ACRA

Methodology for Assigning Credit Ratings under the International Scale to International Financial Institutions and Other Supranational Development Institutions

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1 Scope of the Methodology

This methodology describes the main factors considered by ACRA to determine the creditworthiness of international financial institutions (IFIs) and other supranational development institutions. IFIs include banking organizations founded by sovereign governments of several countries and regulated by international agreements between member countries, so that IFIs are immune to national regulatory standards. Compliance by IFIs with regulatory standards may be either voluntary or based on their charter documents.

IFIs are generally established to pursue noncommercial or long-term investment projects that are difficult to finance through market instruments. Accordingly, the activities of IFIs are in most cases noncommercial and are not intended to generate profit.

The main sources of funding for IFIs include capital provided by the governments of the shareholder countries and debt obligations issued by IFIs. The total (committed) capital includes both the capital paid in by the governments of the shareholder countries and the capital that was committed but not paid in, which an IFI can count on should the need arise.

Due to close relationships between IFIs and the governments of the shareholder countries, IFIs have preferred creditor status, enjoying a first-ranked debt repayment priority.

This methodology contains references to ACRA's Methodology for Assignment of Credit Ratings to Sovereign Entities under the International Scale as regards the relevant credit ratings and credit estimates of sovereign entities. This methodology does not apply to nationally regulated credit institutions.

For this methodology to be applicable, the creditworthiness of the sovereign governments of the shareholder countries has to be assessed, because an IFI credit rating depends heavily on the ability of shareholders—the governments of the shareholder countries—to support IFIs through capital injections or otherwise.

This methodology is applied on an ongoing basis until a new version is approved by ACRA's methodology committee. Current methodology is subject to review on an annual basis.

Credit ratings assigned under this methodology are reviewed in accordance with ACRA's internal documents within six months from the date of the last rating action.

To keep the methodology up to date, ACRA reviews and amends it for the following reasons:

- more than three deviations from this methodology in a quarter when performing rating actions;
- a need to review based on the results of methodology application monitoring by the staff of the methodology group;
- immediate review of the methodology is requested by ACRA's compliance control service.

Based on the review, the methodology may be amended or left unchanged.

If any errors are found in this methodology that affected or can affect the existing credit ratings and/or credit rating outlooks, ACRA will analyze and review it in accordance with the procedures established by the Agency.

If the proposed changes to this methodology are material and affect or can affect the existing credit ratings or credit rating outlooks, ACRA reserves the right to review the credit ratings assigned in accordance with this methodology before the expiry of one year from the date of the last rating action.

2 Sources of Information Used to Assign a Rating

In its analytical activities, ACRA relies upon information obtained from both the rated entity and other sources. Below are the main sources of information used by ACRA in its rating analyses of IFIs under the international scale:

1. Information provided by the rated entity:
   - the IFI's audited IFRS statements (including the auditor's opinion and notes to the statements) for the last three complete fiscal years[1];
   - charter documentation;
   - individual IFI questionnaire, completed on the Agency's form;
   - issuance documents for individual issues of the IFI's securities, if any;
   - internal documents defining the IFI's development plan, including financial outlook;
   - internal corporate governance and risk management regulations;
   - data obtained during rating meetings with the IFI's representatives.
2. Publicly available information:
   - government statistics;
   - publications issued by central banks and international organizations;
   - mass media reports;
   - data from other sources, presenting, in ACRA's opinion, substantial information for rating analysis.
3. The Agency's internal information:
   - data of rating analyses earlier conducted by the Agency;
   - aggregated financial and operating indicators of other rated entities, with relevant analytical adjustments;
   - macroeconomic and industry forecasts by ACRA's internal units;
   - ACRA's internal credit estimates in respect of the shareholder countries.

The above list of sources is not exhaustive.

[1] If an IFI has existed for less than three full years, the rated entity provides its audited statements for the full reporting periods that have been actually completed since the IFI establishment date.

3 Methodology Framework

In assigning a credit rating to an IFI, ACRA considers both the IFI's standalone creditworthiness assessment (SCA) and the degree of support for the institution in question from the shareholder countries.

As IFIs' mandate is to stimulate economic growth through providing financing to strategically important sectors and geographical areas in the shareholder countries and beyond, IFIs' activities may diverge from being exclusively focused on generating profit for the shareholders. This factor may substantially affect credit risk assessment criteria and thus, the IFI's loan portfolio composition, structure of assets and funding structure, risk management practices and business performance targets. Accordingly, the analysis of an IFI's standalone creditworthiness, although primarily based on the principles applicable to traditional (for-profit) banking institutions, mainly focuses on the individual metrics that are most relevant to the standalone creditworthiness of the IFI.

In assigning the final credit rating to an IFI, ACRA pays special attention to (1) the level of support for the institution from the governments of the shareholder countries and (2) the relevance and importance of the projects financed by the IFI to the shareholder countries.

The analysis considers:

- creditworthiness of the sovereign governments;
- proportional shares held by sovereign governments in the IFI's capital;
- political and other non-financial motivations for supporting the IFI, should the need arise.

The final credit rating for an IFI takes into account (1) the level of support and (2) ACRA's sovereign long-term domestic currency credit ratings or (if a respective credit rating is not assigned by the Agency) ACRA's credit estimate for the sovereign shareholder entities.

In cases where the SCA score is higher than the average weighted rating / credit estimate of the shareholder countries, ACRA's Rating Committee may decide to assign a final credit rating lower than the SCA score, based on the interlinkages between the credit profiles of the shareholder countries and the IFI. This decision is based on criteria potentially affecting shareholder support, control level, and corporate governance, including but not limited to:

- IFI asset quality worsening due to weak economic circumstances in shareholder countries;
- Excessively high dividend payments to support the fiscal positions of shareholder countries;
- Expectations of a decrease in an IFI's importance to shareholder countries.

