

Rating FI Subsidiaries and Holding Companies

Sector Specific Criteria

Scope

The current criteria report applies to the ratings of (i) financial institutions (i.e. banks or other financial service companies), which are subsidiaries of banks or non-bank corporates (including insurance companies) and (ii) bank holding companies.

Key Rating Drivers

High Probability of Support: India Ratings and Research's (Ind-Ra) ratings of financial institution (FI) subsidiaries of banks usually factor in a high probability of support from parent institutions. This reflects the fact that performing parent banks have very rarely allowed FI subsidiaries to default. It also considers the often high level of integration between parent banks and subsidiaries, and owners' typically strong business, financial and reputational incentives to avoid subsidiary defaults.

Equalisation or Notching: An FI subsidiary's issuer rating may be equalised with its parent bank where Ind-Ra views the subsidiary as 'core'. A 'strategically important' subsidiary is likely to be rated one to two notches below its parent, and a subsidiary of 'limited importance' at least two notches lower. In determining the notching, Ind-Ra will also consider the subsidiary's integration with its parent, where the subsidiary is incorporated, the relative size of parent and subsidiary, the parent's stake, any support commitments, and the parent's track record of support.

Offshore Support Risk Evaluated: When support flows from a foreign parent to a local subsidiary, Ind-Ra will evaluate the relative differences in the Foreign Currency IDR of the parent and that of the Indian sovereign to arrive at a rating of the subsidiary. Ind-Ra will also evaluate the potential for sovereigns to impose payment restrictions. A parent bank regulator may also restrict the parent's ability to support foreign subsidiaries by not allowing sovereign support to flow through to subsidiaries or by imposing limits/risk weightings on subsidiary exposures.

Sale Risk Partially Captured: Ind-Ra does not explicitly capture sale risk in its FI ratings, prior to a disposal being announced. However, subsidiaries at greatest risk of being sold are usually of lower strategic importance, and so notched further off parents' issuer ratings. Upon a sale announcement, a subsidiary's ratings will likely be placed on Watch, and may also be downgraded if Ind-Ra views parent support as less likely pre-sale or should a sale not go through.

Non-Bank Parents: Non-bank parents that are prudentially regulated (e.g. insurance companies) or whose FI subsidiaries support the parent's core business (e.g. captive car lenders, or banks acting as group treasuries) are likely to have a higher propensity to support FI subsidiaries than corporate parents whose subsidiaries are less core to operations.

Ordinary Support and Contagion: Bank subsidiary standalone credit profile may benefit from 'ordinary support' from a strong parent, for example in terms of stability and cost of funding, management expertise and business origination. Conversely, contagion risks from a weak parent mean a subsidiary's standalone credit profile will not normally be more than three notches above the parent's issuer rating. The extent of potential uplift of subsidiary above parent will depend on the independence of its management, franchise and funding, and the strength of the local regulator.

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Sovereign Support for Subsidiaries: Where parental support is quite uncertain, and the subsidiary is systemically important, sovereign support may be viewed as more reliable than parental support. However, uncertainty as to whether a sovereign will bail out part of a foreign banking group could weigh on the level of the subsidiary's support floor.

Holding Companies Equalised or Notched: Long-Term issuer ratings of bank holding companies (BHCs) will usually be equalised with, or rated one notch lower than, their main bank subsidiaries. The nature of group regulation, the extent of BHC double leverage and the materiality and credit profiles of non-bank subsidiaries will be key factors in determining notching.

Application and Limitations

Application

The key elements of Ind-Ra's analysis of FIs are outlined in 'Financial Institutions Criteria' (the FI master criteria). This sector-specific criteria report supplements the FI master criteria.

The criteria described in this report are applicable to:

- FIs that are subsidiaries of banks or non-bank corporates (including insurance companies);
- holding companies that own a bank, which may or may not be the holding company's main operating subsidiary; this may include bancassurance holding companies, particularly those in which a bank is the dominant operating subsidiary.

Ind-Ra defines an FI as an entity principally engaged in providing banking or other financial services, but excluding insurance companies and real estate investment trusts.

Limitations

Along with general limitations outlined in Ind-Ra's FI Master criteria, there are additional limitations applicable to financial subsidiaries of banking and corporate groups.

