complex risk management issues to address than small and/or non-complex lenders. Complexity has also

increased for small and/or less complex institutions. For example key person risk can be material, reputational risk can be exacerbated by media reports and hearsay, and cyber criminals can target issuers perceived to lack structural complexity and robust data security.

46. While typically unsuitable for model-based measurement, forms of risk other than credit and market risk can weigh heavily on management and distract successful financial institutions from achieving strategic targets. Generally, such risk is difficult to predict, and we are often limited in our ability to evaluate the robustness of internal protection against low-frequency, high-severity risk.
47. Our risk governance assessment takes into consideration a financial institution's progress, or lack thereof, in managing environmental, social and governance (ESG) risk internally and among its customers and collateral. Requirements and expectations have increased and we expect them to increase further. Effective control of ESG risk includes management of the risk itself as well as the risk of failure to meet regulatory requirements.

CAPITAL

(17.5% impact on indicative credit assessment)

48. A financial institution's capital position and available buffers before reaching minimum regulatory requirements are vital for absorbing unexpected losses and maintaining investor and regulatory confidence. In addition, the strategy for distributing capital to shareholders and composition of the capital base can provide more or less capital flexibility than reflected purely in risk-based regulatory capital measures.
49. Due to the loss-absorbing nature of common equity Tier 1 (CET1) and additional Tier 1 (AT1) instruments, our capital guidelines generally focus on regulatory Tier 1 capital as a proportion of risk exposure amount (REA). Our assessment guidelines in Figure 12 take into consideration the projected Tier 1 ratio, as long as distances from regulatory CET1 requirements are sufficient.
50. We expect AT1 capital instruments to provide additional protection to senior creditors on a going concern basis due to their full or partial loss-absorbing capacity and write-down or conversion features, but note that the ability to utilise such features could be compromised if the CET1 ratio has deteriorated. We believe that Tier 2 capital instruments are less likely to provide going concern loss absorption, though material amounts of Tier 2 instruments could be considered as positive for senior creditors in borderline capital assessments.
51. In addition, we consider a financial institution's capital flexibility. For example, whether sizeable buffers of accrued dividends are available to absorb losses before Tier 1 capital is affected and for the benefit of senior unsecured bond holders. The rating impact of such buffers is likely to be most relevant in borderline assessments or at low rating levels, where the use of capital instruments for loss absorption is more relevant and the assessment of the magnitude of potential protection for senior creditors is more tangible.
52. A significant drawback of regulatory capital measures is the lack of comparability in the calculation of the denominator (REA) between institutions that employ internal ratings-based (IRB) capital models and those that use standard capital models. In addition, the measurement and implementation of REA can differ between countries due to national discretion that is available as part of current and future international regulatory capital requirement

regulations and the EU's Capital Requirement Directive. These differences often lead to different REAs for identical exposures. For this reason, in addition to our primary focus on regulatory capital ratios, we consider the method for measuring REA when we compare individual issuers.

53. Given differences in REA calculations, national buffer requirements, and risk not captured in risk weights, Tier 1 ratios are considered nominally as well as in relation to a financial institution's regulatory capital requirements. For example, one institution could have larger buffers before reaching its regulatory minimum requirements than another with a higher nominal Tier 1 ratio. For this reason, we evaluate Tier 1 ratios and the likelihood of a financial institution breaching its regulatory requirements.
54. We typically consider all regulatory buffers in our assessment of a financial institution's distance to capital requirements. This includes all minimum requirements, systemic risk or systemically important financial institution buffers, capital conservation buffers, and national counter-cyclical buffers. In addition, we consider regulatory Pillar 2 buffers to be mandatory, whether they are framed as guidance or requirements. We consider the flexibility afforded by capital conservation buffers in our assessment of rating caps below. We do not consider management buffers as mandatory requirements but believe regulators could respond to repeated breaches. We expect financial institutions to have material clearance of regulatory requirements to reach 'aa' capital levels.
55. We assess flexibility through factors such as the ability to cancel dividends or control capital generation through operational decisions, for example through halting growth, or access to capital markets. In cases of exceptional capital ratios and distance to regulatory requirements, flexibility is of lower importance. A lack of flexibility could be characterised by expected strong pushback against cancellation of dividends, limited ability or willingness to make operational changes to support capitalisation, or limited access to capital markets.
56. Our initial scoring guidelines take into consideration regulatory CET1 ratios, capital flexibility, and distance to regulatory capital requirements (see Figure 12). We note that financial institutions can breach capital conservation buffers, but in such instances need to provide a capital restoration plan. If an issuer largely meets the criteria for a score of 'b', but we have concerns about its ability to restore its capital in a timely manner, we could cap the rating at 'BB'. If an issuer does not meet our criteria for a score of 'b', and is consequently at risk of insolvency or severe regulatory intervention, we could cap the rating at 'B-', unless it also meets our criteria for a 'CCC' rating or below (see Figure 23).
57. Risk-weighted capital measures provide more valuable insight than unweighted leverage ratios. When risk-based capital requirements and targets are integrated into internal decision-making, an issuer can adequately factor the non-linearity of its risk profile into its underwriting. However, strong leverage ratios can support our assessment. When regulatory leverage ratios act as a constraint on at-risk capital, the distance to regulatory requirements could negatively affect our assessment.
58. When financial institutions are part of a group, capitalisation is generally assessed at group level. When relevant, we consider the standalone capitalisation of significant legal entities to evaluate potential restrictions in the fungibility of capital within a group.

