Background

Ofgem’s conclusions on the “Best Practice Guidelines for Network Operators Credit Cover” dated February 2005, clause 3.36 establishes that counterparties will be allowed to cover any exposure by using a combination of instrument including an LoC or equivalent bank guarantee from a bank with a long-term debt rating of no less than A by Moody’s or S&P’s.



In this context, and as also stated on Schedule 1 of the “Distribution Connection and Use of System Agreement” dated 5th October 2006, the user shall deliver to the Company one or more forms of collateral which include a Letter of Credit or equivalent bank guarantee. As defined on clause 10.1, the LoC is to be provided by a clearing bank or any other bank which has a long-term debt rating of no less than single A by Standard and Poor’s Ratings Group or by Moody’s Investor Service, or such other bank.



In this document we look at the long-term agency ratings in the UK banking sector at the time of the above mentioned document been published and today’s long-term agency ratings.

We have drawn a comparison amongst a representation of 16 UK, European, Canadian and US banks with UK presence based on publicly available data.

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| --- | --- | --- | --- | --- | --- | --- |
|  | **01-Mar-05** | | | **01-Mar-17** | | |
|  | **Moody's** | **S&P** | **Fitch** | **Moody's** | **S&P** | **Fitch** |
| **Barclays Bank** | Aa1 | AA | AA+ | A1 | A- | A |
| **RBS** |  | AA- |  | Ba1 | BBB- | BBB+ |
| **Lloyds** |  | AA- | AA | Baa1 | BBB+ | A+ |
| **HSBC** |  | A+ | AA- | A1 | A | AA- |
| **Santander** | Aa3 | A+ | AA- | A3 | A- | A- |
| **Deutsche** | Aa3 | AA- | AA- | Baa2 | BBB+ | A- |
| **Soc Gen** |  | AA- | AA- | A2 | A | A |
| **BNP Paribas** | Aa2 | AA | AA | A1 | A | A+ |
| **Credit Agricole** | Aa2 | AA- | AA | A1 | A | A |
| **Uni Credit** |  | AA- | AA- | Baa1 | BBB- | BBB+ |
| **Scotia** | Aa3 | AA- | AA- | Aa3 | A+ | AA- |
| **JPM** | Aa3 | A+ | A+ | A3 | A- | A+ |
| **BAML** | Aa2 | AA- | AA- | Baa1 | BBB+ | A |
| **Citi** |  | AA- | AA+ | Baa1 | BBB+ | A |
| **Goldman Sachs** | Aa3 | A+ | AA- | A3 | BBB+ | A |
| **Morgan Stanley** | Aa3 | A+ | AA- | A3 | BBB+ | A |

Analysis of the above table evidences that:

* From the 16 banks compared all banks have been downgraded in the 12 year period by S&P.
* Moody downgraded all 16 banks over the same period except for Scotia bank that retained the same rating over the period.
* Fitch downgraded all banks except 3 which have retained the same rating (HSBC, Scotia bank and JP Morgan)
* S&P’s downgrade over the period equals an average downgrade of 3.25 notches per bank.
* Moody’s average downgrade over the same period equals 2.9 notches.
* Fitch’s average downgrade equals 2.2 notches.
* In 2005 all 16 banks analysed were rated single A and above by S&P.
* In 2017 only 4 banks out of 16 are rated single A and above by S&P. Only 1 out of these 4 is an UK domestic bank.
* In 2005 10 banks out of 10 were rated single A and above by Moody’s. Please note the long-term ratings for 2005 are not available for the remaining 6 banks.
* In 2017 10 banks out of 16 are rated single A and above.

Conclusion

Since the onset of the global financial crisis in 2008, the global banking sector has undergone a number of changes, which have resulted in a review by the ratings agencies and a downgrading of the ratings of most banks.

This means that the market place for DCUSA parties to procure (and indeed for banks to provide) Letters of Credit is less competitive due to being restricted to fewer banks. Commercial ratings expectations have changed dramatically since 2005.

Appendix

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Moody's** | | **S&P** | | **Fitch** | | **Rating description** | |
| **Long-term** | **Short-term** | **Long-term** | **Short-term** | **Long-term** | **Short-term** |
| Aaa | P-1 | AAA | A-1+ | AAA | F1+ | Prime |  |
| Aa1 | AA+ | AA+ | High grade |  |
| Aa2 | AA | AA |  |
| Aa3 | AA− | AA− |  |
| A1 | A+ | A-1 | A+ | F1 | Upper medium grade |  |
| A2 | A | A |  |
| A3 | P-2 | A− | A-2 | A− | F2 |  |
| Baa1 | BBB+ | BBB+ | Lower medium grade |  |
| Baa2 | P-3 | BBB | BBB | F3 |  |
| Baa3 | BBB− | A-3 | BBB− |  |
| Ba1 | Not Prime | BB+ | B | BB+ | B | Non-investment grade speculative |  |
| Ba2 | BB | BB |  |
| Ba3 | BB− | BB− |  |
| B1 | B+ | B+ | Highly speculative |  |
| B2 | B | B |  |
| B3 | B− | B− |  |
| Caa1 | CCC+ | C | CCC+ | C | Substantial risks |  |
| Caa2 | CCC | CCC |  |
| Caa3 | CCC− | CCC− |  |
| Ca | CC | CC | Extremely speculative |  |
| C | C | Default imminent |  |
| C | RD | D | DDD | D | In default |  |
|  |  |  |  |