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Positive ruble interest rates to raise propensity to save in Russia

Survey of the volume and forms of household savings

- **After 2021, the savings ratio may come close to 15%** versus an average of 10% in 2004–2014. Its growth will be fueled by real ruble interest rates that are expected to remain positive within 3–4 years and by gradual waning of risk perception regarding financial investments. Population ageing will hardly overbalance the main effects.
- **Higher yields make ruble assets more attractive for savings** than at any time over the last 20 years thanks to bank liquidity structural surplus urging the Bank of Russia to maintain high indicative interest rates. Inflation-adjusted interest rates on ruble deposits will probably exceed those on foreign currency deposits in the coming 3–4 years. However, the notorious track record of dramatic inflation surges and ruble devaluations hampers the decline in inflationary expectations and restrains real interest rate growth. Therefore, propensity to save in rubles may climb very slowly. By 2021, we expect the share of ruble deposits in disposable income to gradually increase from 4.3% to 5.6%.
- **The 1990s transformation experience will affect most active population's saving behavior until 2032.** Gradual retirement of people personally affected by hyperinflation, default on government liabilities and banking crises is expected to reduce risk perception relative to financial investments, decrease equilibrium real rates on ruble instruments, and enhance the role of relatively risky ways of saving. At the same time, around 70% of economically active population is likely to still believe in protective properties of foreign currencies by then, so purchasing the latter is bound to remain one of basic adaptation scenarios in case of crisis.
- **The share of cash in savings will decrease** thanks, among other things, to growing confidence in the banking system and evolving information technologies.
- **Demographic trends of growing life span and life expectancy** are to reduce the average propensity to save, increase the equilibrium interest rate, and stimulate the development of insurance forms of savings. By 2021, we expect a gradual climb in the share of claims to insurance companies in disposable income from 0.3% to 0.5%.

Russians didn't return to non-crisis saving behavior in 2016

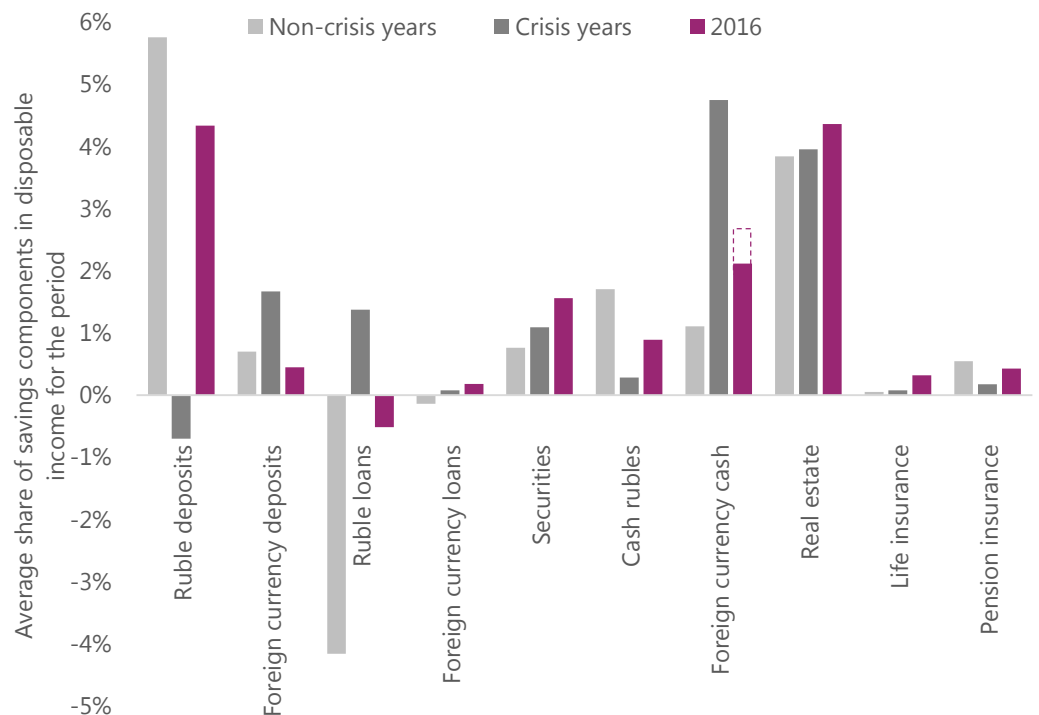
Savings for a period consist of investments in currency and ruble deposits net of changes in debt on foreign currency and ruble loans, changes in the volume of cash (rubles and foreign currency), net securities acquisition, real estate acquisition, life insurance premiums, and pension insurance (the broad definition is available in Appendix 1).

Wealth is the amount of savings over all periods.

Real estate purchases form one of the largest components in total savings, most renowned for its stability. Investments in real estate absorb almost the same portion of disposable income every year and are prone to change very slowly even at the time of crisis (see Figure 1). Staring 2004, their share in savings has never fallen below 26%, while as a percentage of disposable income they have been hovering steady at 2.3–5.5%.

During the periods of economic and financial instability, the population tends to build up cash reserves and foreign currency deposits, slash ruble deposits, take out fewer new loans and repay the ones taken out earlier. A growing share of disposable income used for building up foreign currency savings and curtailing the ruble ones is related to dramatic exchange rate fluctuations during unstable periods and is supported by expectations of the ruble depreciating further. A declining role of lending in crisis years is due to both, growing debt burden and changing bank risk-management policies (see page 8). That said, mortgage lending, being well-collateralized and at times subsidized, doesn't follow the trends shown by other lending segments. In 2015, change in mortgage debt amounted to 0.8% of disposable income versus -0.6% for other debt types.