Figure 12. Initial capital scoring guidelines*

Subfactors	aa	a	bbb	bb	b
Tier 1 capital ratio	Typically above 22%	Typically 18% to 22%	Typically 15% to 18%	Typically 12% to 15%	Typically below 12%
Capital buffers	Capitalisation is exceptional compared with regulatory expectations. Distance to regulatory CET1/Tier 1 requirements is usually higher than 5pp.	Capitalisation is strong compared with regulatory expectations. Distance to regulatory CET1/Tier 1 requirements is usually higher than 3pp.	Capitalisation is above regulatory expectations. Distance to regulatory CET1 requirements is usually higher than 2pp.	Capitalisation is weak compared with regulatory expectations. Distance to CET1 requirements is usually less than 2pp.	Capitalisation is within 1% of regulatory expectations but meets minimum capital requirements. Plan in place with regulator to restore capitalisation.
Flexibility	The issuer has significant flexibility in its capital position.	The issuer has satisfactory flexibility in its capital position.	The issuer has acceptable flexibility in its capital position or is likely to receive timely capital injections.	The issuer has below average flexibility in its capital position and is unlikely to receive timely capital injections.	The issuer has weak or negligible flexibility in its capital position and has minimal likelihood of timely capital injections.

*Thresholds can be adjusted to reflect differences in national capital regimes.

FUNDING AND LIQUIDITY

(15% impact on indicative credit assessment)

59. Funding and liquidity decisions are vital for financial institutions. When funding sources or liquidity buffers are inadequate or volatile, financial institutions can quickly become dependent on contingency financing or lenders of last resort for emergency liquidity.
60. In our assessment of funding and liquidity, we consider many variables that together indicate a financial institution's preparedness for the expected and unexpected. We focus on three key areas; the management of asset and liability-maturity mismatches, the reliability and fit-for-purpose diversity of funding sources, and the availability of liquidity buffers to deal with unexpected contingencies.
61. Our assessment of a financial institution's asset and liability management (ALM) focuses on the maturity and currency structure of assets and liabilities, as well as the appropriateness of inflation-linked or other structured financing, where relevant. In this assessment we consider the type of assets on the balance sheet and evaluate the appropriateness of the duration, granularity and reliability of such financing. We consider the regulatory net stable funding ratio (NSFR) and a financial institution's internal NSFR limits in our evaluation.
62. In our assessment we also consider the fit-for-purpose diversity and reliability of funding sources. We do not adhere to an absolute ranking of financing sources. Instead, we evaluate the merits of stable and small, diverse customer deposits, liquid and reliable covered bond

markets, and diverse senior and subordinated bond financing in relation to the nature of the assets. We evaluate the price sensitivity of deposit sources as well as concentrations of specific depositors. We also consider the level of deposits covered by deposit guarantee schemes, particularly in the case of financial institutions with a high risk of weakening customer trust. While a high level of guaranteed deposits can lessen the risk of a run on deposits, we consider the risk of significant outflows or loss of funding access related to reputational risk, where relevant. We also consider refinancing risk in relation to capital market financing and evaluate the risk associated with a temporary loss of access to seemingly reliable funding or price-sensitive customer deposits.

- 63. In our liquidity analysis we consider the strength of existing liquidity buffers and liquidity risk management within a financial institution's risk appetite. Reviews of stress testing, refinancing concentrations, limit setting and the risk profile of liquid resources are key elements of the evaluation. The 30-day liquidity coverage ratio (LCR) mandated by the Basel accords can provide an historic point-in-time snapshot and is an important regulatory requirement. However, high volatility close to regulatory LCR requirements in combination with poor funding flexibility can be an important indicator of liquidity risk. We consider the proportion of liquid assets on the balance sheet compared with a longer-term view of vulnerable or maturing liabilities and take into account a financial institution's internal policy for maintaining liquidity buffers and contingencies in its risk appetite framework.
- 64. When access to capital markets is limited and deposit financing is losing or has lost its reliability, we assess an issuer's funding and liquidity at 'b'. In certain cases, we could cap the issuer rating at 'BB', assuming that emergency assistance has stabilised the issuer's near-term finances, or at 'B' if its finances have not stabilised.

Figure 13. Funding and liquidity scoring guidelines

Subfactors	aa	a	bbb	bb	b
Funding and liquidity	Some features of ALM, funding profile or liquidity buffers are deemed exceptionally low risk in comparison with those of relevant peers. Risk appetite framework includes material buffers to regulatory requirements.	ALM, funding profile and liquidity buffers are adequate as are access to capital markets and primary funding sources. Risk appetite framework includes material buffers to regulatory requirements.	Some features of ALM, funding profile, liquidity buffers or funding access are deemed weaker, more concentrated or less appropriate than those of relevant peers. Risk appetite framework includes material buffers to regulatory requirements.	Multiple features of ALM, funding profile, liquidity buffers or funding access are deemed weaker, more concentrated or less appropriate than those of relevant peers. Buffers to regulatory LCR and NSFR requirements are weak.	Access to capital markets is limited and deposits are unreliable. An issuer could need or be using emergency liquidity assistance provided by the relevant authorities.

CREDIT AND MARKET RISK

(10% impact on indicative credit assessment)

65. The dominant risk facing most financial institutions involves clients' ability to repay debt or the value of collateral. For this reason, we view credit risk management, lending concentrations, and underwriting practices as essential to credit quality. Accordingly, we emphasise credit risk in our credit and market risk assessment when market risk is deemed negligible and take a more balanced view when market risk is more prevalent.

