



**Rating Action: Moody's downgrades U.S. Bancorp's ratings (senior unsecured to A3 from A2); outlook stable**

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21 Apr 2023

New York, April 21, 2023 -- Moody's Investors Service ("Moody's") has downgraded all long-term and selected short-term ratings and assessments of U.S. Bancorp and its subsidiaries. The holding company's senior unsecured local and foreign currency ratings were downgraded to A3 from A2 and its local currency commercial paper rating was downgraded to Prime-2 from Prime-1. At its bank subsidiary, U.S. Bank National Association, long-term local currency bank deposits were downgraded to Aa3 from Aa2 and short-term local currency bank deposits were affirmed at Prime-1. The bank's senior unsecured local currency rating was downgraded to A2 from A1, its local currency commercial paper rating was affirmed at Prime-1 and its baseline credit assessment (BCA) was downgraded to a2 from a1. A complete list of affected ratings appears below.

Following the rating action, the outlook on U.S. Bancorp and its subsidiaries was changed to stable from negative.

#### RATINGS RATIONALE

Moody's said the rating action reflects a deterioration in the operating environment and funding conditions for US banks. In response to this, Moody's has lowered the macro profile of the US banking system to 'Strong +' from 'Very Strong -'. The change in funding conditions reflects rising asset liability management challenges at US banks. Specifically, the banking system faces rising funding and profitability pressures related to the significant and rapid tightening in monetary policy, which has led to a reduction in US banking system deposits and higher funding costs. Higher interest rates have also reduced the value of US banks' fixed rate securities and loans which increases their liquidity and capital risks.

At the same time, the rating agency noted that the recent failures of two sizeable US regional banks have shaken depositor confidence, especially among uninsured depositors. While Moody's expects US banks will continue to benefit from Federal Reserve liquidity backstops and Federal Home Loan Bank system funding, these funding sources come at a greater cost and also in most cases have shorter duration than core deposits. Moody's believes that banks which depend on more concentrated or higher levels of uninsured deposits are more exposed to these pressures, especially those with high levels of fixed rate securities and loans.

Furthermore, the rating agency noted that those US regional banks with lower regulatory capital ratios in particular face heightened challenges in this environment. Such banks are allowed to exclude unrealized losses on available-for-sale (AFS) securities from their regulatory capital ratios. Given their smaller capital buffers, in the face of systemwide deposit pressures Moody's expects such banks could become significantly more reliant on higher cost deposits and wholesale borrowing in order to avoid the forced sale of fixed rate securities or loans that could crystallize unrealized losses on those assets and impair their regulatory capital ratios.

These developments have lowered the credit profile of US banks, though not all banks equally. This

rating action reflects both Moody's view on the aforementioned macro factors as well as the specific credit considerations of U.S. Bancorp.

Moody's said the downgrade of U.S. Bancorp's ratings reflects its relatively low capitalization, which decreased following the December 2022 acquisition of MUFG Union Bank, N.A.. The downgrade also reflects Moody's view that governance no longer has a positive impact on U.S. Bancorp's ratings, but is instead a neutral component in its currently assigned ratings.

U.S. Bancorp's tangible common equity on a Moody's-adjusted basis (TCE) was 7.6% at year-end, moderately below its 8.4% Common Equity Tier 1 (CET1) ratio at the same date, and materially below that of regional banks with similarly high ratings. The gap between the two arises largely from a 10% cap on deferred tax assets (DTAs) in Moody's Banks methodology and Moody's exclusion of the CECL phase-in. U.S. Bancorp's DTAs grew to \$6.3 billion at the end of 2022 because of unrealized mark-to-market losses on its AFS. At 31 March 2023, CET1 rose modestly to 8.5% and management noted its intent to rebuild it to 9.0% later this year. In addition to the slow, but steady, improvement in capitalization expected over the coming quarters, U.S. Bancorp will face heightened regulatory standards and supervisory expectations as it approaches \$700 billion in total assets, a credit positive in the long run, but potentially driving higher compliance and regulatory costs.

Still, U.S. Bancorp's lower capital position weighs on Moody's assessment of its governance, particularly given deterioration in the operating environment. This is reflected in its lowered governance score of G-2. Previously, the score was G-1, which is the highest score possible. In addition, Moody's lowered U.S. Bancorp's ESG Credit Impact Score (CIS) to a neutral CIS-2 from a positive CIS-1.

