



## Fitch Downgrades USB's Long-Term IDR to 'AA-'; Outlook Stable

Fitch Ratings-Chicago-21 February 2018: Fitch Ratings has downgraded U.S. Bancorp's (USB) long-term Issuer Default Rating (IDR) to 'AA-' from 'AA'. USB's short-term IDR is affirmed at 'F1+'. The Rating Outlook remains Stable. A full list of rating actions is at the end of this release.

### KEY RATING DRIVERS

#### IDRS, VR AND SENIOR DEBT

Today's downgrade incorporates USB's announced legal settlement with various regulators associated with past deficiencies found in its Bank Secrecy Act (BSA) and Anti-Money Laundering (AML) compliance programs. The bank was placed under a consent order related to its BSA/AML program by the Office of the Comptroller of the Currency in the fourth quarter of 2015 (4Q15). The breadth of findings and lapses in risk management since announced are outside of Fitch's rating expectations, particularly at USB's high rating level. Following the downgrade, USB remains one of the highest rated banks in Fitch's global bank universe and reflects its diverse and well-recognized business mix, solid liquidity position, and stable capital ratios.

On Feb. 15, 2018, the company announced that under the resolution, it will pay \$613 million in total fines to the U.S. Attorney's Office for the Southern District of New York, the OCC, the Federal Reserve Board (the Fed) and the Financial Crimes Enforcement Network (FinCEN). USB reserved for the vast majority of these fines in 4Q17; therefore, Fitch expects limited further financial impact. Fitch notes that the legal and regulatory settlement accruals taken during 4Q17 were more than off-set by USB's deferred tax liability revaluation reversal of \$910 million during the same quarter. Thus, the financial impact to capital was immaterial.

USB's high ratings are driven by the company's consistent, better-than-peer

operating performance, and a favorable view of USB's management team, that has contributed to strong execution on strategic objectives over time, as well as a strong risk culture and governance framework. However, Fitch notes that today's downgrade reflects what appears to be USB's lag in addressing regulatory and internal concerns regarding inadequate resources for its BSA/AML program for many years leading up to the consent order. Moreover, Fitch views the details that have emerged in the settlement to be credit negative in terms of USB's credibility with its key stakeholders. Fitch believes these findings related to its governance and internal controls to no longer be consistent with an 'AA' rated bank. Given the number and level of BSA/AML-related fines levied at other financial institutions over the years, the lack of proactive response from USB was outside of our expectations.

Following today's rating action, Fitch expects USB's financial performance and condition to remain relatively strong compared to domestic and global peers. USB has indicated that its BSA/AML systems, practices and staffing have been strengthened following the OCC consent order. Further, management has said that the bank is now in the phase of proving its systems are working adequately.

#### SUPPORT RATING AND SUPPORT RATING FLOOR

USB has a Support Rating of '5' and Support Rating Floor of 'NF'. In Fitch's view, USB is not systemically important, and therefore, the probability of support is unlikely. Issuer Default Ratings (IDRs) and Viability Ratings (VRs) do not incorporate any support.

Elavon Financial Services DAC (Elavon) has a Support Rating of '1', which is an institutional Support Rating, and indicates that there is an unconditional guarantee that USB would provide support to Elavon, which is domiciled in Ireland.

#### SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

USB's subordinated debt is notched one level below its VR of 'aa-' for loss severity. USB's preferred stock is notched five levels below its VR, two times for loss severity and three times for non-performance. USB's trust and REIT preferred stock entities, USB Capital IX and USB Realty Corp, are notched four levels below its VR. These ratings are in accordance with Fitch's criteria

and assessment of the instruments non-performance and loss severity risk profiles.

## LONG- AND SHORT-TERM DEPOSIT RATINGS

The uninsured deposit ratings of U.S. Bank National Association (USBNA) is rated one notch higher than USB's IDR and senior unsecured debt because U.S. uninsured deposits benefit from depositor preference. U.S. depositor preference gives deposit liabilities superior recovery prospects in the event of default.

USB's uninsured deposits outside of the U.S., through Elavon, do not benefit from rating uplift because they may not benefit from U.S. depositor preference rules unless the deposit is expressly payable at an office of the bank in the United States. Since Fitch cannot determine which foreign branch deposits may be dually payable, they do not get the rating uplift.

## HOLDING COMPANY

USB's IDR and VR are equalized with those of its operating companies and bank, reflecting its role as the bank holding company, which is mandated in the U.S. to act as a source of strength for its bank subsidiaries. Ratings are also equalized reflecting the very close correlation between holding company and subsidiary failure and default probabilities.