CREDIT RISK

66. Our credit risk assessment focuses on a financial institution's lending concentrations and/or diversity, lending growth strategy and underwriting, along with loan book collateralisation levels and type. Our assessment is a forward-looking view of credit risk strengths and weaknesses as opposed to our base-case expectations of credit losses and non-performing lending, which we consider in our views on loss performance.
67. Credit risk concentrations are an important consideration, given that highly correlated assets can deteriorate simultaneously and reduce the benefits of an otherwise diverse credit portfolio. We focus on three forms of credit risk concentration:
 - Large, single-name(s) or linked counterparty exposures (typically via lending, guarantees or derivative counterparties) that represent a material portion of a financial institution's CET1 and can result in significant, unexpected capital deterioration.
 - Specific industry concentrations where many corporate counterparties or associated collateral values can be negatively affected simultaneously by changes in the economy, market trends, or other factors.
 - Regional concentrations where corporate and household counterparties could have strong correlations due to local factors such as reliance on significant local employers, demographic changes, physical and transition climate risk, or a lack of industrial diversity.
68. Financial institutions can benefit from being nationally or internationally diverse. We believe a diversification or cross-border strategy that does not operate in silos is of more value than one of disparate business lines or geographies.
69. Strategic decisions to pursue excessive lending growth often precede credit losses. This is particularly true if an issuer's loan growth is significantly higher than total credit growth in the market, or if borrowers are not well known to the lender. We aim to differentiate between instances in which moderately high growth is part of a long-term strategy in compatible markets or customer segments, and instances in which growth is driven by reduced underwriting standards, below-market pricing and/or increased risk appetite. We evaluate growth through acquisitions on a case-by-case basis.
70. An issuer's underwriting practices and track record have a significant impact on our assessment of credit risk. We take into consideration both model-based underwriting and defined limits, as well as an issuer's willingness and resources to undertake nuanced decision-making in the case of complex and/or large exposures. While exceptional underwriting is unlikely to offset the risk of large lending concentrations or weak collateral, it can reduce it. Conversely, we believe that weak underwriting or elevated risk appetite can reduce the positive impact of low lending concentrations and/or strong collateral. We look closely for deteriorating underwriting standards in combination with accelerated loan growth. Within

our assessment of underwriting standards, we take into consideration the extent of non-financial factors, including, ESG factors.

71. While customer quality is a first step in avoiding unwanted credit losses, the level of collateralisation in the loan book can be a key differentiator in terms of the capital impact of non-performing customers. We evaluate the strength of existing collateral and, where possible, compare loan-to-value (LTV) ratios and collateral value vulnerability with those of peers. We consider a financial institution's collateral valuation practices and prudence relative to its loan book characteristics. For example, we could be more cautious about collateral values in an illiquid market.

Figure 14. Credit risk scoring guidelines

Subfactors	aa	a	bbb	bb	b
Credit risk concentration	The credit risk profile is exceptionally diverse across sectors, geographies and counterparties.	The credit risk profile is nationally diverse or somewhat concentrated on sectors that are in line with national risk factors, such as prime mortgage lending. Single-name exposures are immaterial.	Some credit concentration exists, but risk associated with single-name exposures is immaterial or of high credit quality. Industry and/or sectoral concentrations are inherent in the business model or regional profile but are deemed to have diverse credit risk drivers.	Credit concentration is a major weakness, but risk associated with single-name exposures is of high credit quality. Other material concentration is inherent in regional activities.	Significant credit concentration poses a material risk to solvency, particularly in association with large single-name exposures or material concentrations on weak and volatile industries.
Lending growth	N/A*	N/A*	N/A*	Lending growth is materially higher than national averages or for major exposure classes.	Lending growth is materially higher than national averages or for major exposure classes, and targeted towards higher risk segments.

Underwriting	Exceptional underwriting standards and customer selection.	Underwriting standards and customer selection is strong, appropriately complex and nuanced for all exposure classes.	Underwriting standards and customer selection is acceptable but lacking in complexity and nuance for some exposure classes.	Underwriting standards or customer selection is acceptable but lacking in complexity and nuance for most or all exposure classes. Underwriting standards are declining to facilitate growth or higher revenues.	Underwriting standards or customer selection is unsatisfactory and/or not appropriate for the lender's exposure classes.
Collateral position	Credit risk is materially reduced due to exceptionally low LTVs and relatively liquid collateral when compared with those of regional peers.	Most loans are secured by market-consistent LTVs and relatively liquid collateral when compared with those of regional peers.	Most loans are secured by higher-than-market LTVs and/or less-liquid collateral than those of regional peers.	A meaningful proportion of assets is unsecured and recent loss experience demonstrates low recovery prospects.	Most assets are unsecured and recent loss experience demonstrates low recovery prospects.

*Lending growth is considered only if deemed a risk factor in line with the 'bb' and 'b' scoring guidelines.