When considering these factors, ACRA also takes into account strategic importance and relative IFI asset size in comparison to the fiscal resources of shareholder countries.

The corresponding average weighted rating / credit estimate is calculated by weighting ACRA's credit ratings (if assigned) or ACRA's credit estimates (if no rating was assigned by ACRA) for the sovereign shareholder entities by the size of provided (not committed) capital. The corresponding credit ratings and credit estimates are of equal importance in determining the level of support.

4 Rating Analysis Structure

Figure 1. IFI Credit Rating Assignment Steps

Step 1

Analyzing the ownership structure and the degree of support for the IFI from the shareholders. Determining the creditworthiness of the sovereign governments of the shareholder countries and the systemic importance of the IFI.

Step 2

Systemic importance: high, medium, low.

Creditworthiness of the sovereign government

Step 3

Determining the SCA score of the IFI and the adjustment level.

FINAL CREDIT RATING

Source: ACRA

5 Analyzing the ownership structure and the degree of support for the IFI from shareholders. Determining country risk and the creditworthiness of the sovereign governments of the shareholder countries

5.1. Ownership structure and the degree of support for the IFI from shareholders

When assessing IFI ownership structure, ACRA assesses the creditworthiness of the sovereign governments of the shareholder countries to determine the potential amount of support that may be provided by each shareholder to the IFI.

ACRA may exclude shareholders from the analysis of the degree of support for the IFI, if their share in the paid-in capital of the IFI is insignificant. However, the Rating Committee may decide to include minority shareholders in the analysis in cases where the share of voting rights outweighs the share of paid-in capital.

The creditworthiness of a sovereign shareholder entity is assessed as follows:

- If the sovereign shareholder entity has a credit rating assigned by ACRA, the long-term domestic currency sovereign credit rating is used;
- If the sovereign shareholder entity does not have a credit rating assigned by ACRA, the Agency assigns a credit estimate according to the principles described in the Methodology for Assignment of Credit Ratings to Sovereign Entities under the International Scale.

If the credit rating later assigned to a sovereign shareholder entity differs from the initial credit estimate, ACRA will review the IFI's rating within six months from the date the sovereign rating is assigned.

Since IFIs have preferred creditor status and are immune to regulatory restrictions, the capital movement factor is not taken into account when assessing the country risk of the jurisdiction. Nevertheless, the Rating Committee may consider the impact of that factor on the ability of the shareholder to support the IFI in repaying foreign currency loans, using the long-term foreign currency ratings / credit estimates of the shareholder countries in the respective analysis.

ACRA determines the systemic importance of an IFI based on the following:

- size and nature of projects financed;
- systemic importance of such projects for the economy of the country they are implemented in or for the economy of a shareholder country of the IFI;
- additional financial risk in case the financing of such projects stops;
- reputational risk in case the financing of such projects stops.

Indirect indicators of systemic importance of an IFI include the frequency and amounts of capital injections provided to the IFI by its shareholder countries and the availability/unavailability of sovereign guarantees for financial instruments issued by the IFI.

IFI systemic importance is classified using the following categories:

- **"High":**
  - The size of the projects implemented by the IFI is considered substantial on the scale of the jurisdictions in which the IFI operates.
  - Commercial financing is unavailable for the projects or has an unacceptable price.
  - In case of refusal to provide support to the IFI, a material reputational risk arises for the governments of the shareholder countries.
- **"Medium"**:
  - The size of the projects implemented by the IFI is considered medium on the scale of the jurisdictions in which the IFI operates. Financing for the projects themselves can be partly switched to commercial sources.
  - In case of refusal to provide support to the IFI, the reputational risk arising for the governments of the shareholder countries is assessed as moderate.
- **"Low"**:
  - The size of the projects implemented by the IFI is considered insignificant on the scale of the individual jurisdiction in which the IFI operates.
  - Financing for the projects can be switched to commercial sources at an acceptable price.
  - In case of refusal to provide support to the IFI, no reputational risk arises for the governments of the shareholder countries.

If the IFI's shareholders include sovereign entities with different levels of credit rating (if assigned by ACRA) or credit estimate (if no rating was assigned by ACRA), the highest possible shareholder support is assessed based on the weighted average credit rating / credit estimate and systemic importance according to the shares of the shareholder countries in the IFI's paid-in capital. Credit ratings and credit estimates are of equal importance in determining the level of support.

It is for ACRA to determine whether expert adjustments should apply and what their values should be. Subject to the requirements set forth in Table 1, the number of adjustment notches is not limited.

The final credit rating is generally assigned on the basis of one of the two assessments: SCA or the maximum attainable support assessment. If the SCA exceeds the maximum possible support level, ACRA may lower the final credit rating to be equal to the support assessment, if, in the Agency's opinion, the level of sovereign risk directly affects the credit quality of the IFI due to support factors and geographic footprint. If, in the opinion of ACRA's Rating Committee, there are additional risks of unavailability of support for the rated entity from shareholders, the final credit rating may be set below the maximum attainable support level, but not lower than the SCA.

The final credit rating may be set below the level determined pursuant to Table 1 based on an expert assessment of shareholders' willingness to provide support, assuming shareholders acting not in concert and a potentially strong granularity of shareholder capital.