Figure 1. Half of the savings structure was typical for a crisis period in 2016 due to increased liquidity demand and lending stagnation¹



Source: Bank of Russia, Federal State Security Service (FSSS), Association of Life Insurers, ACRA estimates²

Sustainability of Russians' preferences with regard to their savings structure may be explained by the existence of internal 'background' motives, which depend on

¹ The non-crisis periods were in 2004–2007, 2009–2013 and 2015, while the crisis stuck in 2008 and 2014, when the Russians' savings structure experienced major changes driven by external shocks. We review only ruble loans for 2009 and 2015, as these loans were affected with a certain lag.

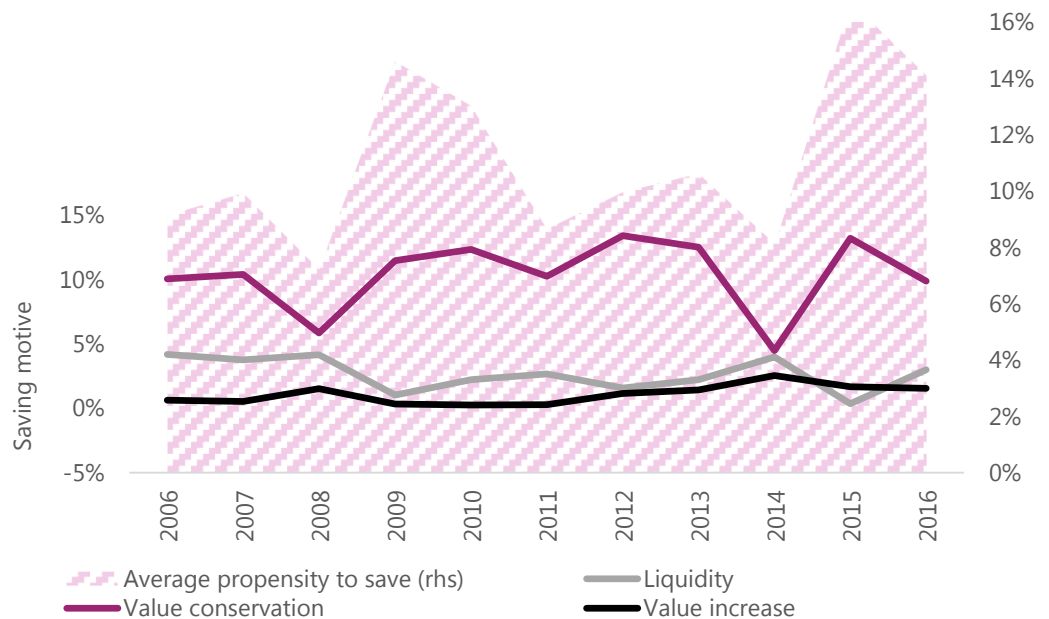
² Full December 2016 data on foreign cash movement have not been published yet. The dotted column on the diagram stands for an estimated range of values.

the environment, but are clearly prioritized relative each other. We point out to three key saving motives that determine the population's saving instrument preferences (see Figure 2):

- Liquidity³. The necessity to have cash for consumption and financial transactions in the future (even in case of a decline in current income and a financial crisis outburst);
- Value conservation⁴. The intention to preserve real wealth and protect the purchasing power of earned money from inflation;
- Value increase⁵. Taking advantage of the current situation in order to get short-term income from purchase or sale of assets, or accepting a higher risk counting on increased yield on a financial instrument.

Read more about the factors affecting saving behavior in Table 1.

Figure 2. Saving motives (% of disposable income)



Average propensity to save (savings ratio) is a share of disposable income over a period directed to savings rather than current consumption.

Source: Bank of Russia, FSSS, Association of Life Insurers, ACRA estimates

The dominant motive is value conservation, as people are more prone to keeping their wealth in less risky, but less profitable instruments. In 2016, the liquidity motive recovered after a sharp fall in 2015 climbing to its 2006–2014 average. This increase in the share of cash in disposable income was manifested mainly in the growing foreign currency volume, which contributed 67% to the total cash increase in 2016, while non-crisis years saw this figure averaging 34%. However, this is not a consequence of increased foreign tourist inflow. We expect that, in the absence of negative shocks, the existing hierarchy of motives will remain unchanged, although the liquidity motive will play an increasingly smaller role on the back of growing confidence in banks and the financial system, as well as due to development of financial and information technologies. The factors and mechanisms that determine changes in actual saving behavior in an environment of relative stability of the basic motives are listed in Table 1.

³ On Figure 2: cash element in rubles and expert adjusted part of foreign currency in disposable income.

⁴ On Figure 2: share of deposits, real estate purchase, pension insurance and insurance of life in disposable income.

⁵ On Figure 2: share of securities purchase and expert adjusted part of foreign currency savings in disposable income.

Table 1. Factors potentially affecting aggregated saving behavior of the population