MARKET RISK

- 72. We consider the materiality of market risk exposures for a given financial institution, on the basis of our definitions of a significant trading book (at least 10% of total assets or REA) and a large trading book (at least 25%). Market risk can be deemed not material in instances where foreign exchange and investment risk is minimal.
- 73. In the case of financial institutions dominated by credit risk, but with material market risk exposure, 25% of our credit and market risk assessment will reflect market risk. In the case of financial institutions with minimal credit risk, market risk can account for up to 100% of the assessment. In cases where market risk is deemed minimal, the market risk weight is 0%. We can also reflect market risk in our assessment of risk governance, either if it is particularly high, or if it does not qualify under our materiality threshold, but nonetheless presents a higher risk compared with that of peers.
- 74. We focus on a financial institution's limit setting and use of available limits to determine risk appetite for key aspects of market risk associated with its trading and banking book positions. We rely on regulatory capital requirements for market risk to provide insight into the magnitude of risk associated with the trading book and banking book, including listed and unlisted equity positions.
- 75. Where material, we could consider downside risk associated with pension liabilities, concentrated public and private equity positions, risk linked to the recapitalisation needs of insurance companies, or high levels of illiquid marked-to-model financial assets.

Figure 15. Market risk scoring guidelines

Subfactors	aa	a	bbb	bb	b
Market risk	Market risk is maintained by stringent risk limits restricting earnings volatility and downside risk to capital.	Market-related activities contribute an important component of core earnings and result in occasional earnings volatility. Risk limits are well defined and market risk not captured by regulatory measures is limited.	Market-related activities contribute an important component of core earnings and result in some quarterly earnings volatility. Risk limits are well defined and market risk not captured by regulatory measures represents additional risk in comparison with peers.	Market-related activities are a major cause of core earnings volatility. Risk limits are well defined, but less stringently observed than at peers. Specific market risk not captured by regulatory measures is materially higher than at peers.	Market-related activities are a major cause of core earnings volatility. Breaches or increases in risk limits to accommodate higher risk are common.

COMPETITIVE POSITION

(15% impact on indicative credit assessment)

76. We believe that a financial institution's competitive position plays a material role in its ability to affect the market in which it operates. Market-leading institutions usually have strong pricing power and material influence that supports their ability to perform in line with their risk appetite. Financial institutions with dominant competitive positions in one or more key areas of retail and commercial banking, asset management, market-making, investment banking or general financial services are more often able to take advantage of economies of scale, revenue diversity and brand recognition. Small financial institutions, especially those operating without the revenue, cost and product diversity afforded by financial services alliances, are often compelled to follow product and pricing trends set by larger participants or adapt their underwriting standards to improve their competitive position. This can also apply to issuers operating in highly price-sensitive customer segments in which brand awareness is limited.
77. We believe that scale does not always correlate with success, particularly when markets are volatile or when scale equates to greater complexity or involvement in risky areas of financial services. In our assessment, we aim to consider regional positioning, importance to a given sector and/or positioning within a banking or financial services alliance, which could provide a small institution with some of the benefits of market-leading banks in terms of diverse product offerings, pricing, influence and shared costs. In the case of financial institutions operating only in a region of a larger jurisdiction, we factor in the beneficial nature of its competitive position, alongside its growth prospects in relation to those of the region.
78. We consider a diverse business model, in which net interest income is complemented by stable fee, commission, and other income as positive for an issuer's competitive position, to the extent that the issuer can exert control over such revenue. In this context, we also consider

the diversity of sources for net interest income, including an issuer's reliance on only a few customers or customers with similar risk attributes.

79. We believe that ESG factors are increasingly important for a financial institution's standing among customers and other stakeholders. In our view, an issuer can both strengthen and weaken its competitive position through its management of ESG risk and opportunities.

Figure 16. Competitive position scoring guidelines

Subfactors	aa	a	bbb	bb	b
Competitive position	Dominant national or strong international competitive position in retail and commercial banking.	Strong national or international competitive position in retail and/or commercial banking typically or dominant regional or niche franchises. Small institutions with leading positions in financial alliances and significant aggregate market presence.	Modest competitive position in retail and/or commercial banking or very strong regional or niche franchises. Small institutions with key positions in financial alliances with significant aggregate market presence.	Small competitive position in retail and/or commercial banking, but with material regional or niche franchises. Very small institutions with minor positions in large financial alliances.	Limited competitive position in core markets. Very small institutions with modest benefit from financial alliances or lacking alliance membership.
Business diversity	Revenues are well distributed across retail and commercial banking, including stable fee and commission income from diverse products, business areas or geographies.	Revenues are balanced between multiple business lines but somewhat over reliant on net interest income. Stable fee and commission income from diverse products, business areas or geographies complements net interest income.	Revenues are mainly from net interest income from retail or commercial banking or concentrated on fee or other income sources. Modest or market-dependent alternative revenues provide some revenue diversity.	Revenues are mainly from a single business line and income type, such as net interest income, commissions or other monoline revenue streams.	Revenues are mainly from just a few, volatile business lines.

PERFORMANCE INDICATORS

80. While our analysis of risk appetite focuses on the strength of the balance sheet, our analysis of performance indicators provides insight into recent and projected capital generation, loss performance and asset quality metrics. These indicators help us assess if a financial institution's financial results support or contradict our qualitative view of risk appetite.