The fact that Ind-Ra presumes some support from a parent entity to a financial subsidiary should not be construed as an assurance that a parent entity would provide support to a subsidiary if required. Moreover, as bank resolution schemes introduced around the world evolve, Ind-Ra's view of the provision of full and timely support to FI subsidiaries, in particular those located in different jurisdictions to their parents, could change. Ind-Ra would likely alter this criteria report if regulatory barriers to support were to increase. In addition, high-profile cases of a viable parent allowing subsidiaries to default could also cause Ind-Ra to lower its support expectations and revise the criteria.

Rating FI Subsidiaries: An Overview

In rating FIs, Ind-Ra adopts a "higher of" approach. In other words, the agency will first determine what level of Long-Term issuer rating an FI could attain (1) based solely on its stand-alone financial strength (2) based solely on institutional support from its shareholders; and (3) based solely on sovereign support. Ind-Ra will then assign the FI's Long-Term issuer rating at the highest of these three levels.

The current criteria report will focus mainly on step (2), i.e. how Ind-Ra determines the probability of shareholder support for an FI subsidiary. In addition, the report addresses how the presence of a strong shareholder can affect the standalone credit profile and support rating floor of a subsidiary FI. Ind-Ra will follow the steps outlined below when rating an FI subsidiary of a bank:

Applicable Criteria

Financial Institutions Rating Criteria, December 2015

Non-Bank Finance Companies Criteria, December 2015

Rating of Bank Legacy Hybrids and Subordinated Ratings, December 2015

1. Evaluate subsidiary's standalone credit profile (where appropriate).
2. Determine potential parental support for subsidiary:
 - a. Consider the parent's ability to support subsidiary.
 - b. Consider any legal or regulatory obligations for the parent to support subsidiary.
 - c. Consider the parent's propensity to support subsidiary, and in doing so classify subsidiary as 'core', 'strategically important' or of 'limited importance'.
 - d. Consider any legal or regulatory barriers to the parent supporting subsidiary.
3. Evaluate subsidiary support floor (where appropriate).
4. Consolidate the above to determine subsidiary issuer rating.

1. Evaluating Subsidiary's Standalone Credit Profile

Banks' stand-alone strength is evaluated in accordance with Ind-Ra's FI master criteria. There may be cases where a bank subsidiary does not have a meaningful standalone franchise that could exist without the ownership of the current parent. Ind-Ra will assess the stand-alone strength of non-bank FI subsidiaries where this is an important input into the rating process.

Where Ind-Ra assesses the stand-alone strength of non-bank FI subsidiaries, these may benefit, or suffer, as a result of parental ownership, depending on the strength of the shareholder and the degree of parent/subsidiary integration.

Positive for Subsidiary: Ordinary Support

Ind-Ra distinguishes between 'ordinary support', from which a bank benefits in the usual course of business, and 'extraordinary support', which is provided to a non-viable bank to prevent it from defaulting. The former is reflected in a bank's standalone credit profile, and the latter in its support view and support floor. A subsidiary bank usually benefits from some forms of 'ordinary support' from its parent, for example in terms of stability and cost of funding, transfer of management expertise and operational systems, and assistance with business origination, and these benefits are reflected in the subsidiary's standalone credit profile.

Negative for Subsidiary: Contagion Risk

Subsidiary ratings are not usually higher than parent Long-Term issuer ratings. The main reason for this is simply that banks rarely acquire other lenders with stronger credit profiles than their own, or are able to develop subsidiaries to the extent that the latter would become superior credits. In addition, subsidiaries' often material dependence on 'ordinary support' from their parents, and often significant exposure to contagion risk in case of a sharp deterioration in the parent's credit profile, mitigate against assigning a subsidiary rating above the parent's Long-term issuer rating.