Factor	Effects	Expected factor dynamics on a 5-year horizon
Average level of real income and inequality	More wealthy people have more opportunities to save, as they can satisfy their basic needs in goods and services by spending a smaller share of current income. Propensity to save may increase as a result of average real income growth of the population, or in the aftermath of greater inequality (an increase of the income share attributable to wealthy people), with the average level remaining unchanged.	Average increase of real income of population in 2017-2021 could amount 0.8% per annum. The level of inequality probably will be increasing, as in the periods of relatively high real rates, persons with considerable wealth, receive higher current interest income. Herewith, tax system due to possible amendments after 2018 will occur neutral influence subject to approximate permanence of the level of tax burden and maintenance of flat Personal Income Tax Scale.
Consumption and living standards	The amount of necessary spending for current consumption (and the balance of current income that can be saved) depends living standards. Average endowment of the society with certain goods firms a subjective perception of the purchasing power and poverty level by means of compiling a consumer goods basket. Growth in the actual income level does not always correspond to the dynamics of consumption standards.	An 11% decline in real household income as a result of 2014–2015 recession has resulted in deterioration in consumer goods basket quality compared to previous years (the indicator compares income with the previous year's basket value). Therefore, on a 2 to 3-year horizon, all of the real income growth may be used to achieve previously common consumption standards without building up saving incentives. In a long-term, consumption standards will slightly drift down, as in 2–3 years, income will hardly return to previously seen levels. This will stimulate an increase in propensity to save.
Current value of previously accumulated wealth	This factor forms the perception of protection from macroeconomic force majeure and current income fluctuations. A considerable increase in this factor relative to current spending results in a decline in significance of the precaution motive in savings formation and decreases the value of savings.	In view of moderated income dynamics, the only real opportunity for a considerable change in value of wealth in the coming years may be provided by market asset prices. Under a base case scenario, we expect real estate prices, securities value, or foreign currency value to show neither outperforming, nor underperforming dynamics.
Real and nominal interest rate level	An increase in the average return on financial investments bolsters incentives to save. The difference between interest rates on different instruments tends to change the structure of savings in favor of those with higher interest rates.	The monetary policy principles for the next 2–3 years unveiled by the Bank of Russia, coupled with demographic trends, will probably result in interest rates on ruble deposits exceeding both inflation and rates on most of foreign currency deposits (adjusted for inflation, see page 5).
Risk perception pertaining to individual financial instruments and financial investments as a whole	An increase in the average level of perceived credit risk or liquidity risk reduces the propensity to save. Rising risk of a separate instrument reduces its share in the structure of savings.	Gradual retirement of people personally affected by the 1990s crisis (8 pps down against the total number) will reduce the average risk perception of financial instruments and increase incentives to invest in higher-yielding instruments, although the process will likely be prone to high inertia (see page 7).
Average age and distribution by age	People of working age show the highest propensity to save, as their savings are expected to support both their children and themselves upon reaching an old age. Growth in the average age reduces incentives to save, on the one hand, and stimulates young people to save more for their old age, on the other.	Life expectancy at birth will rise from 71.5 to 72.9 years and is bound to grow further. The proportion of non-working and working age people is to grow from 54.1% to 62.8% (see page 9).

Source: ACRA

Inflexible inflationary expectations to restrain shift to higher-yielding ruble deposits

Tight monetary policy envisages measures aimed at reducing inflation, slowing down lending and money supply growth, increase in interest rates, and prevention of overheating the economy.

Starting 3Q2016, yields on ruble deposits have been protecting their holders from inflation. This is largely due to the interest rate policy of the Bank of Russia, which is forced to absorb from the banking system the excess liquidity stemming from financing the federal budget deficit via the Reserve Fund. By our estimates, the Bank of Russia will maintain the tight monetary policy at least until the budget is balanced at the -1% mark (2019). The regulator's logic is based on the assumption that, with the GDP dynamics close to the potential level, fiscal stimulation may impede reaching the 4% inflation target. High interest rates encourage savings and weaken lending activity, which in turn removes consumption stimuli and restrains inflation. We expect the Bank of Russia to cut its key interest rate from 10% to 8–8.5% in 2017 and further to 5.5% by 2020.

On average, nominal interest rates on ruble instruments are to decline faster than inflation, but should still remain above its level until 2021. Previously, the Russian economic history saw a similar situation only once – in 2012–2013, when deposit yields were also higher than inflation. But then, the trend was less durable and stable than the one expected now and was caused by one-offs, i.e. by the decline in global food prices and the postponement of utility tariff indexation from the start of the year to summer. The key difference the current situation makes is the fact that inflation-adjusted ruble deposits will probably be more profitable than those in foreign currency for a long time. Interest rates on foreign currency deposits will also gradually climb due to the expected rounding up of the lax monetary policy cycle in Europe and the U.S., but are still unlikely to overtake ruble rates in the next 3–4 years (see Figure 3).

Relatively high real interest rates on ruble deposits should incentivize a churn of savings from currency to ruble deposits, and possibly from long to short ones, as indicative rates have a stronger impact on short rates). In 2016, the share of ruble deposits in total savings shrank from 34% to 31% while that of foreign currency ones squeezed from 9% to 3%. However, this might well have been driven more by exchange rate expectations than profitability considerations. The very contraction in the share of ruble deposits is indirectly confirmed by the fact that, if calculated correctly, real rates remain below zero and below foreign currency deposit rates, which is due to inflationary expectations being significantly above the actual inflation. This means that deposit yields expected by the population underperforms the actual one.