EARNINGS

(7.5% impact on indicative credit assessment)

81. We aim to evaluate a financial institution's historical performance and ability to generate stable and healthy pre-provision earnings on the basis of its existing and projected balance sheet and business strategy. Stable, predictable and robust pre-provision earnings act as a first line of loss absorption and can materially improve a financial institution's ability to survive fluctuations in customer activity, increases in loan impairments, revaluations of financial assets, and margin compression.
82. Our assessment of earnings focuses on revenue stability, cost efficiency and risk-based pre-provision returns against historical results and future projections. Our analysis can be more lenient for institutions with exceptional capital buffers or more conservative where strong growth overshadows the impact of strong capital generation. In cases where loan-loss provisions have a strong impact on return on equity, we can incorporate this into our assessment of earnings.
83. First, we evaluate the stability of core revenues, excluding material non-recurring, one-off impacts. Our evaluation reflects historical revenues where relevant to the future business model and a forward-looking projection of future revenues, based on our assumptions about the future operating environment. When evaluating stability, we focus on factors that an issuer can control, excluding trading income, dividends from non-associated entities, and changes in market interest rates that we deem short term.
84. Second, we analyse cost efficiency, which we view as a key indicator of the success and viability of management's strategy in comparison with that of peers with similar business models. Material non-recurring, one-off impacts are excluded from the assessment, though long term restructuring and investments which become quasi-permanent features of the cost base are included. In the case of financial institutions with exceptional cost-income ratios due to small operations or few employees, we aim to capture efficiency benefits in our earnings analysis and the related risk within our assessments of market position and risk appetite.
85. Finally, we evaluate a financial institution's risk-adjusted returns by comparing core pre-provision operating profits with regulatory REA. Because regulatory REA can differ materially between financial institutions, we can adjust our assessment to reflect material differences in the measurement of REA.

Figure 17. Earnings scoring guidelines

Subfactors	aa	a	bbb	bb	b
Revenue stability	Core revenues exhibit exceptional stability in comparison with those of relevant peers due to lower structural volatility in underlying revenues and are likely to continue to perform with only modest fluctuations around trend levels.	Core revenues exhibit stability in line with those of relevant peers with minimal downside volatility and are likely to continue to perform with only moderate volatility around trend levels.	Core revenues are somewhat more volatile than those of relevant peers due to greater structural volatility in underlying revenues and are likely to continue to perform with similar volatility around trend levels.	Core revenues are volatile due to greater structural volatility in underlying revenues and are likely to continue to demonstrate material volatility around trend levels.	Core revenues exhibit exceptional volatility and are difficult to project with any certainty due to high levels of reliance on capital market conditions or other factors.
Cost efficiency	Core cost-income ratios are exceptional in comparison with those of relevant peers. Typically at or below 45%.	Core cost-income ratios are strong in comparison with those of relevant peers. Typically at or below 50%.	Core cost-income ratios are average in comparison with those of relevant peers. Typically at or below 60%.	Core cost-income ratios are weaker than those of relevant peers. Typically at or below 75% but somewhat more volatile due to fixed costs and variable revenues.	Core cost-income ratios are weak and unpredictable. Typically above 75% or highly volatile due to a high proportion of fixed costs and variable revenues.
Risk-adjusted returns	Risk-adjusted capital generation is exceptional. Typically, pre-provision earnings amount to more than 3% of REA.	Risk-adjusted capital generation is strong or in line with that of relevant peers. Typically, pre-provision earnings amount to more than 2% of REA.	Risk-adjusted capital generation is average compared with that of relevant peers. Typically, pre-provision earnings amount to more than 1.5% of REA.	Risk-adjusted capital generation is weaker than that of relevant peers. Typically, pre-provision earnings amount to more than 1% of REA.	Risk-adjusted capital generation is weak and more volatile than that of relevant peers. Typically, pre-provision earnings amount to less than 1% of REA.

LOSS PERFORMANCE

(7.5% impact on indicative credit assessment)

- 86. A financial institution's asset quality metrics provide insight into the recent and projected success of management's risk appetite. We review the loss history and incorporate our forward-looking projections of asset quality and potential loss provisions.

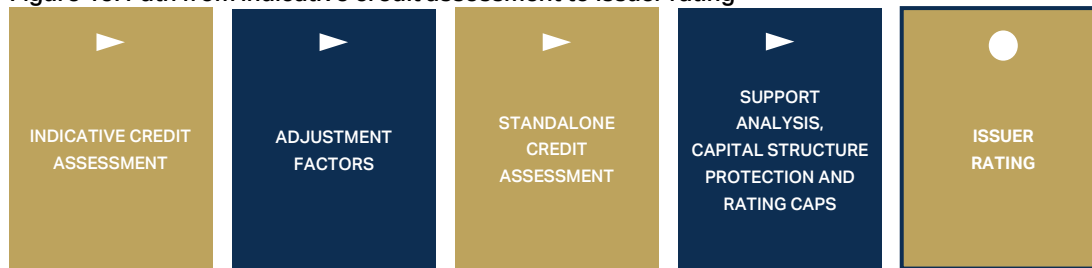
87. We compare a financial institution's asset quality metrics – loan loss provisions, accumulated reserves, problem or watch list loans, and net non-performing loans – with the corresponding metrics of relevant peers to provide perspective on the relativities of the metrics. In supportive economic conditions, most issuer's loan-loss provisions can be at benign levels, which partly explains our emphasis on risk appetite and mitigation of downside risk. However, material variations in an issuer's loan-loss provisions can also demonstrate differences in underwriting standards and collateralisation policies.
88. We focus on historical metrics reported since the implementation of IFRS9, the most recent loan-loss provisioning standard for financial institutions that report under IFRS. Under IFRS9, financial institutions are required to take a forward-looking approach to loan-loss provisioning. However, IFRS9 can lead to increased volatility in loan-loss provisioning, due to dependence on economic variables. We mainly focus on Stage 3 loans, which include non-performing loans. Stage 3 loans also include loans deemed to be at high-risk of becoming non-performing. We also consider Stage 2 loans as an indicator of risk for future loan loss provisions.
89. In our view, management of loan stage classifications and loan-loss provisions can differ between financial institutions and regulatory expectations at national level. Our loss performance assessment takes into consideration a combination of qualitative and quantitative analysis of an issuer's management of at-risk loans.
90. Our analysis can include qualitative parameters or downside risk not visible in our base-case forecast of asset quality metrics. For example, a financial institution with large single-name exposures could have a base-case forecast with modest Stage 3 loans and loan-loss provisions, while another could have weaker forecast metrics, but significantly less downside risk. In addition, we consider the risk to asset quality metrics for institutions that maintain strong Stage 3 metrics by actively selling non-performing loans in a market that might not always be functioning effectively. We typically consider details of problem loans, associated collateral and reserves in our projections for future increases in loan-loss provisions and Stage 3 loans. While we focus on credit-related asset quality, we can also adjust our view of loan-loss provisions and/or future capital projections for material one-off write-downs of other non-credit assets that could affect an issuer's capitalisation.