Table 1. Determining the maximum attainable level of shareholder support for IFI credit rating

		Systemic importance		
		High	**Medium**	**Low**
Sovereign creditworthiness	**AAA**	**AAA**	**AA+**	**AA**
	AA+	**AA+**	**AA**	**AA−**
	AA	**AA**	**AA−**	**A+**
	AA−	**AA−**	**A+**	**A**
	A+	**A+**	**A**	**A−**
	A	**A**	**A−**	**BBB+**
	A−	**A−**	**BBB+**	**BBB**
	BBB+	**BBB+**	**BBB**	**BBB−**
	BBB	**BBB**	**BBB−**	**BB+**
	BBB−	**BBB−**	**BB+**	**BB**
	BB+	**BB+**	**BB**	**BB−**
	BB	**BB**	**BB−**	**B+**
	BB−	**BB−**	**B+**	**B**
	B+	**B+**	**B**	**B−**
	B	**B**	**B−**	**No support**
	B−	**B−**	**No support**	**No support**

Source: ACRA

5.2. Standalone creditworthiness assessment

An IFI's SCA reflects its ability to comply with financial obligations within contractual time limits in full, without any support from shareholders.

To assess the solvency of an IFI, ACRA uses four key rating factors:

- management quality, strategy quality, and operational transparency;
- capital adequacy;
- quality of assets and quality of the risk management system;
- funding and liquidity.

Each factor is assessed on a scale of 1 to 5 in accordance with Table 2.

Table 2. Assessment of rating factors

Assessment	Assessment score
Strong	1
Adequate	2
Satisfactory	3
Weak	4
Critical	5

Source: ACRA

SCA quantitative assessment score is a weighted average of the factors (weights are shown below in the description of each factor), and it is translated into a character-based SCA value ranging from "ccc" to "aaa." An SCA is assigned in accordance with Table 3.

Table 3. Correspondence of quantitative assessment scores and SCA categories

SCA quantitative assessment score	SCA category*
1–2	aaa, aa
2–2.5	a
2.5–3	bbb
3–3.5	bb
3.5–4	b
4 or more	c, cc, ccc

* A specific SCA value within a single category to the notch is selected to an accuracy of a notch, and SCA in "c", "cc," or "ccc" categories is assigned, on an expert basis, by decision of the Rating Committee. In case a critical assessment is assigned to at least one of the four key rating factors, the Agency reserves the right to assign a "ccc" SCA by decision of the Rating Committee.

Source: ACRA

Each factor (except the first) is a predominantly quantitative characteristic of the IFI's financial profile. The following sources are used to analyze key risk factors:

- financial statements produced in accordance with the international accounting standards (IFRS);
- managerial and other information obtained directly from the rated IFI.

In assessing key risk factors, ACRA uses several basic financial ratios, as well as qualitative indicators (including when assessing risk management, market risk, other on-balance-sheet assets subject to value change risk, and liquidity risk) that further disclose the IFI's financial standing. When using certain items from financial statements to assess the ratios more accurately, ACRA may also apply corrections (for example, adjustments to capital, reserves for possible losses, and profit). Key indicators are listed in section "Key indicators used in analysis."

5.2.1. Management quality, strategy quality, and operational transparency (weight: 0.25)

This factor is assessed on a scale of 1 to 5, with 1 being the best score. The baseline score (3) is adjusted up or down depending on how the situation in a specific IFI is assessed.

The assessment of the quality management factor includes the IFI's organizational structure, management team's competence, composition, volatility and performance, and corporate governance standards adopted by the company. Regulatory compliance (including voluntary) and covenants in loan agreements are also subject to assessment. To assess management quality, ACRA uses the following main indicators:

- organizational structure;
- management and corporate governance.

The IFI's organizational structure can affect the quality of management decisions and their implementation.

A simple and clear organizational structure makes it possible to maintain high efficiency, both in daily activities and in building a strategy. On the contrary, a complex and nontransparent organizational structure increases the risk of mistakes both in achieving the objectives set and in adopting a strategy. If the organizational structure is inadequate to risks taken, ACRA may downgrade the management quality factor.

Assessment of the management is mostly qualitative. The Agency considers the experience of members of the executive board and the board of directors, the distribution of roles in the team, and the process of making key decisions.

For example, a team of managers with work experience relevant to their positions who efficiently organized the IFI's operations will be assessed positively within this subfactor.

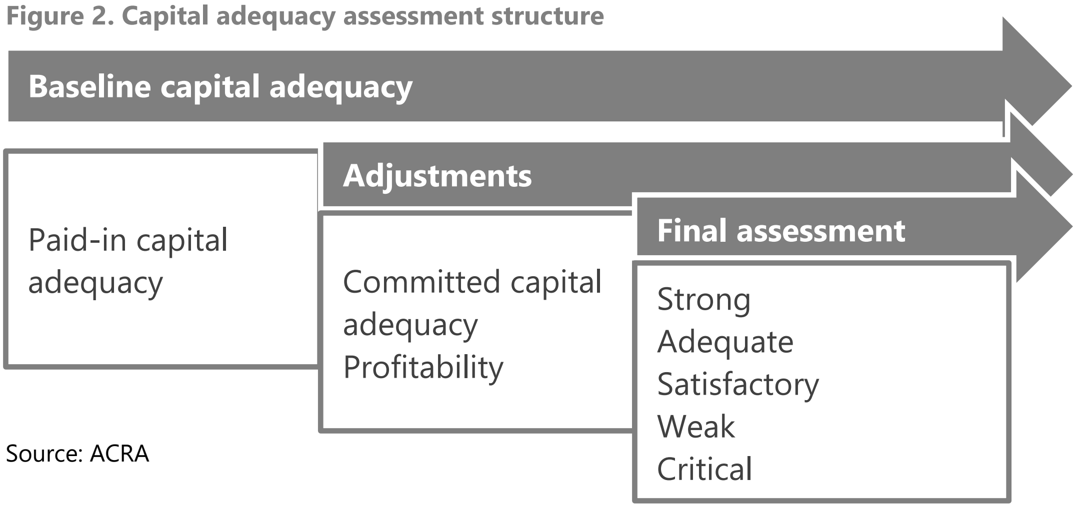
Assessment of the strategy defined for the IFI is an important component of standalone creditworthiness analysis. Since, in developing a strategy, any IFI takes into account its goals in sectoral business, main products and performance targets, this subfactor is linked to all previous ones. Assessment of strategy also helps to understand how the IFI plans to react to events occurring in a particular sector and the entire economy, and which macroeconomic assumptions it uses for planning.