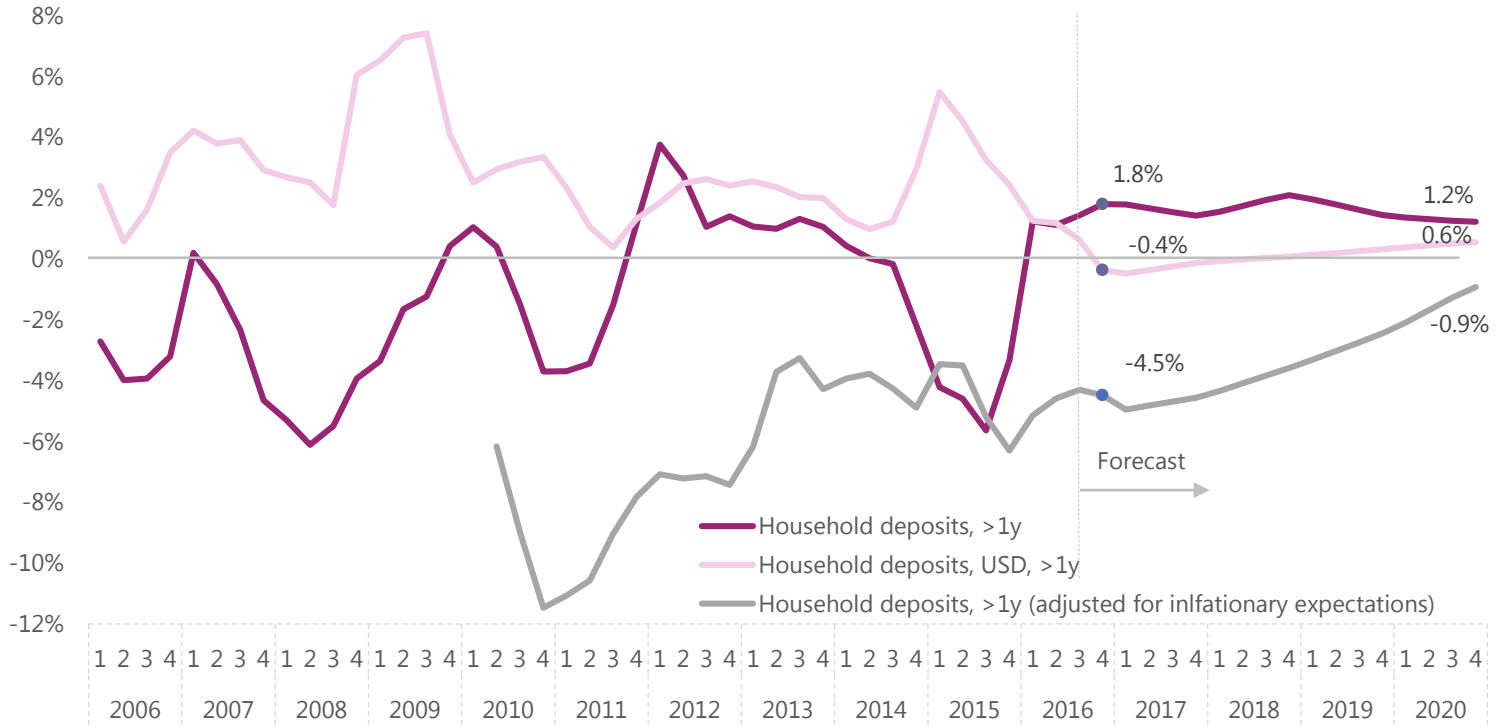
If inflationary expectations keep on following the same pattern, with no new price shocks coming over, real interest rates on ruble deposits will verge on the positive territory only in 2021. Nevertheless, the perceived ruble deposit yield is expected to beat its historical highs every year. As a result, the percentage of disposable income placed on ruble deposits may gradually reach 5.5–5.8% due to a modest decline in the share of ruble liquidity and foreign currency deposits.

Real rates are calculated by the following formula:

$$r_t = \frac{1+R_t}{1+\pi_{t+1}^e} - 1,$$

where R_t is the nominal rate, π_{t+1}^e stands for expected inflation. Real rates characterize the perception of financial instrument's yield in terms of changing purchasing power of invested money.

Figure 3. Real interest rates



Source: Bank of Russia, Cbonds, ACRA estimates

Flashbacks to 1990s to affect most active population’s saving behavior until 2032

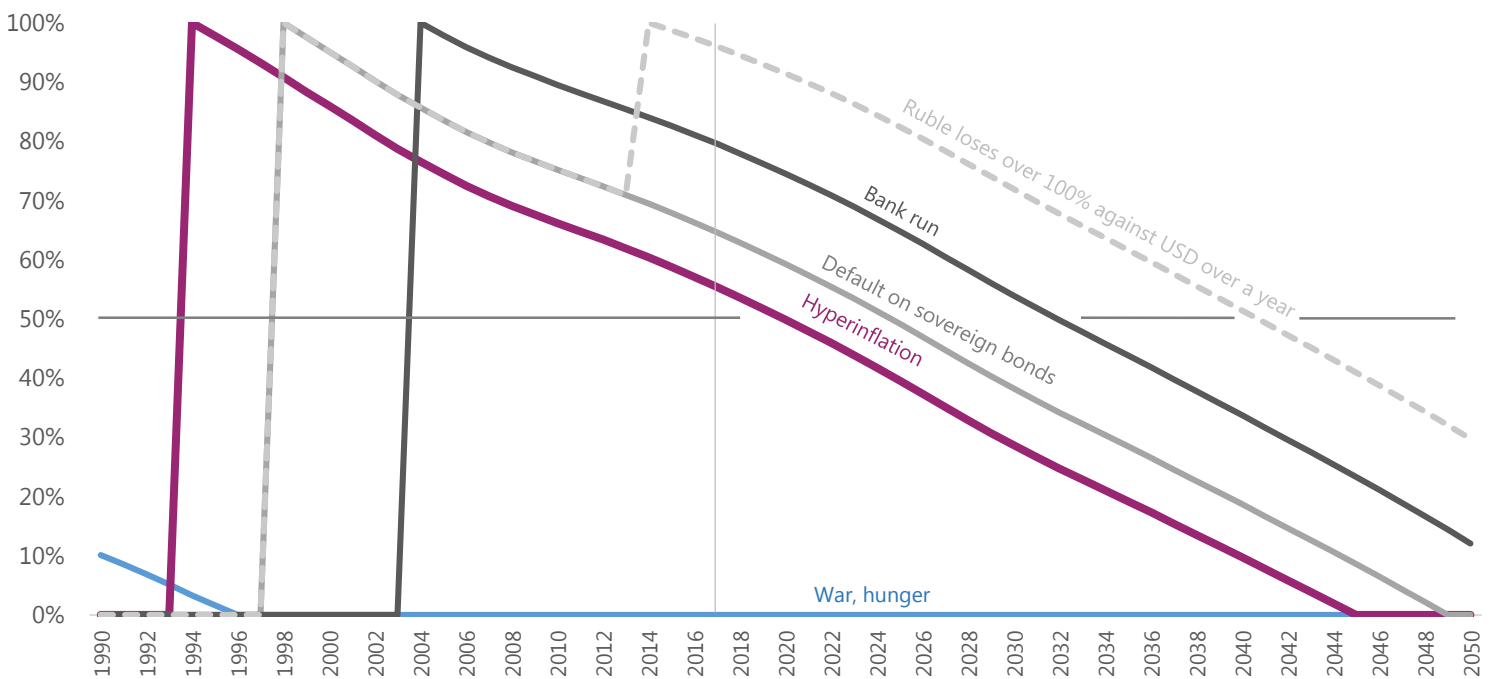
Hyperinflation in 1993, unemployment surges in 1994 and 2009, sovereign bond default in 1998, bank panic in 2004, dramatic ruble weakening in 1998 and 2014.