Figure 18. Loss performance scoring guidelines

Subfactors	aa	a	bbb	bb	b
Loss performance	Asset quality metrics have been and are likely to remain exceptional when compared with those of relevant peers and present no material risk to capital generation throughout the forecast.	Asset quality metrics have been and are likely to remain similar to those of relevant peers and are thoroughly covered by pre-provision operating profits throughout the forecast.	Asset quality metrics have been and are likely to remain weaker than those of relevant peers but are not likely to impair capital generation significantly throughout the forecast.	Asset quality metrics are weak but stable. Significant new provisions for problem loans could result in bottom-line losses in the forecast period.	Asset quality metrics are weak and likely to deteriorate further. Significant new provisions have resulted in reported losses and/or are a material risk to existing capital in our projections.

ADJUSTMENT FACTORS AND SUPPORT

Figure 19. Path from indicative credit assessment to issuer rating



ADJUSTMENT FACTORS

91. We compare the indicative credit assessment of a financial institution with public issuer ratings on and/or internal credit assessments of its peers to determine if adjustments are necessary due to strengths or weaknesses not adequately captured elsewhere in our methodology. Ultimately, an issuer rating should be a relative assessment of credit risk and in some instances an indicative credit assessment will not result in an appropriate comparison with an issuer's peers. We can raise or lower the rating by one notch on the basis of a peer comparison. In cases where the numerical scoring results in a borderline case, we can adjust the rating if we believe that elements of an issuer's risk profile warrant a different rating.
92. We also consider whether transitional factors that could affect creditworthiness are not reflected in the indicative credit assessment, which we can adjust for. If abrupt and specific concerns arise, we could use additional downward notching to ensure that we assign what we deem to be the appropriate issuer rating. These adjustments cannot be used to raise the rating above any of the rating caps imposed by this methodology.
93. The combination of the indicative credit assessment and any adjustment factors results in the standalone credit assessment.

SUPPORT ANALYSIS

OWNERSHIP

94. Our ownership analysis assesses a financial institution's ownership structure and other material credit enhancements that are not already reflected in the standalone credit assessment. Ownership can have a pronounced impact on credit quality. Strong owners that are deemed likely to provide support to important entities and/or have a track record of supporting the rated entity during financial distress can be viewed as positive. Conversely, weak or unsupportive owners can be viewed as negative.
95. Our principles for assessing and notching to reflect ownership support are defined in our *Group and Government Support* methodology.
96. In light of the EU's Banking Recovery and Resolution Directive, which seeks to avoid taxpayer bailouts, we incorporate no explicit expectations of broad government support into our issuer ratings on financial institutions.
97. Where relevant, we incorporate material linkages between financial institutions that benefit from membership in financial services alliances into our assessment of competitive position

and expect material cost sharing to be reflected in cost efficiency metrics and our evaluation of earnings. Upward notching from the standalone credit assessment to reflect membership in a financial services alliance would require the existence of material credit-enhancing and binding agreements, such as loss guarantees or pledges of extraordinary capital support.

98. Our support analysis also takes into consideration whether perceived support for senior creditors is likely to accrue to subordinated debt holders. When this is the case, our issue rating (s) on individual capital instruments will be notched from the issuer rating. When this is not the case, the rating (s) on capital instruments will exclude notches of owner support.

CAPITAL STRUCTURE PROTECTION

99. We take into consideration whether or not senior unsecured bondholders are materially protected by senior non-preferred instruments or other bail-in-able buffers and if this should be reflected in the issuer rating. In such cases, we can raise the long-term issuer rating and senior unsecured instrument ratings by two notches to reflect such protection. This is most likely to apply to issuers subject to regulatory resolution under the EU's Minimum Requirements for Own Funds and Eligible Liabilities (MREL). Eligible senior unsecured instruments are considered in this assessment only when they are issued as senior non-preferred instruments.
100. The materiality of such buffers depends on their size in relation to REA and the volume of senior unsecured instruments. We also consider the instruments' maturity profile and the issuer's commitment to retaining such buffers.
101. In cases where we consider bail-in-able buffers significant in terms of protecting senior unsecured bondholders, we are likely to raise the issuer rating by two notches. Typically, this would occur when an issuer has been assigned a regulatory MREL requirement that is adequately met by bail-in-able debt instruments and is likely to be subject to resolution. In our view, bail-in-able buffers offer diminishing benefits such that the maximum issuer rating resulting from capital structure protection is 'AA'.
102. Where bail-in-able buffers are material but form a relatively low proportion of outstanding senior unsecured debt, we can limit the notching to one notch.