Rating Subsidiaries Above Parents

In rare cases, however, a subsidiary's Long-Term Issuer Rating can be higher than its parent's Long-Term Issuer Rating. The extent to which a subsidiary rating can exceed its parent's Long-Term issuer rating depends on Ind-Ra's view of the independence of the subsidiary's credit profile from that of its parent, i.e. the extent to which the subsidiary is judged to be exposed to contagion risk from the parent in case of a marked deterioration of the latter's credit profile. Because of contagion risk, the potential uplift of the subsidiary's rating from the parent's Long-Term issuer rating is usually limited to a maximum of three notches, although in exceptional circumstances the differential could be greater. Ind-Ra views the following factors as positive in limiting contagion risk, and therefore enabling greater uplift of the subsidiary rating relative to the parent's Long-Term issuer rating:

- limited direct exposure of the subsidiary to its parent (or to the parent's home market in case the market is suffering systemic stress);
- relatively independent franchise, management and operational infrastructure of the subsidiary;
- limited reliance of the subsidiary on non-equity funding from the parent, limited dependence of the subsidiary's access to third-party funding and liquidity on the health of the parent, and limited acceleration of subsidiary funding in case of parent default;
- strong regulations capable of identifying and, where necessary, restricting transfers of capital and liquidity from the subsidiary to the parent;
- restrictions on transfers of capital and liquidity from subsidiary to parent, with creditor enforceability, contained in subsidiary funding agreements;
- no evidence to date of the parent withdrawing liquidity or capital from the subsidiary to a degree which would significantly impair the subsidiary's credit profile, possibly augmented by statements by the parent's management that it does not intend to do this in the future;
- potentially high sale value of the subsidiary, making its disposal a potential source of recapitalisation of the parent, and serving as a disincentive to impair its profile.

In rare circumstances, Ind-Ra's assessment of the stand-alone strength of a non-bank FI subsidiary may also be higher than the parent's Long-Term issuer rating. However, because non-bank FI subsidiaries are usually highly integrated with their parents and are typically less highly regulated than banks, a non-bank FI subsidiary will usually not be rated more than one notch above the parent institution.

2A. Parent's Ability to Support Subsidiary

Parent Bank Issuer Rating

Ind-Ra's assessment of the parent bank's ability to support its subsidiary starts by considering the parent's Long-Term issuer rating. These ratings cap the ability of the parent to provide support, as Ind-Ra would not expect support for a subsidiary to be forthcoming when the parent is itself in default. In addition, other factors – namely relative size and the parent bank's standalone credit profile - may also affect the ability of the parent to provide support.

Relative Size

In cases where a bank's subsidiaries form a relatively large part of the consolidated group, the parent may find it more difficult to provide sufficient and timely extraordinary support, even in cases where its own (stand-alone) balance sheet remains relatively unimpaired. This risk will be greater where Ind-Ra believes that different subsidiaries' need for support is likely to be quite highly correlated, for example because they operate in a single region. Where subsidiaries are large relative to the consolidated group, Ind-Ra may therefore increase the notching between parent and subsidiary Long-Term issuer rating (where the latter are driven by parental support).

At the same time, Ind-Ra notes that its analysis of parent banks is typically based on consolidated accounts (precisely because the agency usually regards the probability of subsidiaries being supported as high), and so parent ratings will already take account of the credit profiles of subsidiaries, and the potential need to support them. Where Ind-Ra believes support of subsidiaries is more uncertain (for example, because of their large relative size), the agency may also analyse the parent's unconsolidated accounts in assigning the parent's issuer rating.

Common Ratings

In some cases, where a subsidiary is very large (for example, accounting for more than 25% of group assets), it will often not be possible for the parent to support the subsidiary because its balance sheet is simply not big enough. Furthermore, such very large subsidiaries tend to be highly integrated with their parents in terms of management, balance sheet fungibility and systems, meaning subsidiary and parent credit profiles are likely to be highly correlated. In such cases, Ind-Ra will not base the subsidiary's rating on support from the parent, but will instead assign 'common' issuer ratings, to parent and subsidiary, reflecting the fact that their credit profiles cannot be meaningfully disentangled.

Parent Bank Standalone Credit Profile

In cases where the parent bank's Long-Term issuer rating is driven by potential sovereign support, Ind-Ra will consider whether this support would be allowed to flow through to subsidiaries, in particular those operating in foreign jurisdictions. In Ind-Ra's view, parent bank regulators will in many cases have quite strong incentives to allow support to flow through to subsidiaries, given the potential negative impact of a subsidiary default on the group's operations. Formal or informal agreements between parent and subsidiary bank regulators could also make it more likely that support will flow through.