According to the Public Opinion Fund survey dated February 2017, 42% of Russians do not trust and never trusted any financial companies, 61% have no bank deposits, over 70% never make any financial savings, and around 45% would prefer to spend any extra money on current consumption.

Savings behavior of the population hinges not only on yield considerations, but is also affected by risk perceptions associated with a possibility of losing wealth. While the former adjust to current interest rates and inflation, the latter depend strongly on individual experience of overcoming the crisis. People who suffered from unemployment or wage delays may opt more for savings in order to avoid recurrence of former mishaps. Those hit by the banking crisis may strive for liquidity. Hyperinflation survivors would fear that wealth in the national currency may vaporize and might have strong incentives to save in foreign currencies or invest in goods. Multiple cases of losing wealth one way or another may breed uncertainty about the very feasibility of using any financial instruments at all. Strongly negative experience creates inertia in saving behavior.

The transformation period of the 1990s provided the greater part of Russians with an extensive insight into all possibly wrong ways the economic situation can go, which explains the high average level of investment risk perception across the country. That said, the proportion of economically active population whose saving strategies are overshadowed by strongly negative experience will wane with time (see Figure 4). If Russia confronts no extra transformations, more than half of its active population will likely assess the risks of bank deposit losses, sovereign bond defaults and ruble collapses as low by 2032, which in turn will dampen equilibrium real interest rates on ruble instruments and enhance the role of relatively riskier savings vehicles. At the same time, around 70% of economically active individuals are likely to still believe in protective properties of foreign currencies by then, so purchasing the latter is likely to remain one of basic adaptation scenarios in case of crisis (see Figure 1).

Figure 4. Economically active population broken down by negative experience categories



Source: ACRA estimates

Low consumer loan availability may bolster current and future savings ratios

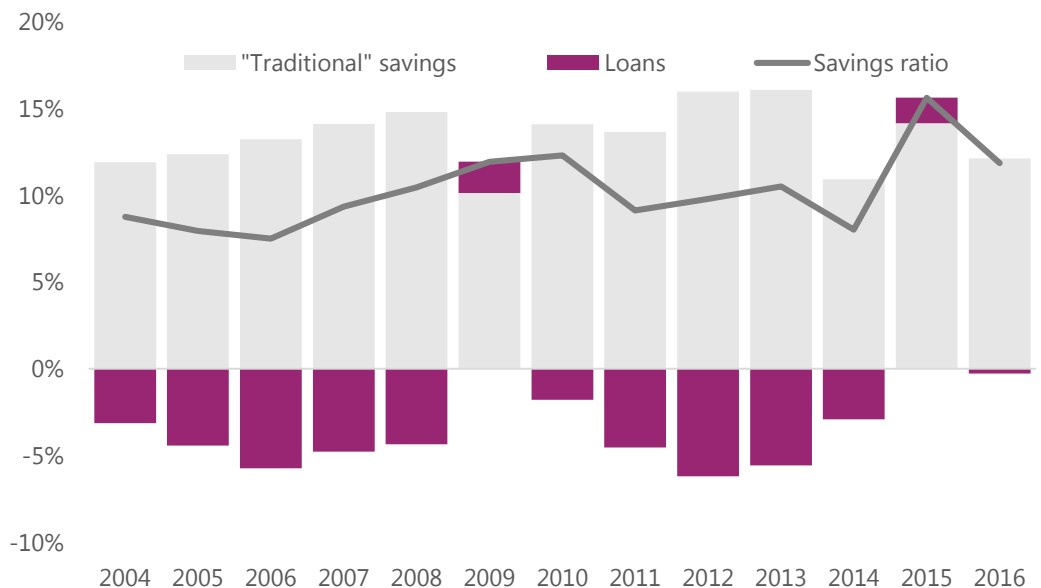
In 2012–2013, loans made up some 9% of disposable household resources in Russia. In 2016, servicing those loans pushed household resources 7% down.

See the ACRA July 5, 2016 research titled ["Lowering interest rates to provide modest impetus to consumer lending."](#)

Consumer lending plays against savings by converting future income into current consumption or investment, while savings work the opposite way. Lending affects "conventional" savings via two main channels: the short- and the long-term ones. On the one hand, a loan taken out increases disposable cash in the current period and expands opportunities for "conventional" savings and consumption. On the other hand, the very same loan reduces disposable resources of future periods due to an increase in mandatory servicing costs. The current slightly heightened savings ratio is to a large extent related to a lending decline amid an environment of increased loan rates and tighter non-price terms.

Early in 2017, loan availability was determined by a relatively high debt load of the population, with the cash amount required to service bank debt and repay its short-term part equaling 8.3% of disposable income. In addition, the recession has dampened households' credit quality, as the share of 3-month overdue payments is hovering above the 2009 high – 9.3% vs 9%. In response, the banking system and the regulator have naturally opted for tighter risk management policies that those used before the crisis, which has resulted in generally steeper borrower requirements.