An important component of strategy analysis is assessing the attainability of the goals set. When building a strategy, both the IFI's financial targets and the ways to achieve the planned results are important. In addition to assessing attainability, the subfactor includes assessment of implementation. This indicator is monitored throughout the implementation of strategy, where dynamics and the final result are important indications. A mismatch of planned and actual indicators at a particular point in time does not necessarily lead to a lower assessment of the strategy subfactor. A typical assessment method is a comparative analysis of the results of the last long-term (more than two years) strategy and the target levels outlined in it. At the same time, ACRA pays considerable attention to any differences between the targets designated in the strategy and actual results (with the difference assessed taking into account changes in the market situation or macroeconomic factors). If ACRA considers the difference substantial, the strategy subfactor score may be decreased. Given the specifics of IFIs, failure to meet the targets set by beneficiaries may subsequently decrease the likelihood of the IFI obtaining support from sovereign governments.

5.2.2. Capital adequacy (weight: 0.2)

Capital adequacy is one of the most important financial indicators describing the creditworthiness of an IFI, because capital is a buffer absorbing losses, including unforeseen losses, and enabling an IFI to operate as a going concern. A significant capital adequacy level indicates the possibility to offset a certain level of on-balance-sheet and off-balance-sheet risks. In general, no minimum capitalization value is established for an IFI, as the operations of an institution of this kind are non-regulated in nature, as opposed to classical banks and banking groups.

Figure 2. Capital adequacy assessment structure



Source: ACRA

ACRA assesses capital adequacy in the following two steps:

- conducting a baseline capital adequacy assessment;
- Adjusting baseline capital adequacy assessment, taking into account paid-in capital adequacy and profitability.

5.2.2.1. Baseline capital adequacy assessment

An IFI's baseline capital adequacy assessment is derived from paid-in capital adequacy, which is the ratio of total capital to assets and credit related contingent liabilities combined net of high-liquid short-term assets as per Table 4. The Agency reserves the right to expertly reduce the amount of capital by the amount of impaired assets, which differs from that disclosed in the financial statements but, in the Agency's opinion, may arise with a high probability (especially in economic stress periods), as well as by the amount of receivables due from the shareholder countries and associated with contributing the paid-in capital, taking into account the creditworthiness of such states.

Table 4. Baseline capital adequacy assessment

	Paid-in capital adequacy, %				
Ratio value	**Less than 8%**	**8%–10%**	**10%–15%**	**15%–25%**	**More than 25%**
Assessment	5	4	3	2	1

Source: ACRA

5.2.2.2. Adjustments to baseline capital adequacy assessment

To ensure a more correct and accurate assessment of IFI capital adequacy, ACRA may adjust the baseline capital adequacy assessment, taking into account:

- adequacy of committed capital net of capital committed by those sovereign governments whose creditworthiness (determined in accordance with the long-term domestic currency sovereign credit rating) is assessed by ACRA at a level corresponding to a credit rating / credit estimate of BB+ or lower;
- capital adequacy ratio calculated in accordance with the Basel requirement;
- profitability ratio.

Committed capital adequacy. If the committed capital adequacy exceeds the paid-in capital adequacy by more than 1.5 times, the Agency may improve the baseline capital adequacy score one notch up.

Total/core capital adequacy ratio calculated in accordance with the Basel requirement. The Agency may adjust the baseline capital adequacy assessment, taking into account the actual and projected total/core capital adequacy calculated in accordance with the Basel requirement. The adjustment may be up to two notches.

Profitability ratio. Using the profitability ratio, the Agency can understand the efficiency of the IFI's total capital utilization over the last three years. The profitability ratio is calculated in accordance with Formula 1.

Formula 1. Calculating the profitability ratio for IFIs[2]

$$ROE = ROE_n \cdot 0.5 + ROE_{n-1} \cdot 0.3 + ROE_{n-2} \cdot 0.2,$$

where ***n*** is the recent full year.

If the last three years' profitability ratio is negative, the assessment may be worsened one notch down. If the profitability ratio for the last completed full reporting year is lower than the profitability ratio for the last three completed full years, the score may be adjusted by no more than two notches. The profitability assessment may also be adjusted if the IFI has significantly changed its strategy and/or business model over the last three years.

In addition, the Agency reserves the right to expertly reduce the amount of profit before tax by the amount of impaired assets, which differs from that disclosed in the financial statements but, in the Agency's opinion, may arise with a high probability (especially in economic stress periods).

5.2.3. Quality of assets and quality of the risk management system (weight: 0.15)

Risk-taking is an integral part of IFIs' operations. Therefore, identifying the scale and nature of risks taken by IFIs, as well as the quality of risk management, is a mandatory component of rating analysis. The main focus is on credit risk, since it is the most significant risk for IFIs.

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[2] If no data is available for the last three full years, the calculation is based on the data actually available. If an IFI has existed for less than one year, its profitability receives a score of four or five.