However, in cases where Ind-Ra judges there to be considerable uncertainty about support flowing through, it may use the parent bank's standalone credit profile, rather than its Long-Term issuer rating, as its anchor rating in assessing the parent's ability to support its subsidiary. In such cases, Ind-Ra will usually seek to consult with representatives of the parent bank's regulatory authorities in order to form a view on whether support would flow through. In addition, many of the factors listed below in section 2C as determining a parent bank's propensity to support a subsidiary (e.g. strategic importance, integration, ownership) will, in Ind-Ra's view, also be likely to influence a parent bank regulator's decision on whether to let support flow through.

2B. Legal or Regulatory Obligations to Support Subsidiary

Regulation

Regulatory requirements to support subsidiary banks can positively influence the levels of ratings assigned to a subsidiary, resulting in them being closely aligned to those of the parent even where propensity to support might otherwise have been low.

Legal Status

In rare cases, a subsidiary may be incorporated with unlimited liability, creating a clear legal obligation for the parent institution to provide support. In such cases, Ind-Ra would be likely to equalise the Long-term issuer ratings of subsidiary and parent, unless there are constraints arising from country risks.

Guarantees

An unconditional and irrevocable guarantee, which contains specific third-party beneficiary language, is the strongest form of parental financial support. This type of support permits subsidiary creditors to press claims against the guarantor in the event of default or covenant violation by the subsidiary. Where an unconditional and irrevocable guarantee exists, this will serve as a floor for the issuer rating of the subsidiary and/or its guaranteed debt.

Formal Support Agreements

A formal support agreement signed by the parent entity's board of directors or an empowered member of executive management, for example to maintain capital and liquidity requirements of an FI subsidiary above a defined threshold, will be regarded as moderately positive for subsidiary ratings. However, although certain support agreements are legally binding while in force, they are usually revocable, and can also be withdrawn if the FI subsidiary is divested, meaning they will typically provide very limited uplift, if any, for a subsidiary's ratings.

Non-Binding Commitments to Support

Non-binding commitments from parent banks to support subsidiaries, such as public management comfort letters (for example, in bond prospectuses), strategic statements (for example, in annual reports) or letters lodged with subsidiary regulators, add some value to the rating process by defining management's intent and potentially providing a stronger moral obligation on the part of the parent to provide support to the subsidiary. However, as such non-binding commitments are not enforceable they generally have limited direct bearing on rating decisions in and of themselves.

Cross-Default Clauses

Cross-default clauses in parent bank funding agreements may specify that a subsidiary default will constitute a technical default on the parent obligation, thereby granting acceleration rights to parent creditors. While this creates no obligation for the parent to support the subsidiary, it may create a significant incentive to do so, raising the propensity to provide support. The strength of this incentive will depend, among other things, on the volume of obligations potentially subject to acceleration, whether the terms of the acceleration would be attractive to creditors and hence be taken up (for example, whether the redemption price would be above or below the current market price), and whether creditors might be sufficiently 'friendly' to waive their acceleration rights, maybe in exchange for a fee.

Ratings of Branches

Subject to country risks, Ind-Ra will equalise the ratings of foreign branches with their 'parent' institutions, reflecting the fact that the branch is a part of the parent legal entity. A branch's ratings will usually reflect the parent institution's foreign currency IDRs unless extreme conditions prevail in the host country which might significantly impede the ongoing operations of the branch.

2C. Parent's Propensity to Support Subsidiary

Strategic Importance

Ind-Ra will classify each rated subsidiary as being either 'core', 'strategically important' or of 'limited importance' to the parent institution. This classification will be based on whether a subsidiary meets the defining characteristics listed in Figure 1, and Ind-Ra's assessment may differ from that of management. Core subsidiaries also include those very large, highly integrated entities where common ratings have been assigned to parent and subsidiary (see *Common Ratings*, above).

In some cases, a subsidiary taken in isolation may seem to fit into a 'lower' category, e.g. 'limited importance', but form part of a group of subsidiaries, which taken together belong to a higher category, e.g. 'strategically important'. An example may be a small foreign bank subsidiary which is one of several operating in a strategically important region for the parent. In such cases, Ind-Ra's designation of the subsidiary, for the purpose of applying these criteria, may reflect the strategic importance of the broader group of subsidiaries.

