Ranking MREL/TLAC Senior Unsecured Debt: Roadmap of Scope's Bank Rating Adjustments

Yesterday Scope released the finalised version of its updated bank rating methodology (published as a request-for-comments version in March). The updated methodology entails rating adjustments to reflect the forthcoming MREL/TLAC ranking of senior unsecured debt. This brief Q&A report aims to clarify the contents and timing of current and future rating actions related to the updated methodology.

Q: Why and how is the methodology update leading to rating adjustments?

Scope's latest methodology update includes MREL/TLAC unsecured debt rankings in the rating waterfall. To reflect evolving regulatory and legal developments, when there is sufficient clarity about them, we will notch down the ratings of senior unsecured debt specifically allocated to, or eligible for TLAC and/or MREL. This will occur via a one-off uplift of the respective banks' Issuer Credit-Strength Ratings (ICSRs) by one notch and, if applicable, ratings of senior unsecured liabilities not specifically allocated to, or eligible for MTEL/TLAC.

These adjustments do not in any way signal a shift in the fundamental approach underpinning our rating methodology for banks. They do reflect, however, our opinion that going forward the ICSR and non-MREL/TLAC liabilities should benefit from the protection of a materially more ample capital cushion in a default-like situation.

It is important also to highlight that the above adjustments do not affect the existing ratings on subordinated debt and capital securities. However, with immediate effect, the anchor for the notching down of these classes of securities' ratings will no longer be the ICSR but the bank's senior unsecured ratings – either those of the MREL/TLAC senior debt or those of senior unsecured liabilities when no specific allocation to, or eligibility for MREL/TLAC exists.

Q: What scenarios related to MREL/TLAC-eligible senior debt do you foresee?

We highlight four such scenarios:

1. **Structural subordination**: for banking groups with a holding company parent issuance of senior TLAC/MREL debt via the holding company.
2. **Statutory subordination** (in liquidation and by extension in resolution) of senior unsecured debt compared to bank deposits and other unsecured liabilities, for groups without a holding company structure.
3. **Contractual subordination:** the issuance of a specific category of MREL/TLAC senior unsecured debt, as opposed to other senior unsecured debt (and other senior unsecured liabilities) which will not be MREL/TLAC eligible.
4. **No special clauses or structures:** bail-in will be based solely on the BRRD, without any specific allocation of senior debt to MREL/TLAC.

There will be no rating actions in the form of one-off uplifts of ICSRs and non-MREL/TLAC senior debt ratings in the case of rated banks for which no specific rules and provisions exist to differentiate MREL/TLAC senior debt from other senior liabilities (scenario 4 above). Our methodology explains in detail the reasons why.

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Bank capital securities rating methodology

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Q: What is the planned roadmap of the methodology-driven rating actions?

Scenario 1:
Earlier today we placed on review for possible upgrade the ICSRs and non-MREL/TLAC senior unsecured debt ratings of banking groups with a holding company structure which are issuing or already have the possibility to issue senior unsecured debt allocated to, or eligible for MREL and/or TLAC out of the holding company. The banks affected are in the **UK** – Barclays (A/Stable), HSBC (AA-/Stable), Lloyds (A/Stable) and RBS (BBB+/Stable); **Switzerland** – Credit Suisse (A/Stable) and UBS (A/Stable); and **Belgium** – KBC (A/Stable). Some of these banks have already started issuing senior debt with TLAC language and others plan to issue MREL/TLAC-eligible senior debt out of their holding companies.

Our aim is to conclude these rating reviews quickly – no later than early next month.

Scenario 2:
We are also assessing similar rating actions in the case of rated banks where clarity exists with respect to the ranking in liquidation (and by extension in resolution) of senior unsecured debt. These are in **Germany** – Deutsche Bank (A-/Negative), and Commerzbank (A-/Stable); and **Italy** – Intesa (A-/Stable) and Unicredit (BBB+/Stable).

In Germany, the law on the subordination of banks' senior unsecured debt to other senior unsecured liabilities (primarily deposits) in liquidation (and by extension in resolution), was approved late last year and will become effective early next year. We are planning to carry out similar rating actions on the ICSRs of the two rated banks in Germany before the end of the current quarter, once our analysis of the implications of this law is completed.

In Italy, government decrees at the end of last year have established depositor preference over banks' senior unsecured debt in liquidation (and by extension in resolution), effective from the beginning of 2019. We are currently analysing the impact of the new legal framework and considering the appropriate timing for methodology-driven rating actions. It is probable that such rating actions will be considered during the course of this year.

Scenario 3:
We are also evaluating the proper timing for similar rating adjustments in the case of rated banks in France and Spain. In **France**, the banks affected would be BNP Paribas (A+/Stable), BPCE (A+/Stable), Credit Agricole (A+/Stable), Credit Mutuel (A/Stable), and Societe Generale (A/Stable). In **Spain,** they would be BBVA (A/Stable) and Santander (A+/Stable).

In France, the government earlier this year drafted provisions on the hierarchy of bank liabilities in liquidation (and by extension in resolution) by introducing the possibility for banks to issue senior non-preferred debt which, in liquidation or bail-in (in resolution), would rank below other senior liabilities (primarily deposits, but also other senior unsecured debt). The proposals are awaiting final approval. Once there is sufficient clarity regarding this proposed framework we plan to implement similar methodology-driven rating changes, most likely before the end of the year.

In Spain, a law adopted last year provides banks with the possibility of issuing debt securities which would be senior to subordinated debt and capital securities, but subordinated in the bail-in ranking to other senior unsecured liabilities (notably deposits but also other liabilities such as senior debt). This approach resembles the more recent French proposal. We believe that there is insufficient clarity at this time on the Spanish approach, despite the existence of legislation since 2015. Once more clarity emerges we will consider applying methodology-driven rating adjustments to the ICSRs and outstanding senior debt of the rated Spanish banks.

Scenario 4:

To date there are no regulatory or legal provisions in the case of rated banks in other European countries – **Denmark, Norway, Sweden,** and **Netherlands** – for specific TLAC/MREL eligibility of senior unsecured debt from the other senior unsecured liabilities in the event of liquidation (or by extension bail-in in resolution). As a consequence, the specific rating approach detailed in Scope's updated methodology for the notching down of ratings of MREL/TLAC-eligible senior unsecured debt would not apply in the case of the rated banks in these countries: Danske Bank (A-/Positive), DNB Bank (A+/Stable), Handelsbanken (A/Stable), Nordea (A+/Stable), Swedbank (A-/Stable), Rabobank (A+/Stable) and ING Bank (A/Positive).

We do not exclude, however, that specific provisions regarding MREL/TLAC eligibility for all or selected senior unsecured debt will be adopted by other EU/EEA countries. Equally, we do not exclude, and in fact would welcome, a common approach to be decided, approved and implemented for the entire EU with respect to this. We would envision that the European Commission will consider such a plan when more clarity on MREL – levels, timing and eligibility – will emerge, later this year or at the latest in early 2017.

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