The Agency also takes into account the IFI's market risk, including interest rate risk and currency risk[3]. Structurally, the Agency's approach is based on assessing two interrelated factors: financial assets quality and risk management quality. The resulting risk profile assessment may be subject to analytical adjustments relating to non-financial assets impairment risks and other types of risk. The interrelation between the two indicators and the resulting assessments are presented in Table 5.

Table 5. Risk Profile factor structure

		Risk management quality		
		Adequate	**Satisfactory**	**Weak**
Quality of financial assets	**Strong**	Strong	Strong	Adequate
	Adequate	Adequate	Adequate	Weak
	Satisfactory	Adequate	Satisfactory	Weak
	Weak	Satisfactory	Weak	Critical
	Critical	Weak/Critical	Critical	Critical

Source: ACRA

ACRA believes that risk management quality directly influences the quality of the IFI's assets. Therefore, an institution with "weak" risk management quality cannot obtain a "strong" final assessment for the factor, even if the quality of the financial assets is high. On the contrary, an IFI with financial assets of "critical" quality can partially offset the assessment if risk management quality is assessed as adequate. However, it should be noted that such cases are extremely rare.

5.2.3.1. Risk management quality

Risk management quality assessment is primarily qualitative and is based on the examination of the IFI's internal risk management regulations by ACRA and the results obtained in the course of interaction between rating analysts and the management team of the rated entity. In the course of analysis, ACRA takes into account how compliant the risk management system is with global best practices.

The risk management function must include the principles of risk identification, assessment, control and acceptance. Availability of quantitative risk assessment and risk management systems and processes is an important advantage. The features of the three categories used to assess risk management quality are set out in Table 6.

[3] For more details on the approach to assessing currency risk and its effect on expert adjustments, see Table 10 in section 5.2.3.3 "Analytical adjustments in assessing other types of risk."

Table 6. Assessment of risk management quality

Risk management quality	
Adequate	▪ The IFI has developed an integrated risk management system with a focus on the global best practices, which is applied and allows the IFI to accurately identify all types of risk and manage the acceptance of risk. ▪ Risk appetite is transparent and integrated at all levels of limits and ratios/covenants. The IFI's supervisory board is involved in risk management, and the risk management position generally plays an important role in decision-making. ▪ Risk appetite is assessed quantitatively by business line. ▪ Risk policies are updated regularly.
Satisfactory	▪ Risk strategy generally matches the profile and scale of the IFI's operations. ▪ The IFI's risk management system is transposed into regulations and strictly complied with. ▪ The IFI's supervisory board is involved in risk management. ▪ Risk appetite is assessed quantitatively by business line. ▪ Risk policies are updated regularly. ▪ Personnel has a relevant and sound risk management expertise.
Weak	▪ Risk strategy is not well developed and does not cover the IFI's business lines. ▪ The IFI's risk management system is fragmentarily transposed into regulations and not always complied with. ▪ The IFI's supervisory board is not involved in risk management, or such involvement is formalistic. ▪ Risk policies are updated irregularly. ▪ Risk management personnel is minimal in number, with minimal subject expertise.

Source: ACRA

The assessment is based on the comparative analysis of risk management quality at different IFIs, which allows ACRA to identify differences in approaches, the examples of efficient systems and, on the contrary, the examples of the occurrence of events with an increased degree of risk. In assessing risk management quality, ACRA mainly focuses on the following aspects:

- *Organization of the risk management system*. An efficient and independent risk management system is the foundation of an adequate risk culture in a financial institution. In most cases, such framework involves the board of directors as the body that determines risk management strategy direction and risk appetite institution-wide. In addition, high-quality organization of the risk management function is characterized by transparent and clear decision-making systems, limits and constraints communicated to each employee, including front office employees. Risk management position must be taken into account when making decisions, and its decisive influence must be manifested. The limit system must include a differentiation by geography, product, and type of counterparty, by concentration on groups of counterparties and industries. The risk management system must at least include areas such as credit risk, market risk (including foreign currency risk, interest rate risk, and equity risk), and operational risk. Liquidity risk management may be included in the functions of the treasury department. Stress testing is an important attribute of an integrated risk management system—for the purposes of rating assessment, ACRA pays attention to periodicity, the structure of approach, model assumptions and types of stress carried by the IFI's financial profile.

- *Underwriting quality*. Credit risk is the most substantial risk for IFIs. Therefore, the process of making credit-related decisions determines the potential exposure to risk that can materialize in the form of losses on the assets bearing credit risk. Inasmuch as credit process principles substantially vary by lending product and type of borrower, the Agency focuses on the most important areas specific to each IFI. ACRA analyses credit process regulations, decision-making principles at various levels, and credit committee organizational principles. The examination focus is also on the systems of limits and constraints for different categories of employees/departments.
- *Personnel expertise*. When analyzing this factor, it is necessary to take into account the expertise of key employees exercising their functional duties as part of the risk management process and their ability to implement efficient control and monitoring procedures and tools.
- *Process automation and flexibility of technical solutions*. The degree of process automation can affect operational risk levels, while software flexibility indicates the ability of the IFI to adapt to changing environment promptly.

5.2.3.2. Quality of the portfolio of financial assets

ACRA understands financial assets to mean all credit risk bearing assets of the IFI (including loan portfolio, investments in debt securities, interbank transactions, etc.), and credit-related contingent liabilities. Analysis of financial assets quality includes the assignment of a score to credit quality of financial assets, followed by analytical adjustments to the score. The principles for analyzing the main factors of financial asset quality are described below.

As compared to other asset risk types, credit risk accepted by an IFI is often the factor that has the most influence on the overall financial sustainability of the institution. Structurally, the Agency's approach rests on assessing two interrelated factors: risk concentration on major borrowers/issuers/counterparties, and country diversification of financial assets. The interrelation between these two indicators and the resulting baseline assessment of the quality of financial assets portfolio are presented in Table 7.