Figure 5. Lending stagnation (% of disposable income)



Source: ACRA estimates

See the ACRA February 27, 2017 research titled ["Weak demand for loans stimulates risk appetite among Russian banks."](#)

On the 5-year horizon, we expect the share of bad loans to be gradually diluted on the back of a material improvement in population's average credit quality, but the forthcoming 2–3 years are most likely to see the crisis capping household lending and pushing up the savings ratio. Mortgage lending may enjoy a relatively more benign environment, thus raising real estate's appeal as a form of savings.

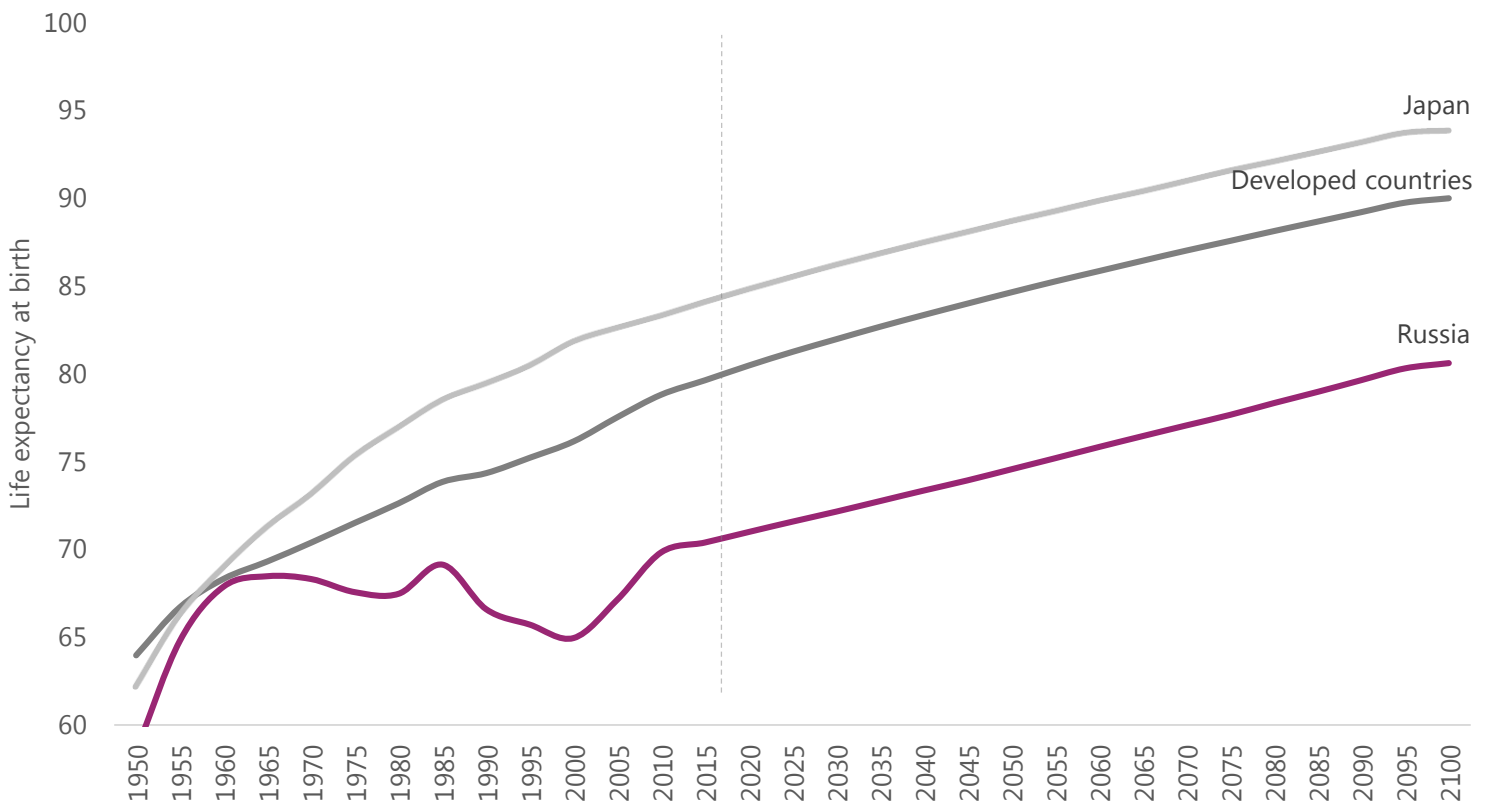
Population structure changes may reduce propensity to save and increase investment role of insurance

See the ACRA January 16, 2017 commentary titled ["Russia: En route to maturity."](#)

Demographic trends are much more predictable than any other economic phenomena. The analysis of international experience (primarily that of developed countries, for example Japan) and the current economic theory allows to single out two opposing effects associated with population ageing and capable of impacting the savings process in Russia:

1) Increasing life expectancy backed by lower old age mortality. This trend should entail growth in the expected duration of non-working or less productive period of life. Other things being equal, to provide for the usual consumption level in the old age, those currently employed will have the incentive to save a larger portion of their income, which may exert a downward pressure on equilibrium real interest rates, due to growing supply and declining demand for borrowings.