The rating action also reflects U.S. Bancorp's asset liability management challenges. Specifically, based on regulatory filings at year-end 2022, about half of its total deposits were uninsured, which is above the median rated US bank, and its unrealized securities losses, both AFS and held-to-maturity (HTM), were 62% of TCE, an elevated level for a highly-rated bank. Adding in an estimated 15% loss on the firm's residential real estate loans brings unrealized losses to 109% of TCE at year-end. This limits its balance sheet flexibility in the event of unexpected deposit outflow.

However, U.S. Bancorp's deposit base is strong and highly diversified and management classifies more than half of its uninsured deposits as operational, including the sizable component sourced from its trust business. Moreover, at 31 December, prior to funding strains in the sector, U.S. Bancorp had a sound level of cash on its balance sheet relative to its large regional bank peers, at more than 7% of total assets. At 31 March 2023, the level of cash on its balance sheet had grown to roughly 10% of total assets. U.S. Bancorp also benefits from multiple sources of contingent liquidity.

With respect to profitability, U.S. Bancorp's net income to tangible assets was lowered by merger expenses in 2022, but Moody's expects the firm's earnings will strengthen over the coming quarters as it integrates MUFG Union Bank, N.A and realizes the anticipated synergies. Historically, the diversity of U.S. Bancorp's franchise and efficient operating platform has generated above peer average profitability metrics and this could help U.S. Bancorp to rebuild capital.

Positively, U.S. Bancorp's exposure to CRE loans is not significant at less than 1.2x Moody's TCE, including construction, which was just 0.3x Moody's TCE at year-end 2022. This low CRE exposure is credit positive given our expectation that challenges facing commercial real estate will increase over the next 12-18 months.

**OUTLOOK CHANGE TO STABLE**

The stable outlook reflects the diversity of U.S. Bancorp's franchise, its strong management team and clear strategy, as well as Moody's expectation that the bank will successfully execute the integration of MUFG Union Bank, N.A. while also strengthening its capital profile.

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

Given the stable outlook, and an above median rating, a rating change is unlikely over the next 12-18 months. Longer-term, the bank's BCA and ratings could be upgraded if U.S. Bancorp's TCE ratio exceeds 11% and if its profitability metrics return to their historic above-average levels. Other prerequisites for an upgrade are the maintenance of strong credit quality and liquidity, and disciplined risk management.

U.S. Bancorp's BCA and ratings could be further downgraded if the bank's capitalization does not improve, if its credit quality materially weakens, or if its profitability and liquidity metrics deteriorate.

The principal methodology used in these ratings was Banks Methodology published in July 2021 and available at <https://ratings.moodys.com/api/rmc-documents/71997>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

## LIST OF AFFECTED RATINGS

Issuer: U.S. Bancorp

..Downgrades:

.... LT Issuer Rating, Downgraded to A3 from A2, STA from NEG

....Senior Unsecured Regular Bond/Debenture (Foreign Currency), Downgraded to A3 from A2, STA from NEG

....Senior Unsecured Regular Bond/Debenture (Local Currency), Downgraded to A3 from A2, STA from NEG

....Senior Unsecured Shelf (Local Currency), Downgraded to (P)A3 from (P)A2

....Senior Unsecured Medium-Term Note Program (Local Currency), Downgraded to (P)A3 from (P)A2

....Subordinate Regular Bond/Debenture (Local Currency), Downgraded to A3 from A2

....Subordinate Shelf (Local Currency), Downgraded to (P)A3 from (P)A2

....Subordinate Medium-Term Note Program (Local Currency), Downgraded to (P)A3 from (P)A2

....Junior Subordinate Shelf (Local Currency), Downgraded to (P)Baa1 from (P)A3

....Pref. Shelf (Local Currency), Downgraded to (P)Baa1 from (P)A3

....Pref. Stock Non-cumulative (Local Currency), Downgraded to Baa2 (hyb) from Baa1 (hyb)

....Pref. shelf Non-cumulative (Local Currency), Downgraded to (P)Baa2 from (P)Baa1

....Commercial Paper (Local Currency), Downgraded to P-2 from P-1

..Outlook Actions:

...Outlook, Changed To Stable From Negative

Issuer: MUFG Union Bank, N.A.

