MOODY'S

Rating Action: Moody's takes rating actions on 11 Australian banks following Banks methodology update

06 Mar 2024

Sydney, March 06, 2024 -- Moody's Investors Service (Moody's) has today taken rating actions on AMP Bank Limited (AMP), Australia and New Zealand Banking Group Limited (ANZ), Bank of Queensland Limited (BOQ), Bendigo and Adelaide Bank Limited (BEN), Commonwealth Bank of Australia (CBA), HSBC Bank Australia Ltd (HBAU), ING Bank (Australia) Limited (IBAL), Macquarie Bank Limited (MBL), Macquarie Group Limited (MGL), National Australia Bank Limited (NAB), Suncorp-Metway Limited (SUN) and Westpac Banking Corporation (WBC), including the banks' branches and their affiliates.

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The actions include the upgrade of senior unsecured debt ratings of five issuers by one notch and downgrade of senior unsecured debt ratings of two banks by one notch. The ratings for CBA have been placed on review for upgrade while the ratings for SUN remain on review for upgrade. The outlook on AMP's ratings remains negative while the outlooks of all other affected Australian banks remain stable.

The rating actions resulted from the application of Moody's Advanced Loss Given Failure (Advanced LGF) analysis to certain Australian banks following the publication of Moody's updated Banks methodology on 5 March 2024. The methodology is available at this link: https://ratings.moodys.com/rmc-documents/409852.

Please click on this link https://www.moodys.com/viewresearchdoc.aspx?docid=PBC_ARFTL486662 for the List of Affected Credit Ratings. This list is an integral part of this Press Release and identifies each affected issuer.

All other Australian banks rated by Moody's are not affected by today's rating actions.

RATINGS RATIONALE

The rating actions follow the introduction of an operational resolution regime for banks in Australia designated by the local regulator as "significant financial institutions", together with other banks Moody's expects the authorities to designate as providing critical functions important to financial system stability, or to ensure the availability of essential financial services. Moody's applies its Advanced LGF analysis to banks operating in jurisdictions with Operational Resolution Regimes. The Advanced LGF framework assesses the potential impact of a bank's failure on its various debt classes and deposits, taking into account the subordination of more junior liabilities and the volume of each class of liabilities.

Furthermore, the rating actions also reflect Moody's view that, following the implementation of the bank resolution regime, the likelihood of extraordinary government support has reduced.

LONG-TERM RATINGS

The upgrade of the Australian banks' Counterparty Risk Ratings and Counterparty Risk Assessments takes into account the expected extremely low loss-given-failure for these senior-ranking obligations due to loss absorption provided by subordinated creditors and the volume of deposits. For those bank ratings that benefit from government support, the very low expected losses under Moody's Advanced LGF framework more than offset the impact of reduced government support.

The upgrade of ANZ's, MBL's, MGL's, NAB's and WBC's senior unsecured debt ratings reflects both (i) the expected very low loss-given-failure for senior unsecured creditors due to the loss absorption provided by subordinated creditors and (ii) the volume of senior unsecured debt across which remaining losses are spread. This results in a 2-notch uplift in the preliminary rating assessments for senior unsecured debt above the banks' Adjusted Baseline Credit Assessments (BCA) for ANZ, NAB and WBC. For MBL, this results in a 3-notch uplift from the bank's Adjusted BCA. The senior unsecured debt ratings of these banks receive a further 1-notch uplift due to Moody's expectation of a moderate probability of government support, which has been reduced from a very high probability (or high for MBL), reflecting the implementation of an operational resolution regime.

The a2 BCA, long-term ratings and counterparty risk assessment of CBA have been placed on review for upgrade, reflecting its strong financial metrics, which are consistently higher or at the higher end of its domestic peer group. In particular, the bank's return on assets is the highest amongst the four major banks and has exhibited lower volatility historically. CBA's position as Australia's largest bank, and its leading market shares in retail banking, have not only underpinned its strong profitability but also limited its market funding requirement, given the strength of its retail deposit franchise. CBA's through-the-cycle asset quality performance has also been one of the strongest amongst Australian peers, reflecting the bank's focus on residential mortgages. That said, Moody's expects a more challenging profitability outlook for the Australian banks as margins continue to be pressured by competition and higher funding costs. High interest rates and declining, but still elevated, inflation remain key risks to asset performance. Accordingly, in its review, Moody's will focus on whether CBA's strong financial metrics are commensurate with banks globally whose BCAs are positioned at a1, and the extent CBA is able to sustain its financial performance in the more challenging earnings and asset quality environment. Moody's will also review the bank's future debt issuance plans to incorporate the impact of applying its Advanced LGF framework.