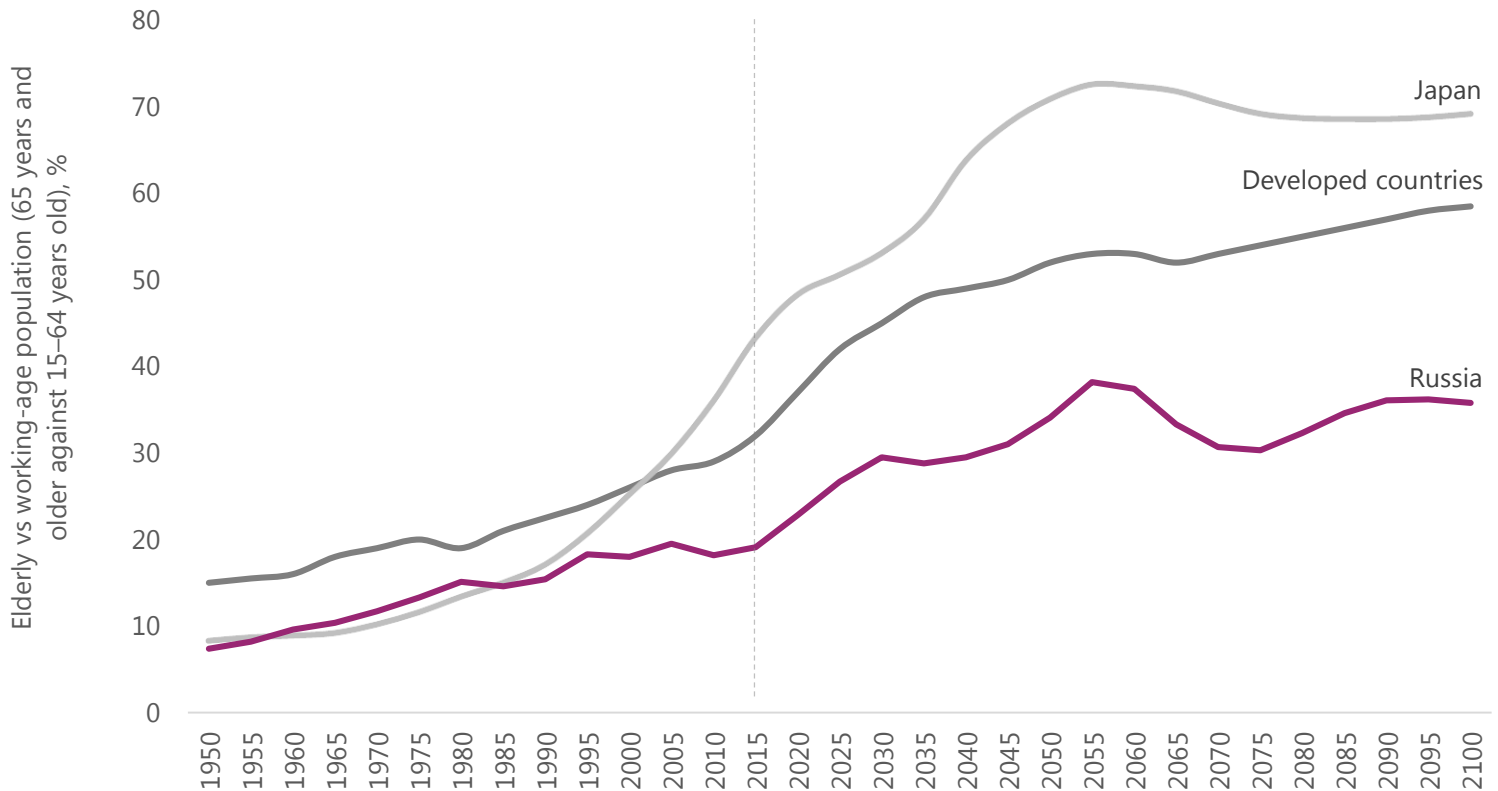
Figure 6. Russia may perform in line with global life expectancy trends for the first time in 50 years



Source: UN, FSSS, ACRA estimates

2) Increasing proportion of the elderly population as a result of older age mortality decline. People that have reached non-working age tend to increase consumption by spending their savings. This should reduce the average credit supply and stimulate demand for borrowings, putting an upward pressure on real interest rates.

Figure 7. Share of population inclined to spend wealth will grow



Source: UN, FSSS, ACRA estimates

See the ACRA October 18, 2016 research titled "[Life insurance takes market lead, car insurance is driven back.](#)"

In Russia, claims to insurance companies amounted to around 1% of household wealth in 2016, compared to an average of some 35% in Germany over the period between 2004 and 2015.

Both effects present simultaneously are responsible for 1.25 pps of the 1.5 pps decline shown by equilibrium real interest rates in the U.S. over the past 30 years⁶, and for 0.8 pps of the corresponding 3.5 pps decrease seen in Japan⁷.

In Russia, ACRA expects a combined effect of demographic processes on the average propensity to save to be slightly negative in the next 5 years, due to an accelerated growth in the proportion of elderly population and a slower increase in life expectancy. This will exert an upward pressure on equilibrium real interest rates.

That said, demographics will mainly change the structure of household savings. A shift to a more aged society and a longer decision-making horizon amid slower inflation should fuel the investment insurance and non-state pension instrument markets on the demand side. In the long term, this will entail a significant increase in the proportion of claims to insurance companies in household wealth.

⁶ Gagnon E., Johannsen B. K., Lopez-Salido D. Understanding the New Normal: The Role of Demographics // Finance and Economics Discussion Series 2016-080. 2016. FEDS Working Paper No. 2016-080.

⁷ Ikeda D., Saito M. The Effects of Demographic Changes on the Real Interest Rate in Japan // Japan and World Economy. 2014. № 32, pp. 37-48.