RATING CAPS

103. We can cap an issuer rating for capital-related reasons or when access to capital markets is limited and deposit financing is losing or has lost its reliability (See sections on Capital and Funding and Liquidity). In addition, we could deem it appropriate to cap an issuer rating due to material risk associated with short-term liquidity, or low or deteriorating credit quality at the sovereign or primary owner.
104. We do not apply rigid restrictions to issuer ratings above our sovereign credit assessment of the jurisdiction in which an issuer is domiciled or our issuer rating on or credit assessment of the primary owner, given the possibility of regulatory buffers that could ring-fence an issuer from the negative impact of weaker sovereigns or owners. Rather, we evaluate individual situations as they arise and can apply rating caps in line with, above or below our credit assessment of the sovereign or our issuer rating on or credit assessment of the primary owner.

This is in line with our principles for assessing ownership support as defined in our Group and Government Support methodology.

RATING INDIVIDUAL DEBT INSTRUMENTS

105. We typically align senior unsecured instrument ratings with the issuer rating, including any capital structure protection afforded by bail-in-able instruments as described above.
106. In addition, the issuer rating is the basis for the notching of various instruments. We believe that the risk of non-payment of senior non-preferred and subordinated capital instruments is dependent on the creditworthiness of the issuer (see Figure 20). In our view, the risk of default on capital instruments by highly rated entities is lower than the risk of default by issuers with lower issuer ratings. Consequently, we adapt the notching of the ratings on individual debt instruments depending on the underlying credit quality and the ability of the issuer to repay its debts.
107. We believe that the risk associated with senior non-preferred and capital instruments becomes increasingly material as the issuer rating level decreases. Consequently we increase the notching from the issuer rating for each of the defined rating ranges. The notching of senior non-preferred and capital instruments reflects the possibility that coupons could be deferred on such instruments or the instruments could be written down, converted to equity, or subject to a distressed exchange prior to an issuer entering resolution or liquidation.
108. Where one or two notches of capital structure protection are incorporated into the issuer and senior unsecured issue ratings, the capital structure protection notches are removed for senior non-preferred and capital instruments. We then follow the same notching principles as for issuers without capital structure protection.

Figure 20. Individual debt instrument notching guidelines from the issuer rating given capital structure protection uplift

Capital structure protection	No uplift			One notch uplift			Two notches uplift			
	Instrument	BBB+ or higher	BBB/BBB-/ BB+	BB or lower	BBB+ or higher	BBB/BBB-/ BB+	BB or lower	BBB+ or higher	BBB/BBB-/ BB+	BB or lower
Senior unsecured	-	-	-	-	-	-	-	-	-	-
Senior non-preferred	0	-1	-2	-1	-2	-3	-2	-3	-4	-4
Tier 2	-1	-2	-3	-2	-3	-4	-3	-4	-5	-5
Additional tier 1	-3	-4	-4	-3	-5	-5	-4	-6	-6	-6

*In cases involving ownership or government support, notching of capital instruments can be adjusted to exclude support notches if we deem support for such instruments unlikely.

109. For instruments issued by non-operating holding companies and intended as bail-in-able in the event of resolution, our approach is generally similar to that to senior non-preferred debt

instruments. However, further consideration could be given as to whether support can accrue to such instruments and structural subordination is needed.

110. Our guidelines cover standard instruments only. Specific features or differences in regulatory track record or treatment could result in different levels of notching if we perceive risk to be higher or lower or if buffers to specific capital triggers are inadequate.

SHORT-TERM DEBT RATINGS

111. Our short-term rating scale and mapping between long- and short-term ratings are defined in our *Rating Principles* methodology. The short-term rating reflects a combination of the long-term issuer rating, and the issuer's short-term liquidity profile and emergency funding access.

APPENDIX 1: NATIONAL BANKING MARKET ASSESSMENT ADJUSTMENT GUIDELINES

112. Below, we provide examples of positive and negative reasons for adjustments (see Figure 22) from our issuer rating starting point (one notch below our sovereign credit assessment, maximum 'a').

Figure 21. National banking market factor adjustment considerations

Subfactors	Potential positive adjustment	Potential negative adjustment
Economic adjustments	<ul style="list-style-type: none"> Declining unemployment. Stable positive projected population growth. Declining volume of bankruptcies and defaults. Strong but sustainable investment appetite. Job creation in line with population growth. Strong economic diversity. Strong debt servicing ability among households and/or corporates. Highly liquid collateral markets. Stable and reliable collateral values. Stable international growth prospects and stability. 	<ul style="list-style-type: none"> Rising unemployment. Highly volatile or negative projected population growth. Rising volume of bankruptcies and defaults. Weak or unsustainable investment appetite. Insufficient job creation. High economic concentration. Weak debt servicing ability among households and/or corporates. Poor liquidity in collateral markets. Volatile, weak, or unreliable collateral values. Weak or uncertain international growth prospects and stability.
Credit growth	<ul style="list-style-type: none"> Modest credit growth in relation to economic growth. 	<ul style="list-style-type: none"> Materially higher credit growth than economic growth. Stagnant or decreasing credit growth in relation to economic growth.
Regulatory environment	<ul style="list-style-type: none"> Strong enforcement capacity. Strict requirements. Good predictability and transparency. 	<ul style="list-style-type: none"> Weak enforcement capacity. Weak or excessive requirements. Poor predictability and transparency.
Profitability	<ul style="list-style-type: none"> Strong profitability in core earnings supporting capitalisation, without increased risk appetite. 	<ul style="list-style-type: none"> Weak profitability in core earnings impacting capitalisation or causing increased risk appetite.
Funding availability	<ul style="list-style-type: none"> Available stable funding is sufficient for the domestic private-sector loan profile, even in stressed market conditions. 	<ul style="list-style-type: none"> Available stable funding is limited given the domestic private-sector loan profile (in regular or stressed market conditions).
Exposure assessment	<ul style="list-style-type: none"> Low likelihood and magnitude of possible losses. 	<ul style="list-style-type: none"> Excessive exposure to high risk, volatile, or undercollateralised industries. Currency mismatch.

