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REGIONS | RUSSIA

RUNAWAY LETTERS

International and national credit ratings through the prism of sanctions pressure

Credit ratings can be assigned on both international and national scales. Ratings assigned on an international scale make it possible to compare issuers from different countries. If the credit rating of a sovereign government is downgraded, in the absolute majority of cases the credit ratings of the issuers from the country are downgraded following the sovereign's rating. It is assumed that, within its jurisdiction, a sovereign has the ability to impose capital and foreign exchange controls, making it difficult or impossible for issuers (or investors) to convert funds into foreign currency. This approach is called the country ceiling, and is an element of the international scale.

In the first half of last year, after making a number of downgrades, international rating agencies revoked their credit ratings of Russian issuers. The downgrades were mainly due to the changing rating of the Russian Federation, which over a short period was lowered from BBB to B, and then set at pre-default CC before being revoked.

The use of the national scale sufficiently neutralizes the impact of possible currency restrictions, since the issuers are compared within the same jurisdiction. National scale ratings reflect the relative creditworthiness of rating objects compared to the obligations of the national government. In the Russian economy, the obligations of the Government of the Russian Federation have the highest level of creditworthiness. The credit rating of the Russian Federation and the financial obligations it issues are always set at AAA(RU) on ACRA's national scale for the Russian Federation¹.

In addition, the national scale allows issuers' creditworthiness to be more accurately determined. Issuers with a sufficiently tangible difference in creditworthiness may have the same credit rating on the international scale, but in terms of the national scale it will differ.

However, despite the clear advantages of the national scale (country ceiling has no impact, broader possibilities to reflect credit quality), the international scale gives rated entities the advantage of being able to raise funds in the international market. Russian credit rating agencies (CRAs) are not limited in their ability to assign

¹ Key Concepts used by the Analytical Credit Rating Agency within the Scope of its Rating Activities.

international scale ratings, but among them, only ACRA has published ratings on the international scale.

All of ACRA's methodologies, including its methodology for assigning credit ratings on the international scale, are updated and periodically undergo independent quality verification (validation), including using data arrays that include hundreds of thousands of observations of reporting by issuers from all over the world. ACRA's portfolio currently features credit ratings assigned to sovereign governments and non-financial companies under the international scale, as well as ratings assigned to international financial institutions.

National CRAs are deeply immersed in the specifics of their home region, and, in addition, their activities are regulated by the Bank of Russia. The degree of disclosure of information by national CRAs to the regulator is much higher than that of their international counterparts, which makes the former as transparent as possible in their market. ACRA believes that it would be right to expand the recognition of credit ratings assigned on the international scale in jurisdictions where the closest international cooperation takes place (for example, the Eurasian Economic Union).

Nevertheless, credit ratings from international rating agencies² that were in effect as of February 1, 2022³ continue to apply in Russian legislation.

Meanwhile, more than a year has passed since the date on which the rating was assigned. A year is an approximate rating horizon, however, during this period, changes to the creditworthiness of issuers could have occurred, which means that the use of outdated data is no longer an adequate assumption for the purposes of maintaining the stability of the financial system. On the contrary, it is a serious mistake that may lead to inadequate acceptance of risk levels. Opinions formed on the basis of year-old data and forecasts cannot determine the future, and creditworthiness should be assessed taking into account current realities and forecasts for their development.

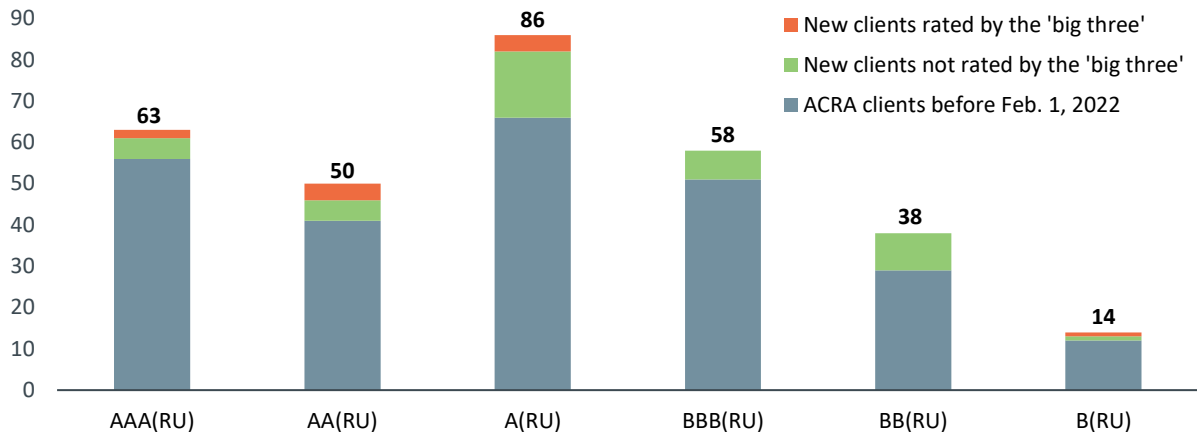
At the date of assigning international ratings, the majority of Russian clients of international rating agencies had credit ratings from the largest national CRAs. The total volume of the Russian rating market is estimated at about 700 unique issuers. Most of them had ACRA and Expert RA ratings, while around 240 issuers had ratings assigned by the Big Three. Only about a fifth of Russian clients of international CRAs did not have ACRA or Expert RA ratings, and this cannot be called a critical share in terms of the Russian market. After the withdrawal of international ratings, some of the companies obtained ratings from national CRAs, with ACRA receiving the largest increase among the other CRAs in the Russian rating market, but the overall level of credit rating coverage of the market remained practically unchanged. For example, out of the 56 new⁴ ratings that ACRA assigned to issuers from February 1, 2022 to February 1, 2023 under the national scale, only an eighth of them previously only held an international rating.