The affirmation of AMP's, HBAU's and IBAL's senior unsecured MTN programme ratings primarily reflects the expected moderate loss-given-failure for senior creditors due to loss absorption provided by subordinated creditors. Accordingly, their ratings remain positioned at the same level as their Adjusted BCAs. In the case of HBAU and IBAL, this includes Moody's assumptions of parental support.

The downgrade of BEN's and BoQ's senior unsecured debt ratings reflects the expected moderate loss-given-failure for senior creditors due to loss absorption provided by subordinated creditors and the volume of senior unsecured debt. Accordingly, their ratings remain positioned at the same level as their Adjusted BCAs, and so the downgrade of these ratings has been driven by the reduction in government support.

SUN's senior unsecured debt ratings remain on review for upgrade at A1, 1-notch above the bank's Adjusted BCA, reflecting the expected low loss-given-failure for senior creditors due to loss absorption provided by subordinated creditors and the volume of senior unsecured debt. The A1 ratings do not incorporate any benefit for government support. The ratings remain on review for upgrade pending the potential acquisition of SUN by ANZ. This transaction, should it close, will be favorable for SUN because it will be acquired by ANZ, a bank with a robust credit profile, strong access to capital markets, and having a moderate likelihood of support from the Australian Government (Aaa stable), which lifts ANZ's long-term issuer rating and long-term senior unsecured ratings by 1-notch. These benefits will likely result in a further uplift in SUN's senior ratings due to a higher government support assumption.

SUBORDINATED DEBT

Moody's has upgraded the point of non-viability subordinated debt instrument ratings of MBL by 2 notches, and by 1 notch for all other affected banks. Previously, these ratings were positioned 2 notches below the banks' Adjusted BCAs, with 1 notch deducted due to higher loss severity relative to senior debt, and an additional notch deducted to reflect the risk associated with the timing of principal write-downs inherent in contractual securities.

Moody's expects Australia's revised bank resolution framework to reduce the uncertainty over when the Australian Prudential Regulation Authority will declare banks to be non-viable. Accordingly, the ratings are now positioned 1 notch below each respective bank's Adjusted BCA with the exception of MBL, for which the subordinated debt rating is positioned at the same level as its Adjusted BCA given its greater volume of Additional Tier 1 securities.

The rating for MBL, London Branch's preference shares has been affirmed. Moody's Advanced LGF analysis confirms a high loss-given-failure, given the small volume of debt and limited protection from residual equity. Moody's also incorporates additional notching from the Adjusted BCA for preference share instruments reflecting their coupon features.

BASELINE CREDIT ASSESSMENT

The BCA of CBA has been placed on review for upgrade. The BCAs of all the other banks have been affirmed. The affirmation reflects Moody's view that the banks are well positioned to weather a likely weakening of asset quality, with strong balance sheets that are underpinned by high capital levels and strong liquidity. High levels of loan-loss reserves will also provide banks with sufficient buffers against potential increases in loan losses. Moody's expects the operating environment for Australian banks to be stable, although borrowers will remain under pressure from elevated interest rates and high – though falling – inflation. Banks' profitability is also likely to weaken as increases in funding costs lead to a narrowing of net interest margins.

OUTLOOK

The outlook on AMP's ratings remains negative. The outlooks of other affected Australian banks are stable, except

SUN and CBA, whose ratings are on review for upgrade.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Moody's could upgrade the long-term ratings following a strengthening of the banks' stand-alone creditworthiness, as expressed by their BCAs, but also due to potentially higher ratings uplift from parental support, where applicable. Upward rating pressure could also materialise if the banks, on a sustained basis, increased the amount of instruments designated to absorb losses in resolution relative to their total balance sheet size, which could result in additional rating uplift from Moody's Advanced LGF analysis.

Moody's could downgrade the banks' ratings following a weakening of their BCAs, but also due to potentially lower assumptions of parental or government support, or due to a significant decrease in bail-in debt volumes outstanding, possibly leading to fewer notches of rating uplift as a result of Moody's Advanced LGF analysis.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks Methodology published in March 2024 and available at https://ratings.moodys.com/rmc-documents/409852. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

The List of Affected Credit Ratings announced here are all solicited credit ratings. For additional information, please refer to Moody's Policy for Designating and Assigning Unsolicited Credit Ratings available on its website https://ratings.moodys.com. Additionally, the List of Affected Credit Ratings includes additional disclosures that vary with regard to some of the ratings. Please click on this link https://www.moodys.com/viewresearchdoc.aspx?docid=PBC_ARFTL486662 for the List of Affected Credit Ratings. This list is an integral part of this Press Release and provides, for each of the credit ratings covered, Moody's disclosures on the following items:

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For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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