Appendix 1. Calculation method and source data

Table 2. Broad savings definition components

	Calculation method	Initial data source	Compared to the FSSS definition ⁸
Ruble deposits	Ruble deposit portfolio growth over a specified period	Bank of Russia	No difference
Dollar deposits	Currency deposit portfolio growth in ruble terms through monetary transactions = portfolio growth – currency revaluation over a specified period (at the average exchange rate for the period)	Bank of Russia	Not used by the FSSS
Ruble loans	Ruble loan debt growth over a specified period	Bank of Russia	The FSSS does not split ruble and currency loans. The sum does not differ
Currency loans	Currency loan debt growth in ruble terms through monetary transactions = debt growth – currency revaluation over a specified period (at the average exchange rate for the period)	Bank of Russia	
Securities	Private securities savings portfolio growth over a specified period	FSSS, MICEX	No difference
Cash rubles	Accumulation of cash rubles by the population over a specified period	FSSS	No difference
Foreign currency cash	Accumulation of foreign currency cash by the population over a specified period. Initial data in USD were converted into rubles at the average monthly exchange rate	Bank of Russia, FSSS	The FSSS uses foreign currency purchases only, while we subtract its sales from this figure
Real estate purchase	Real estate purchases over a specified period. The FSSS data for 2016 are unavailable, so the calculation was made by netting the average of real estate purchase share in the 2015 figure combining real estate purchases and individual entrepreneurs' account balances	FSSS	No difference
Life insurance	Premium assessment and forecast for investment and universal life insurance, and pension insurance	Bank of Russia, Association of Life Insurers	The FSSS does not use this indicator
Pension insurance	Growth in pension savings with the Pension Fund of Russia and pension savings and reserves with non-state pension funds	Bank of Russia	The FSSS does not use this indicator
Individual entrepreneurs' account balances	Ruble deposit portfolio growth over a specified period.	Bank of Russia, FSSS	ACRA does not use this indicator in order to avoid mixing saving behavior motives with those aimed at supporting economic activities

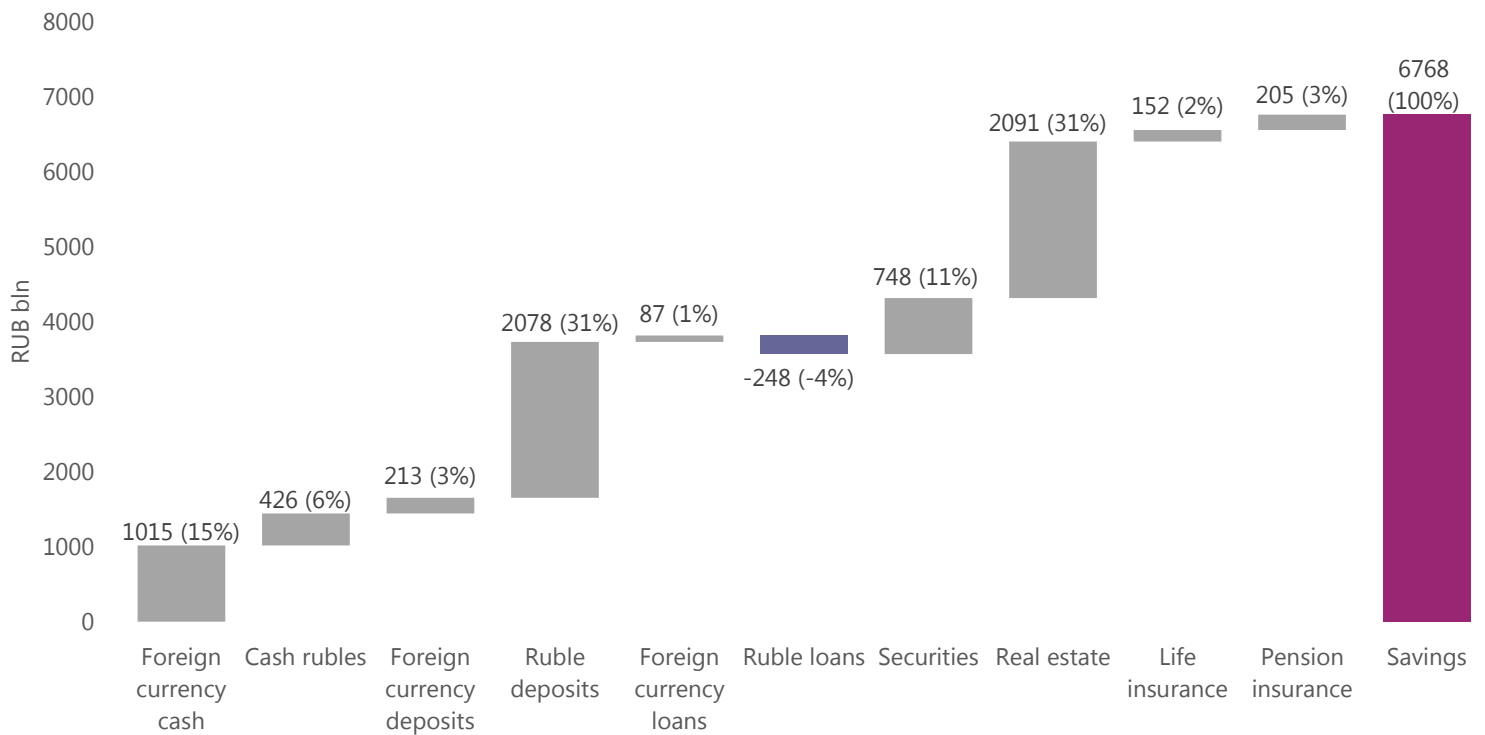
Source: ACRA estimates

By using the broad savings definition, we have arrived at some qualitatively new conclusions about the dynamics and structure of savings. For example, we believe that average propensity to save tends to remain flat over time, while the FSSS sees an opposite trend.

⁸ The Federal State Statistics Service methodology outlined in Table 4.4.3. of the "Short-Term Economic Indicators".

Appendix 2. Savings structure in 2016

Figure 8. Russians were saving into ruble deposits and real estate in 2016



Source: Bank of Russia, FSSS, Association of Life Insurers, ACRA estimates

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