² For example, Bank of Russia Regulation No. 421-P dated May 30, 2014 "On the procedure for calculating the short-term liquidity indicator (Basel III)" and Bank of Russia Regulation No. 511-P dated December 3, 2015 "On the procedure for calculating market exposures by credit institutions".

³ Bank of Russia Ordinance No. 3453-U "On the specifics of using creditworthiness ratings in order to apply Bank of Russia regulations".

⁴ During the period from February 1, 2022 to February 1, 2023.

Figure 1. ACRA's credit ratings as of February 1, 2023



Ratings are grouped by rating category: for example, the AA(RU) category includes AA+(RU), AA(RU), and AA-(RU).

Sources: CRAs' websites, ACRA

The pressure of the external environment is not something new for the Russian market. Since the beginning of the coronavirus pandemic in 2020, the influence of external factors has been significant and affected some credit ratings. However, with the increase of sanctions pressure and the ongoing changes to information disclosure, credit ratings are beginning to play an increasingly important role. Within a fairly short period, various authorities decided to limit the disclosure of some sensitive financial information. For example, the Bank of Russia reduced the volume of financial statements disclosed by banks on their websites⁵, although later it noted the need for disclosure of financial statements and proposed to disclose them in a concise form, without any information that potentially creates sanctions risks.

The Government of the Russian Federation has allowed issuers to reduce the volume of disclosed reports or not to disclose them⁶; the Federal Customs Service has stopped publishing statistical data; and the Federal Treasury has stopped publishing data on the execution of regional budgets. In conditions of limited public information, the relevance of ratings increases, since a rating agency has an advantage in using data and, thus, can eliminate asymmetry in the information market.

ACRA puts considerable effort into eliminate information asymmetry through both credit ratings and the development of in-house data services. In addition to revoking the credit ratings of Russian issuers, international CRAs cut off access to their paid services, such as counterparty creditworthiness assessment and databases of corporate financial statements. To fill in the data gap, ACRA-RM (a subsidiary of ACRA) has developed **ACRA-LENS**, a proprietary system for assessing counterparty creditworthiness. This system is designed to replace foreign services and thereby ensure the continuity of risk management systems of Russian companies and banks.

Under the conditions of the negative impact of the external environment and, specifically, sanctions pressure, the importance of the state and government support in the economy is increasing. This is clearly evidenced by the support provided to Russian regions. In 2020, the share of transfers to regions reached 28% of their

⁵ <https://cbr.ru/press/event/?id=12737>.

⁶ Resolution of the Government of the Russian Federation No. 351 dated March 12, 2022 "On the specifics of disclosure and submission of information in 2022, which is subject to disclosure and submission under the Federal Law "On joint-stock companies" and the Federal Law "On the securities market", and the specifics of disclosure of insider information under the Federal Law "On countering the use of insider information and market abuse".

revenues (21% in 2019), while their nominal volume grew by 54%. Subsequently, the share of transfers decreased due to the growth of regions' tax and non-tax revenues.

Another significant factor in supporting budgets was the provision of budget loans to refinance the commercial debt of regional and municipal authorities. In some cases, this allowed regions and municipalities with a high debt load and a significant share of expensive commercial debt to reduce their interest expenses. However, an even more important goal that was achieved by this voluntary restructuring was the minimization of refinancing risk, which became relevant again at the beginning of last year amid the growing key rate. As a result, the structure of the regions' debt has changed dramatically — for the first time, budget loans accounted for 71% of the total debt of regions (data as of January 1, 2023 including loans granted to fund infrastructure projects). Bank loans, which are generally borrowed for a period of no more than one-and-a-half years and create significant refinancing risks, amounted to a mere 5% of the total regional debt at the beginning of this year.

Many regions shared a portion of budget loans with municipalities, who have refinanced their commercial debt as well. The share of subsidized debt of municipalities increased from 35% to 65% in 2022, while the volume of total debt has remained almost unchanged. Overall, regions transferred RUB 111 bln to municipalities; the largest amounts — RUB 3 bln or more — were granted by the Belgorod, Kemerovo, Kostroma, Nizhny Novgorod, Omsk, Samara, Tula, and Yaroslavl Regions, and the Udmurt Republic. Among ACRA-rated municipalities, Tomsk, Nizhny Novgorod, and Bratsk used the opportunity to refinance their debt. Generally, municipalities cannot borrow on terms comparable to those available to regions; therefore, the change to the debt structure of municipalities is no less noticeable and significant for budget expenditures, which often has a positive influence on their credit quality.

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