Table 7. Assessment of the quality of the financial assets portfolio

	Credit risk concentration on major borrowers/issuers/counterparties, %				
Country diversification, %	<75	75–100	100–150	150–200	>200
<15	1	2	3	4	4
15–30	2	3	4	4	5
30–50	3	4	4	5	5
>50	4	4	5	5	5

Source: ACRA

In case the value of one or more indicators is close to any of the range limits shown in Table 7, baseline assessment of the quality of the financial assets portfolio includes ACRA's expectations relating to the dynamics of such indicator on a horizon of 12 to 18 months and may be adjusted by no more than one notch up or down from the value specified in Table 7.

Risk concentration on major borrowers/issuers/counterparties (%). Ratio of the debt owed by the ten largest groups of related borrowers/counterparties/issuers to the IFI's paid-in capital (as shown in IFRS statements), taking into account all information available. All indicators used in calculations are taken before possible loss provision. The Agency reserves the right to exclude sovereign governments and central banks of countries from the largest groups if, in ACRA's opinion, the estimate of the sovereign risk of such countries matches or exceeds a credit rating / credit estimate of AA.

Country diversification (%). Share of debt attributed to borrowers/issuers/counterparties from the one largest country in the IFI's total financial assets portfolio (as shown in IFRS statements and taking into account all information available). All indicators used in calculations are taken before possible loss provision.

ACRA also assesses the following indicators of the quality of financial assets: share of bad debt in the loan portfolio and sufficiency of loss provision for bad debt, material volume of assets prone to high impairment risk outside the loan portfolio, risk on credit related contingent liabilities and other indicators affecting, in the Agency's opinion, the assessment of risks accepted by the IFI. Description and ranges of permitted adjustments are shown in Table 8.

Table 8. Analytical adjustments to asset portfolio quality assessment[4]

Adjustment	Range	Description
Share of problem assets in the total portfolio of financial assets and credit related contingent liabilities, %	Max +2 (negative adjustment)	The Agency's assessment of the share of debt more than 90 days past due and bad debt (impaired but not overdue debt with a high likelihood that it may stop being serviced within next 12–18 months; forced debt restructuring failing which the borrower would have difficulties with servicing its financial obligations) in the total portfolio of the IFI's financial assets and credit related contingent liabilities (according to IFRS statements and taking into account all available information). The debt used in calculations is taken before possible loss provision.
Risk concentration on problem assets	Max +2 (negative adjustment)	Existence of overdue/bad debt of a counterparty or a group of related counterparties the sum of which exceeds 20% of the IFI's paid-in capital after provision.
Provision coverage	Max −2 (positive adjustment)	If bad debt provision coverage for possible losses tends to be 100% or higher, credit risks are considered partially materialized, and the score may be increased by up to two notches.
Credit assets coverage with guarantees/suretyships issued by sovereign states	Max −2 (positive adjustment)	Credit assets are well covered with guarantees or suretyships issued by states with ACRA's credit rating / credit estimate of BBB− or higher.

Source: ACRA

[4] Data sources include the IFI's IFRS statements and management reporting information (data from the questionnaire on the Agency's form).

The value of adjustments presented in Table 8 is determined by ACRA's Rating Committee expertly. The aggregate of negative and positive adjustments may not exceed three notches from the baseline assessment of asset portfolio quality.

Ultimately, based on loan portfolio credit quality assessment and analytical adjustments, the overall assessment of financial assets quality falls into one of the five categories presented in Table 9.

Table 9. Assessment of the quality of the financial assets portfolio

1	2	3	4	5
Strong	Adequate	Satisfactory	Weak	Critical

Source: ACRA

5.2.3.3. Analytical adjustments to other types of risk assessment

At the final step of the risk profile assessment process, the Agency identifies non-credit risks for other types of assets, as well as other types of risk that can affect the IFI's financial sustainability. Non-credit risk is characterized by other consequences from the materialization of risk events, which causes, in some or other way, impairment of assets (increase in liabilities) and generation of losses. Descriptions and ranges of adjustments applicable to risk profile assessment derived as per Table 5 are given in Table 10.

Table 10. Analytical adjustments to other types of risk assessment[5]

Adjustment	Range	Description
Market risk	Max +2 (negative adjustment)	Market risk includes equity risk, currency risk, commodity risk and interest rate risk. ACRA considers it possible to conduct a qualitative assessment of market risk by setting a qualitative benchmark: "Acceptable risk," "Heightened risk," and "High risk." The Agency may also take into account substantial changes in the volume and share (in the paid-in capital) of assets prone to market risk. If the Agency has reasons to believe that the actual value of market risk exceeds the one reflected in the financial statements, it conducts additional market risk analysis. Such analysis is based on a simulation of the results of losses under different exchange rate scenarios (currency risk) and interest rate scenarios (interest rate risk), as well as stock index volatility (equity risk) against the paid-in capital. When analyzing the size and nature of projects financed, ACRA also takes into account the potential occurrence of currency risk because of a mismatch between the currency structure of the IFI's projects and the IFI's capital created by the shareholder countries. If, in ACRA's opinion, the currency risk[6] is substantial, the Agency may apply expert adjustments.
Other on-balance-sheet assets subject to value change risk	Max +3 (negative adjustment)	If the share of non-core assets (including investment property, fixed assets, intangible assets and other assets) on the IFI's books is substantial (above 5% of the paid-in capital), ACRA further analyzes their fair value and liquidity, and the financial institution's plans to dispose of them.