A core subsidiary's Long-Term issuer rating will typically be equalised with that of its parent, and a strategically important subsidiary will usually be rated one or two notches lower. A subsidiary with limited importance will typically be rated two or more notches lower.

However, these typical degrees of notching may be modified depending on the extent to which the subsidiary also meets the 'typical characteristics' for the relevant type of subsidiary, as listed in Figure 1. For example, if a core subsidiary has a large number of the characteristics listed as typical for a strategically important one, then its Long-Term issuer rating may be notched off its parent's Long-Term issuer rating, rather than equalised. In addition, as noted in other sections of this report, the differentiation between subsidiary and parent ratings may be influenced by legal/regulatory requirements/restrictions in respect to parental support, or by the subsidiary having a high standalone credit profile or support floor.

Figure 1
Notching of Subsidiaries

Type of subsidiary	Core	Strategically important	Limited importance
Typical IDR notching^a	Equalised	One or two notches	Two or more notches ^b
Defining characteristics			
Role in group	Key and integral part of the group's business, provides some of group's core products/services to core clients	Strong synergies with parent, providing products/services in markets identified as strategically important	Limited synergies with parent, not operating in target markets
Potential for disposal	Sale is very hard to conceive; disposal would noticeably alter overall shape of group	No plans to sell, although disposal would not fundamentally alter overall group franchise	Potential candidate for sale, or might already be up for sale; disposal would not be material for group franchise
Implication of subsidiary default	Default would constitute huge reputational risk to parent, damage its franchise and could threaten its viability	High reputational risk for parent, with potential for significant negative impact on other parts of group	Reputational risk would probably be containable for parent
Typical (not defining) characteristics:			
Integration	High level of management and operational integration; capital and funding largely fungible	Significant management independence; some operational/regulatory restrictions on transfers of capital and funding	Significant management independence; some operational/regulatory restrictions on transfers of capital and funding
Jurisdiction	Operates in same jurisdiction as parent or in market long viewed as core	Could be located in core or other market	Could be located in core or other market
Ownership	Full ownership or large majority stake (usually >75%)	Might have material (>25%) minority shareholder	Might have material (>25%) minority shareholder
Support track record	Support has been unquestioned, reflecting high level of integration and fungibility of capital/funding	Timely and sufficient provision of support, when the need has arisen	Support may have been timely and sufficient, or some delays may have been evident
Subsidiary performance and prospects	Long and successful track record in supporting group objectives, which is likely to continue	More limited track record than Core subsidiary, greater uncertainty about long-term prospects	Mixed performance track record, question marks over long-term viability of business
Branding	Shares same brand as parent	May share parent brand or have its own	More likely to have own brand
Rationale for separate legal entity	Legal, taxation, accounting or historical reasons, rather than current business logic	Provides distinct products/services, or operates in different market	Provides distinct products/services, and/or operates in different market

^a Indicates typical differential between support-driven Long-Term rating of subsidiary and Long-Term rating of parent, absent legal/regulatory requirements/restrictions in respect to parental support. Notching could be modified depending on whether a subsidiary meets most of the 'typical' characteristics for that subsidiary type. Subsidiary could be rated higher than the level implied by parental support if it has a higher standalone credit profile or support floor

^b Where Ind-Ra judges support to be unlikely or highly uncertain, the Long-Term rating of a subsidiary with limited importance may be based solely on its stand-alone strength, or may be notched up from a rating level commensurate with its stand-alone strength

Source: Ind-Ra

Other Factors Influencing Support Propensity

Integration

A high level of management, operational and balance sheet integration between parent and subsidiary would usually be viewed by Ind-Ra as underlining the parent's strategic commitment to the subsidiary, and making a default of the subsidiary potentially more onerous and costly for the parent. These factors would typically result in a higher propensity to support, in the agency's view, and therefore lower notching between parent and subsidiary Long-Term issuer ratings. In particular, if the parent provides a high proportion of the subsidiary's non-equity funding, this could raise considerably the cost for the parent of the subsidiary's default and potential bankruptcy, and increase the incentive to provide support.