..Downgrades:

... LT Counterparty Risk Rating (Foreign Currency), Downgraded to A2 from A1

... LT Counterparty Risk Rating (Local Currency), Downgraded to A2 from A1

... LT Bank Deposits (Local Currency), Downgraded to Aa3 from Aa2, STA from NEG

... LT Counterparty Risk Assessment, Downgraded to A1(cr) from Aa3(cr)

... LT Issuer Rating, Downgraded to A2 from A1, STA from NEG

... Baseline Credit Assessment, Downgraded to a2 from a1

... Adjusted Baseline Credit Assessment, Downgraded to a2 from a1

...Senior Unsecured Bank Note Program (Local Currency), Downgraded to (P)A2 from (P)A1

...Subordinate Bank Note Program (Local Currency), Downgraded to (P)A3 from (P)A2

...Commercial Paper (Local Currency), Downgraded to P-2 from P-1

..Affirmations:

... ST Counterparty Risk Rating (Foreign Currency), Affirmed P-1

... ST Counterparty Risk Rating (Local Currency), Affirmed P-1

... ST Bank Deposits (Local Currency), Affirmed P-1

... ST Bank Note Note Program (Local Currency), Affirmed (P)P-1

... ST Counterparty Risk Assessment, Affirmed P-1(cr)

..Outlook Actions:

...Outlook, Changed To Stable From Negative

Issuer: U.S. Bancorp (Old)

..Downgrades:

...Subordinate Regular Bond/Debenture (Local Currency), Downgraded to A3 from A2 (Assumed by U.S Bancorp)

Issuer: U.S. Bank National Association

..Downgrades:

... LT Counterparty Risk Rating (Foreign Currency), Downgraded to A2 from A1

.... LT Counterparty Risk Rating (Local Currency), Downgraded to A2 from A1

.... LT Bank Deposits (Local Currency), Downgraded to Aa3 from Aa2, STA from NEG

.... LT Counterparty Risk Assessment, Downgraded to A1(cr) from Aa3(cr)

.... LT Issuer Rating, Downgraded to A2 from A1, STA from NEG

.... Baseline Credit Assessment, Downgraded to a2 from a1

.... Adjusted Baseline Credit Assessment, Downgraded to a2 from a1

....Senior Unsecured Regular Bond/Debenture (Local Currency), Downgraded to A2 from A1, STA from NEG

....Senior Unsecured Bank Note Program (Local Currency), Downgraded to (P)A2 from (P)A1

....Subordiante Bank Note Program (Local Currency), Downgraded to (P)A2 from (P)A1

..Affirmations:

.... ST Counterparty Risk Assessment, Affirmed P-1(cr)

.... ST Counterparty Risk Rating (Foreign Currency), Affirmed P-1

.... ST Counterparty Risk Rating (Local Currency), Affirmed P-1

.... ST Bank Deposits (Local Currency), Affirmed P-1

....ST Bank Note Program (Local Currency), Affirmed (P)P-1

....Commercial Paper (Local Currency), Affirmed P-1

..Outlook Actions:

....Outlook, Changed To Stable From Negative

Issuer: Elavon Financial Services DAC

..Downgrades:

.... Backed LT Bank Deposits (Local Currency), Downgraded to A1 from Aa3, STA from NEG

.... Backed LT Issuer Rating (Local Currency), Downgraded to A2 from A1, STA from NEG

..Affirmations:

.... Backed ST Bank Deposits (Local Currency), Affirmed P-1

.... Backed ST Issuer Rating (Local Currency), Affirmed P-1

..Outlook Actions:

....Outlook, Changed To Stable From Negative

Issuer: U.S. Bank Trust Company, National Association

..Downgrades:

... LT Counterparty Risk Rating (Foreign Currency), Downgraded to A2 from A1

... LT Counterparty Risk Rating (Local Currency), Downgraded to A2 from A1

... LT Counterparty Risk Assessment, Downgraded to A1(cr) from Aa3(cr)

... LT Issuer Rating (Foreign Currency), Downgraded to A2 from A1, STA from NEG

... LT Issuer Rating (Local Currency), Downgraded to A2 from A1, STA from NEG

... Baseline Credit Assessment, Downgraded to a2 from a1

... Adjusted Baseline Credit Assessment, Downgraded to a2 from a1

..Affirmations:

... ST Counterparty Risk Rating (Foreign Currency), Affirmed P-1

... ST Counterparty Risk Rating (Local Currency), Affirmed P-1

... ST Counterparty Risk Assessment, Affirmed P-1(cr)

..Outlook Actions:

...Outlook, Changed To Stable From Negative

Issuer: USB Capital IX

..Downgrades:

...Pref. Stock Non-cumulative (Local Currency), Downgraded to Baa2 (hyb) from Baa1 (hyb)

Issuer: USB Realty Corp.

..Downgrades:

...Pref. Stock Non-cumulative (Local Currency), Downgraded to Baa2 (hyb) from Baa1 (hyb)

Issuer: U.S. Bank National Association, Canada Br.

..Affirmations:

...Commercial Paper (Local Currency), Affirmed P-1

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