Source: ACRA

[5] Data sources include the IFI's IFRS statements and management reporting information (data from the questionnaire on the Agency's form).

[6] Assessment of currency risk may be conducted using IFRS statements.

Ultimately, based on risk management quality assessment and loan portfolio credit quality assessment (or assets outside of its perimeter) and analytical adjustments for other types of risk, the overall risk profile assessment is generated, as presented in Table 11.

Table 11. Risk profile characteristics

Assessment	Typical characteristics
Strong	• Stable portfolio of claims; low historical losses from lending activities. • Low share of non-performing loans; high reserve coverage for non-performing loans. • High quality and diversified portfolio of securities; minimal share of trading positions and such positions are fully hedged. • Predominantly complete natural hedging of currency risk within the balance sheet structure. • Absence/unsubstantial share of highly liquid quickly realizable intangible assets on the books.
Adequate	• Most risk profile characteristics are at medium levels, tending to minimal riskiness.
Satisfactory	• Most risk profile characteristics are at medium levels and present no heightened risk for individual business lines.
Weak	• Most risk profile characteristics are below medium levels, generating individual high-risk areas.
Critical	• Substantial losses incurred due to a decline in assets quality (high share of overdue debt in the portfolio combined with incomplete provision coverage). • Large share of trading positions in the securities portfolio; no hedging and low diversification; relatively high VaR. • Poor credit quality of the bond portfolio. • Significant discrepancy in the currency structure of the balance sheet. • Significant share of poorly liquid slowly realizable non-core assets (for example, real estate) on the books.

Source: ACRA

5.2.4. Funding and liquidity (weight: 0.4)

The funding and liquidity factor is another factor assessed when generating the SCA, which combines the assessment of the IFI's liquidity position and funding profile, as they are similar in their economic nature. The funding and liquidity factor is critically important from the standpoint of an IFI's operations and sustainability, since the materialization of liquidity risk leads to losses arising from the IFI's inability to ensure compliance with its obligations in full when due for repayment under normal or unforeseen circumstances.

Assessment of the funding and liquidity factor consists in assigning a score for each of the subfactors and determining the overall assessment. Analysis of each subfactor results in a score on a five-point scale, where 1 is the best score, and 5 is the worst score. The interrelation between the two indicators and the resulting assessment are presented in Table 12.

Table 12. Funding and liquidity factor assessment structure

		Liquidity assessment				
		1	2	3	4	5
Funding assessment	1	Strong	Strong	Adequate	Satisfactory	Weak
	2	Strong	Adequate	Adequate	Satisfactory	Weak
	3	Adequate	Adequate	Satisfactory	Weak	Weak
	4	Adequate	Satisfactory	Satisfactory	Weak	Critical
	5	Weak	Weak	Weak	Weak	Critical

Source: ACRA

5.2.4.1. Liquidity

Liquidity is assessed on a scale of 1 to 5 (where 1 is the best score and 5 is the worst). The assessment score is generated by assessing the values of the ratio of highly liquid assets to short-term liabilities and the minimum ratio of highly liquid assets to the IFI's total assets over the last 36 months[7]. The interrelation between them and the resulting baseline liquidity assessment are presented in Table 13.

Table 13. Liquidity assessment

		The ratio of liquid assets to short-term liabilities				
		<1	1–1.5	1.5–2.5	2.5–3	>3
The minimum ratio of highly liquid assets to the IFI's total assets	<1%	5	4	4	3	3
	1%–3%	5	4	4	3	2
	3%–5%	4	3	3	2	2
	>5%	3	3	2	1	1

Source: ACRA

In case the value of one or more indicators is close to any of the range limits shown in Table 13, baseline liquidity assessment includes ACRA's expectations relating to the dynamics of these indicators on a horizon of 12 to 18 months and may be adjusted by no more than one notch up or down from the value specified in Table 13. Based on the IFI's IFRS statements and management reporting information (data from the questionnaire on the Agency's form), the Agency analyzes the following in addition to the ratios specified above:

- share of highly liquid assets in the IFI's total assets;
- coverage of interest payments;
- liquidity position (gap) for 1–36 months;
- share of liabilities due within three months (except outstanding debt on repo transactions) net of cash on hand, funds deposited with the central bank of a country whose risk level is not lower than A−, and funds deposited in NOSTRO accounts with credit institutions of a high credit quality (in ACRA's opinion) in total liabilities.

[7] If no data is available for the last three full years, the calculation is based on the data actually available.

ACRA has the right to worsen the baseline liquidity assessment score (by up to two points) following the analysis of the above liquidity indicators.

5.2.4.2. Funding

Via assessment of funding, the SCA accounts for the main structural aspects of the IFI's resource base. The funding subfactor is assessed on a scale of 1 to 5, with 1 being the best score, and 5, the worst score. In this context, the baseline score of 3 is the anchor value for this factor, and it is assigned to all rated IFIs at the first step of the analysis. At the second step, the funding assessment is adjusted depending on specific indicator values.

The indicators used to assess funding include[8]:

- diversification of resource base (liabilities);
- dependence on bank loans.

Diversification of resource base (liabilities). An IFI's structurally balanced resource base allows it to go through financial stresses with more comfort. Therefore, dependence on a single financing source is a negative credit factor. Market shocks may force IFIs to look for alternative sources of finance. On the contrary, diversified funding sources help in offsetting risks in case of adverse events in capital markets or the economies of the shareholder countries. ACRA applies the Herfindahl–Hirschman index (HHI) to assess diversification of funding sources, as presented in Table 14.