Jurisdiction

When rating the subsidiary of a foreign parent, Ind-Ra will typically evaluate the strategic importance and integration with the parent, the contagion risk from a subsidiary default and any pressure from the parent bank's regulator to provide support to a foreign, as opposed to a domestic, subsidiary.

At the same time, Ind-Ra will also evaluate if the subsidiary operates in a market long regarded as core by the parent and whether the subsidiary is a relatively small entity with limited operational independence, i.e. where it essentially operates as a branch of the parent.

Ownership

Ind-Ra does not usually distinguish between full and large majority (over 75%) ownership in assessing a parent's propensity to support a subsidiary. However, if a minority owner has a relatively large (over 25%) stake, this could moderately reduce the perceived moral obligation of the parent to unilaterally support the subsidiary, and might complicate and delay decisions on the provision of joint support. Ind-Ra will therefore be less likely to equalise ratings where a large minority shareholder exists. Furthermore, the agency might notch twice or more, rather than once, where the stakes of majority and minority shareholders are close to parity, or where some element of competition or confrontation exists between the shareholders.

Support Track Record

A strong track record of provision of timely extraordinary support to a subsidiary under a broad range of stress scenarios can positively influence Ind-Ra's assessment of a parent institution's propensity to provide support, and thus limit the notching of a subsidiary's Long-Term issuer rating relative to that of its parent. In addition, Ind-Ra views positively a high level of 'ordinary' support, whereby a parent operates a subsidiary with comfortable liquidity and, in particular, capital buffers, rather than simply meeting minimum regulatory requirements.

Subsidiary Performance and Prospects

A strongly performing subsidiary with generally good prospects will usually, in Ind-Ra's view, be somewhat more likely to be supported by its parent than a subsidiary with a track record of mixed performance. At the same time, the agency also takes into account that a subsidiary in need of extraordinary support has by definition suffered a sharp deterioration in its performance, which weakens the relevance of any historically strong profitability in assessing future prospects.

Cost of Support

Where a subsidiary is relatively small, and hence the cost of providing support quite low, the parent's propensity to support may be somewhat higher, in Ind-Ra's view, potentially resulting in closer alignment of the parent and subsidiary Long-Term issuer ratings than would be suggested by the strategic importance of the subsidiary.

Support Commitments

As outlined in section 2A above, Ind-Ra may view non-binding support commitments, and cross default clauses in funding agreements, as creating significant incentives and/or moral obligations to support subsidiaries. This could increase Ind-Ra's view of the parent's propensity to support, and result in lower notching of the subsidiary from the parent.

Non-Bank Parents

The propensity and ability of corporate and insurance parents to support FI subsidiaries is assessed using similar principles as for parent banks. The relative size of the parent and subsidiary, the parent's creditworthiness and financial flexibility and the importance of the subsidiary to the core business of the parent will always be relevant considerations. In general, Ind-Ra believes parents that are prudentially regulated (e.g. insurance companies) or whose FI subsidiaries support the parent's core business (e.g. captive car lenders, or banks acting as group treasuries) are likely to have a higher propensity to support FI subsidiaries than corporate parents whose banking subsidiaries are more akin to investments driven by diversification goals.

Changes in Support Propensity and Sale of Subsidiary

Based on changes in circumstances, Ind-Ra may change its view on a parent's propensity to support a given subsidiary. In some cases, for example if Ind-Ra were to reclassify a subsidiary as being of 'limited importance' rather than 'core', the potential change in a subsidiary's rating could be significant (e.g. by multiple notches).

Gradual Trend

If Ind-Ra believes that a parent's propensity to support a given subsidiary is gradually changing, whether because of changes in strategic importance or due to other factors listed above, Ind-Ra may change the Outlook on the subsidiary's Long-Term issuer rating, and the revised Outlook could be different to that on the parent's Long-Term issuer rating. For example, if a parent has a Stable Outlook, but Ind-Ra believes a core FI subsidiary is becoming less important to the group, Ind-Ra could change the Outlook on the subsidiary to Negative to indicate the potential change in rating associated with its lessening strategic importance. Conversely, a gradual increase in a subsidiary's strategic importance could result in its Long-Term issuer rating having a Positive Outlook while the Outlook on the parent's Long-Term issuer rating is Stable.