## SUBSIDIARY AND AFFILIATED COMPANY

The VR of USBNA is equalized with USB's VR, reflecting Fitch's view that these are core to USB's business strategy and financial profile. The IDRs and VRs of USB's other major rated operating subsidiaries are equalized with USB's IDR, reflecting Fitch's view that these entities are core to USB's business strategy and financial profile.

## RATING SENSITIVITIES

### IDRS, VR AND SENIOR DEBT

Given today's action and the fact that USB's ratings are among the highest of Fitch's global banks, Fitch sees limited potential upward rating movement.

Fitch's rating action has incorporated an expectation that the BSA/AML

consent orders will be outstanding for a reasonable period of time as the bank proves to the regulators that its systems are working properly. While there is no industry standard in terms of a timeframe for these orders to be lifted, Fitch would expect the timing to be no more than 24 months. Therefore, if the OCC consent order is not lifted within 24 months, this could point to governance weaknesses outside Fitch's expectations and could result in further rating pressure.

Further downward rating pressure could also develop if Fitch observes reputational damage being brought on USB as the result of the announced resolutions, although this is viewed as unlikely. Furthermore, Fitch could take negative rating action should additional risk or compliance related consent orders surface that do not align with Fitch's expectations for one of the highest rated banks globally.

#### SUPPORT RATING AND SUPPORT RATING FLOOR

Since USB's Support and Support Rating Floors are '5' and 'NF', respectively, there is limited likelihood that these ratings will change over the foreseeable future.

Additionally, there is limited likelihood that Elavon's institutional Support Rating of '1' will change over the foreseeable future.

#### SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

The ratings for USB and its operating companies' subordinated debt and preferred stock are sensitive to any change to USB's VR.

#### LONG- AND SHORT-TERM DEPOSIT RATINGS

The long- and short-term deposit ratings are sensitive to any change to USB's long- and short-term IDR. In addition, given their high level, any change in the U.S. sovereign rating (AAA/Stable) could also negatively impact deposit ratings due to Fitch's country ceiling methodology.

#### HOLDING COMPANY

Should USB's holding company begin to exhibit signs of weakness, demonstrate trouble accessing the capital markets, or have inadequate cash flow coverage to meet near-term obligations, there is the potential that Fitch

could notch the holding company IDR and VR from the ratings of the operating companies. Fitch does not expect such a scenario at USB's current high rating levels.

#### SUBSIDIARY AND AFFILIATED COMPANY

As the IDRs and VRs of the subsidiaries are equalized with those of USB to reflect support from their ultimate parent, they are sensitive to changes in the parent's propensity to provide support, which Fitch currently does not expect, or from changes in USB's IDRs.

Fitch has downgraded the following ratings:

##### U.S. Bancorp

- Long-Term IDR to 'AA-' from 'AA'; Outlook Stable;
- Viability Rating to 'aa-' from 'aa';
- Senior debt to 'AA-' from 'AA';
- Subordinated Debt to 'A+' from 'AA-';
- Preferred Stock to 'BBB' from 'BBB+'.

##### U.S. Bank National Association

- Long-term IDR to 'AA-' from 'AA'; Outlook Stable;
- Viability Rating to 'aa-' from 'aa';
- Long-term deposits to 'AA' from 'AA+';
- Senior debt to 'AA-' from 'AA'.

##### Elavon Financial Services DAC

- Long-term IDR to 'AA-' from 'AA'; Outlook Stable;
- Long-term deposits to 'AA-' from 'AA'.

##### USB Capital IX

##### USB Realty Corp.

- Preferred stock to 'BBB+' from 'A-'.

Fitch has affirmed the following ratings:

##### U.S. Bancorp

- Short-term IDR at 'F1+';

- Short-term debt at 'F1+';
- Support at '5';
- Support Floor at 'NF'.

U.S. Bank National Association

- Short-term IDR at 'F1+';
- Short-term debt at 'F1+';
- Short-term deposit at 'F1+';
- Support at '5';
- Support Floor at 'NF'.

Elavon Financial Services DAC

- Short-term IDR at 'F1+';
- Support at '1';
- Short-term deposit at 'F1+'.

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### **Applicable Criteria**

Global Bank Rating Criteria (pub. 25 Nov 2016)

(<https://www.fitchratings.com/site/re/891051>)

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