Table 14. Diversification of funding sources

	HHI*, %		
	More than 25%	From 25% to 50%	More than 50%
Adjustment	−1	0	+1

* Sources are subdivided into the following types: debt securities issued, interbank liabilities, funds raised from third parties, and total capital.

Source: ACRA

Dependence on bank loans. While finance obtained from commercial banks contributes to diversification, a high share of this type of finance is a negative factor for liquidity. Table 15 shows the assessment of an IFI's dependence on credit transactions with commercial banks.

Table 15. IFI's dependence on bank loans

	Share of interbank funds in the IFI's liabilities, %		
	Less than 10%	From 10% to 25%	More than 25%
Adjustment	−1	0	+1

Source: ACRA

[8] Data sources include the IFI's IFRS statements and management reporting information (data from the questionnaire on the Agency's form).

In addition to quantitative analysis, ACRA conducts qualitative assessment of the IFI's funding structure, which includes:

- maturity analysis of raised funds;
- presence of covenants in loan agreements, compliance/consequences of noncompliance with such covenants;
- diversification of funding sources by geographic market;
- wholesale funding qualitative assessment;
- assessment of difficulties in refinancing funds raised from capital markets.

Depending on the results of qualitative analysis, baseline funding assessment score can be adjusted within the range from plus two notches (worsening) to minus two notches (improving).

6 Credit rating outlook

Credit rating outlook for a rated entity reflects ACRA's opinion on the likely change in its credit rating over a certain time interval (usually 12 to 18 months).

When preparing cash flow outlook and calculating forecast financial ratios, ACRA applies a number of key assumptions that form a subjective internal source of information used for the rating assessment. They can be based on both ACRA's internal calculations and information obtained from the rated entity. A credit rating may be sensitive to changes in such assumptions, including in the absence of new factual information about the rated entity's operations. In the course of rating assessment, ACRA also sets threshold ratios, the breach of which can result in a change of credit rating.

Pursuant to the Procedure for Disclosure of Credit Ratings and Other Related Communications, disclosure of the following information is mandatory when ACRA performs rating actions:

- list of principal rating assumptions used when building outlooks;
- list of principal key indicators and factors that the rated entity's credit rating is sensitive to, and threshold values of such indicators and factors.

When forecasting, ACRA may also adjust qualitative indicators if the Agency anticipates any changes in internal and external risk factors that may lead to a change in any assessment categories applicable to one or more qualitative indicators.

A change in the credit rating outlook is typically associated with ACRA's internal forecasts of possible changes in quantitative and qualitative factors and key internal and external risk factors that affect the SCA or the creditworthiness of the main shareholder countries of an IFI.

Credit rating outlook is not necessarily a precursor to a change in credit rating.

7 Key indicators used in analysis[9]

Profitability

Name of ratio	Formula	Description
Profitability ratio	The sum of weighted return-on-equity (ROE) values for the last three years	Weights for the current year and the preceding years: 0.5; 0.3; 0.2.

Capital adequacy

Name of ratio	Formula	Description
Paid-in capital adequacy	Total capital (IFRS)/Sum of assets and credit related contingent liabilities (IFRS) net of short-term highly liquid assets	(Total capital (IFRS) – ACRA adjustments) / (Total assets + credit related contingent liabilities (IFRS) – short-term highly liquid assets)
Committed capital adequacy	Total capital including committed capital (according to constituent documents)/ Sum of assets and credit related contingent liabilities (IFRS)	Total capital including committed capital (according to constituent documents)/Sum of assets and credit related contingent liabilities (IFRS)

Quality of assets

Name of ratio	Formula	Description
Risk concentration on major borrowers/issuers/counterparties	Ratio of the debt owed by the ten largest groups of related borrowers/counterparties/issuers to the IFI's total paid-in capital (as shown in IFRS statements and taking into account all information available). All indicators used in calculations are taken before possible loss provision.	All indicators used in calculations are taken before possible loss provision.
Country diversification	Share of debt owed by borrowers/issuers/counterparties from one country in the IFI's total financial assets portfolio (as shown in IFRS statements and taking into account all information available)	All indicators used in calculations are taken before possible loss provision.
Share of bad debt in the portfolio of financial assets, %	Loan debt and other debt more than 90 days past due (90+) + Forcibly restructured debt + Bad debt/Total financial assets	All indicators used in calculations are taken before possible loss provision.
Provision coverage	Bad debt provision coverage for possible losses/ Loan debt and other debt more than 90 days past due (NPL90+) + Forcibly restructured debt + Bad debt	All indicators used in calculations are taken before possible loss provision.

[9] Profit and loss statement data for the last 12 months are generally used in analysis.

Funding and liquidity

Name of ratio	Formula	Description
The ratio of highly liquid assets to short-term liabilities	Highly liquid assets/ short-term liabilities	Highly liquid assets = Cash + Funds deposited with central banks of a high credit quality (in ACRA's opinion) + Funds deposited in NOSTRO accounts with banks of a high credit quality (in ACRA's opinion) + Bonds of a high liquidity (in ACRA's opinion) + ACRA adjustments
		Short-term liabilities = Total financial liabilities of the bank due within 30 days (including cash on settlement accounts and current accounts)
		Total assets = According to the statement of financial position (IFRS)
Minimum share of highly liquid assets in the IFI's assets for the last three years	Minimum (Highly liquid assets (t)/ Assets (t)) for the last 36 months	Highly liquid assets = Cash + Funds deposited with central banks of a high credit quality (in ACRA's opinion) + Funds deposited in NOSTRO accounts with banks of a high credit quality (in ACRA's opinion) + Bonds of a high liquidity (in ACRA's opinion) + ACRA adjustments

The above list is not exhaustive; it provides information on the main ratios used by ACRA in rating analysis.

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