Sale Risk

Ind-Ra does not explicitly capture sale risk in its ratings, prior to a formal announcement that a subsidiary is to be sold. However, in the agency's view, there is usually a close correlation between a subsidiary's strategic importance and the likelihood of it being sold (see Figure 1). Sale risk should therefore usually be low in cases where a subsidiary's Long-Term issuer rating is equalised with, or within one notch of, that of its parent.

Sale Announced, Buyer not Identified

If a parent announces that a subsidiary is up for sale without a buyer yet being identified or that management is exploring strategic alternatives with respect to the entity, or if a regulator requires that a parent divest a subsidiary, then Ind-Ra will reassess the parent's propensity to provide support to the entity concerned. If the agency believes the parent will have a materially lower propensity to provide support prior to the sale, or in case a sale does not go through, the Long-Term issuer rating of the subsidiary may be downgraded. If Ind-Ra believes there is a significant probability a sale will take place, the ratings of the subsidiary are also likely to be placed on Watch.

In taking rating actions following a sale announcement, Ind-Ra will also consider whether a relatively narrow group of highly-rated potential acquirers has already been identified, or whether a regulator has indicated that it will approve a sale only to a highly-rated entity. In such cases, the risk of the subsidiary's Long-Term issuer rating being downgraded may be limited, and the ratings may therefore be maintained at their former levels even when Ind-Ra believes the subsidiary has become less strategically important for its current parent.

Conversely, if Ind-Ra believes that a subsidiary will most likely be sold to an entity with a much lower rating than the current parent, then the subsidiary's Long-Term issuer rating may be downgraded immediately following the announcement concerning the potential sale. This may be the case, for example, when a highly-rated parent bank is exiting an emerging market and Ind-Ra believes that local, more lowly rated entities are more likely acquirers than other highly-rated foreign banks.

Sale Announced, Buyer Identified

If a parent announces that it has reached an agreement to sell a subsidiary to a specific buyer, and in Ind-Ra's view the probability of support from the new buyer differs from that of the current owner (with the potential to affect the subsidiary's Long-Term issuer rating), then Ind-Ra will place the subsidiary's Long-Term issuer rating on Watch. The rating Watch may be Positive, Negative or even Evolving, depending on the potential impact of support from the new owner on the rating.

If the Long-Term issuer rating is likely to be downgraded following the sale, and if Ind-Ra believes the current owner would have a materially lower propensity to support the subsidiary should the sale not go through for any reason—i.e. in all likely scenarios the ratings will be downgraded—then it may downgrade the issuer rating immediately following the announcement.

Upon completion of the sale, or earlier if appropriate, Ind-Ra will resolve the Watch on the rating based on its assessment of the probability of support from the new owner.

2D. Legal or Regulatory Barriers to Supporting Subsidiary

Parent Bank's Jurisdiction

In some cases, significant regulatory restrictions at the parent bank level may reduce the fungibility of capital and liquidity within a group. For example, the parent bank's regulator may impose limits on the parent's permitted total exposure to its subsidiary, or may apply high risk weightings or capital deductions to the exposures. In such cases, it may be difficult for a parent to support its subsidiary while remaining in compliance with local regulation, and this may negatively influence Ind-Ra's assessment of the probability of parental support. The parent bank may also need to consider potential adverse tax consequences arising from support of a subsidiary, and political considerations may also constrain management's ability to support a foreign subsidiary.

3. Domestic Sovereign Support for Subsidiary

Ind-Ra will usually regard a parent bank as the most likely source of external support for an FI subsidiary. However, in cases where Ind-Ra judges parental support to be quite uncertain local sovereign support, as reflected in the bank's support floor, may be viewed as more reliable than parental support.

In considering potential sovereign support for a subsidiary bank, Ind-Ra will apply its support criteria, as outlined in its FI master criteria. In particular, the agency will consider the sovereign's ability to provide support, its general approach to supporting domestic banks, and the likely propensity to support the specific bank concerned, given its systemic importance and other considerations.

However, in Ind-Ra's view, there will sometimes be additional uncertainty in respect to a sovereign's support for a subsidiary bank owned by a foreign parent, compared to assistance for a domestically-owned lender. This relates to whether, in case of a parent bank default, the local sovereign would be sufficiently supportive to ensure that subsidiary bank creditors would be placed in a better position than creditors of the parent bank, or—to put it more emotively—whether the sovereign would use domestic taxpayers' money to support bondholders and other wholesale creditors of a foreign bank group.