Sustainability

Not applicable.

Economic reliance on potentially stranded assets or resources.
High degree of corruption or other governance concerns.
Significant human rights concerns.
High exposure to physical climate risk with limited mitigatory action.

APPENDIX 2: HIGHEST AND LOWEST RATINGS

113. Our indicative credit assessments cannot result in the highest or lowest ratings on our rating scale. We believe that these rating levels are applicable to issuers with special characteristics, in particular financial institutions with 100% ownership by and specific policy roles for highly rated governments or municipalities. We have therefore specified criteria for what we expect at these rating levels.

Figure 22. AAA/AA+ ratings

Highest possible ratings	
AAA	'AAA' is the highest possible rating and indicates extremely strong credit quality. This rating level is reserved for financial institutions with 100% government ownership and an unquestioned likelihood of support due to their vital roles for sovereigns with 'aaa' credit assessments or local and regional governments with 'AAA' ratings or credit assessments.
AA+	'AA+' is the second-highest rating and indicates very high credit quality and minimal long-term default risk. Such a financial institution is likely to be 100% government-owned and play a vital role as described above, but for sovereigns with 'aa+' credit assessments or local and regional governments with 'AA+' ratings or credit assessments. In addition, such an entity could play an essential, but somewhat less vital, role for a sovereign or sub-sovereign entity with a 'aaa' credit assessment.

114. If necessary, it is possible to extrapolate the vital and essential roles described in Figure 23 for financial institutions that are 100% owned by governments of sovereigns with lower credit quality.

Figure 23. CCC/CC/C ratings

Lowest possible ratings	
CCC	We assign a 'CCC' issuer rating in specific situations if we assess that a financial institution is distressed to the extent that it could be subject to regulatory intervention preventing it from meeting its senior financial obligations, or facing a distressed exchange, even though this might not materialise within the subsequent 12 months. At the 'CCC' level, an issuer might have liquidity to meet short-term obligations but poor operating prospects, raising doubts over the long-term sustainability of its finances.
CC	We assign a 'CC' issuer rating if we think it highly likely that an issuer will default within 12 months.
C	We assign a 'C' issuer rating if an issuer has announced that it will default on its debt but default has not yet taken place. This could be the case if the regulator has intervened with the intention of forcing losses on senior creditors or if an issuer has announced a distressed exchange that has yet to take place.

115. 'CCC', 'CC', and 'C' issue ratings can be assigned to specific debt instruments with expected default prospects similar to those outlined above (see Figure 24).

APPENDIX 3: ESG FACTORS

- 116. We take into consideration how environmental, social, and governance (ESG) factors influence an issuer's creditworthiness.
- 117. We take ESG factors into account and highlight them in our credit rating reports when we believe they are material and relevant. The integration of ESG factors into our credit analysis is holistic, not formulaic. ESG factors can influence ratings, outlooks and headroom within ratings. The influence of ESG factors on our credit ratings depends on the financial impact they could have on an issuer's creditworthiness, whether positive or negative. We consider an issuer's public disclosures on ESG factors and talk to management about exposure to and management of all ESG-related risk.
- 118. A financial institution's exposure to ESG factors is taken into account throughout our methodology, when relevant. Such factors can impact the operating environment or an issuer's risk appetite, competitive position, or performance indicators directly. In addition, we can make adjustments on the basis of peer comparisons, which could include the effect of ESG factors not sufficiently captured in criteria factors leading to the indicative credit assessment.
- 119. We do not separate ESG factors from other non-financial factors in our analysis of an issuer's creditworthiness. However, to improve transparency as to the impact of ESG factors on our ratings, we include an overview of priority ESG factors and their impact on relevant criteria factors in our full rating reports.
- 120. An ESG impact table is included in our rating reports, detailing affected areas of assessment and the level of impact on subfactor scoring, where relevant (see Figure 24). ESG impact levels are not equivalent to sub-scores or rating notches. Rather, they should be interpreted as an indicator of whether ESG factors weigh positively or negatively on a specific assessment.

Figure 24. ESG factor impact levels for subfactor scoring and indicative credit assessment

Significant positive impact	Moderate positive impact	No impact	Moderate negative impact	Significant negative impact
++	+	0	-	--

APPENDIX 4: DATA SOURCES

1. Our analysis of financial institutions includes all available public disclosures, as well as select confidential information related to risk governance, forecasting, strategy and other areas of interest that are provided to us as part of our ongoing surveillance.
2. We also use various publicly available data in our market and economic analyses, including (but not limited to) analyses from national and regional statistical bureaus, the European Central Bank, national central banks and supervisory authorities, and commonly used asset price indices. We also use international sources, such as the Organisation for Economic Co-operation and Development, Eurostat and similar data providers which provide reliable and comparable cross-border economic data. We also consider the views, projections and analytical reports of other market participants in our market oversight and surveillance.
3. We remain abreast of market data and developing trends associated with credit spreads, asset pricing, and market capitalisation through market-standard data aggregation services.

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