In Ind-Ra's view, in addition to considerations relating to a subsidiary's systemic importance, the sovereign is therefore more likely to be supportive of a subsidiary bank where:

- the subsidiary has been managed locally and relatively independently from its parent, and has a well-established domestic franchise and brand;
- the subsidiary has accessed wholesale funding directly and quite independently, without recourse to parent guarantees or other forms of credit enhancement;
- funding and capital have not been very fungible within the group, and there have not been material withdrawals of funding and capital from the subsidiary prior to its failure.

Thus, in Ind-Ra's view, a subsidiary bank which is more likely to receive local sovereign support has many of the qualities which would also usually make a bank's stand-alone profile relatively robust to a parent default. Conversely, a subsidiary which is highly integrated with its parent would both be likely to experience deterioration in its stand-alone profile in case of problems at the parent level, and have weaker prospects for sovereign support.

Rating Bank Holding Companies

The issuer ratings of a bank holding company (BHC) are usually closely aligned with the issuer ratings of the BHC's major operating subsidiaries. Specifically, the BHC's Long-Term issuer rating are usually equalised with, or one notch lower than, those of its main operating

subsidiary. This reflects the typically very close correlation between default probabilities at subsidiaries and the BHC. On the one hand, performing subsidiaries would be highly unlikely to let a BHC default because of the huge reputational risks for the group. On the other hand, subsidiary defaults will be very likely to render the BHC insolvent (because subsidiary stakes will need to be written down) and illiquid (as cash flows from subsidiaries dry up, and debt may be accelerated at the BHC level).

In determining whether to equalise the ratings of the BHC with the ratings of its main bank subsidiary, or to rate the BHC lower than its main bank subsidiary, Ind-Ra will focus primarily on the factors listed in Figure 2. In particular, the nature of group regulation and the extent of double leverage at the BHC level will be key factors in determining any notching.

Ind-Ra may assign the BHC a Long-Term issuer rating more than one notch lower than the Long-Term issuer rating of the main operating subsidiary in cases where:

- other operating subsidiaries form a significant part of the group and are rated lower than the main subsidiary;
- the main operating subsidiary's Long-Term issuer rating is driven by potential sovereign support, and in Ind-Ra's view there is significant uncertainty as to whether the same sovereign support would be extended to the BHC;
- other factors exist which result in a significant difference between the default probabilities of holding company and bank subsidiary, for example (but not restricted to) very high double leverage, very high liquidity risk or regulatory/legal risks specific to the BHC.

Figure 2
Equalisation or Notching of BHCs

	Attributes which support equalising BHC ratings with those of main bank subsidiary	Attributes which support rating BHC lower than main bank subsidiary
Regulatory focus	Group as consolidated entity	Protection of bank creditors
Capital and liquidity fungibility	Light or no regulatory restrictions on subsidiary paying dividends or upstreaming liquidity to BHC	More onerous regulatory restrictions on dividends and liquidity transfers
Jurisdiction	BHC and main bank subsidiary incorporated in same jurisdiction	BHC and main bank subsidiary incorporated in different jurisdictions
Double leverage	Low or moderate, i.e. common equity double leverage (defined as equity investments in subsidiaries plus BHC intangibles, divided by BHC common equity) of below 120%	Significant, i.e. common equity double leverage of above 120%, and indicative of potentially burdensome level of BHC debt service costs
BHC liquidity management	Prudent, with contingency plans in place	Less prudent, with limited contingency plans in place
Subsidiary ownership	Full, or large majority, ownership of main bank subsidiary by BHC	Significant minority ownership of main bank subsidiary
Complexity of group structure	Relatively simple group structure	Overly complex group structure with unclear rationale for existence of certain entities
Branding	Common branding of BHC and main bank subsidiary	Distinct branding of BHC and main operating subsidiary
Credit enhancement	Guarantee of BHC debt by main operating subsidiary, or cross default clauses, referencing BHC debt, in subsidiary funding agreements	No guarantees or cross default clauses

Source: Ind-Ra

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