Methodology for Assigning Credit Ratings to Individual Issues of Financial Instruments on the National Scale for the Russian Federation

March 18, 2022

Table of Contents

1 Scope of the Methodology

This methodology of the Analytical Credit Rating Agency (hereinafter, ACRA, or the Agency) is used to assign ratings and credit estimates to individual issues of financial instruments of issuers in the following categories:

- Banking organizations and organizations whose activities are close to banking in terms of their economic substance[1];
- Nonfinancial companies, including small and medium-sized enterprises, as well as holding companies;
- Insurance organizations;
- Lease financing companies;
- Regional and municipal authorities.

This methodology is applied to debt financial instruments that have such characteristics of debt as recoverability, payment, maturity, and, as a rule, do not involve dependence of investors profitability on the financial results of the issuer and the participation of investors in shareholders' control, as well as to financial instruments that have both characteristics of debt instruments and shareholders' equity, including (but not limited to) financial instruments with the following characteristics:

- The bonds without maturity date;
- The issuer has the right to unilaterally refuse interest payment or postpone them without the occurrence of a default event;
- Availability of loss/lost profit compensatory mechanisms from third parties;
- Contractual and/or structural subordination in relation to other financial instruments of the issuer;
- Conditional or unconditional mechanisms for changing the size of interest payments;
- The possibility of converting a financial instrument into a shareholders' equity instrument.

The decision on assigned credit ratings and the applicability of this methodology is based on the economic substance of the financial instrument, regardless of the way it is reflected in the issuer's financial statements, in particular, regardless of whether it is included or not included in shareholders' equity.

This methodology is not applicable to structured finance instruments. However, exceptions are possible for transactions with structured finance characteristics that have guarantees/suretyships for the entire amount of rated (assessed in case of a credit estimate assessment) obligations.

---

[1] Development institutions (raising and placing money on the condition of interest payment, maturity, and repayment); agencies with specialized functions, primarily engaged in raising and placing money and/or providing guarantees and suretyships. The decision on whether it is possible to apply this methodology to financial instruments of such organizations lies with ACRA's rating committee.

Applying this methodology may result in either assigning a credit rating (credit estimate) to an issue or an expected credit rating to an issue; the analytical approaches are identical in both cases. Expected credit ratings are assigned on the basis of draft issuance documentation. Final credit ratings are assigned after receiving issuance documentation registered in the manner set forth by law.

This methodology is not exhaustive and contains references to other ACRA methodologies.

This methodology is not applied if the assessed obligations represent the obligations of a special-purpose project finance vehicle without guarantees/suretyships for the entire amount of rated (assessed) obligations, or if the terms of obligation contain contractual subordination (or seniority) with respect to other credit obligations of the issuer, with the exception of loans defined as subordinated for financial and non-financial companies in accordance with the current legislation. In the above cases, ACRA applies the Methodology for Assigning Credit Ratings to Structured Finance Instruments and Obligations on the National Scale for the Russian Federation.

The application of this methodology generally requires advance calculation of the Standalone Creditworthiness Assessment (SCA) and/or the credit rating (credit estimate in the absence of a credit rating) of the issuer or the person providing a suretyship (acting as a guarantor) on the obligation or part of the obligations (if applicable). This is based on the dependence of the credit rating (credit estimate) of the issuer's individual financial obligations, in addition to their structure and subordination with regard to other obligations, on the assessment of the creditworthiness of the issuer or the person providing a suretyship on the financial obligation or part of the obligations (taking into account the effect of the new obligation/part of the obligations on its financial profile).

Credit ratings (credit estimates) of financial instruments take into account, among other things, the potential level of compensation for losses borne by investors in the event of an issuer's default. Creditors' projected recovery rates and recovery rate categories, as defined by ACRA, are subjective assessments made based on the information available to the Agency at the time of assessment. Actual recovery rates may depend on the following factors:

- Priority of fulfilling the obligations under a given financial instrument;
- Accuracy of the issuer's financial statements;
- Pre-court interactions between the issuer and particular creditors;
- Court decisions addressing the regulation of relationships between the issuer and creditors;
- Pre-sale assessment procedures and results with respect to individual assets of the issuer;
- Availability of loss/lost profit compensatory mechanisms from third parties;
- The specifics of the issuer's corporate governance.

ACRA may assign expected credit ratings to individual financial instruments based on draft issuance documentation and the expected terms of the issue. Expected credit ratings are assigned based on the Key concepts used by the Analytical Credit Rating Agency within the scope of its rating activities, ACRA's Rating Actions Procedures and General Principles of the Rating Process, as well as ACRA's other internal documents.

Credit rating outlooks are not assigned to individual issues of financial instruments.

This methodology is applied on an ongoing basis until a new version is approved by ACRA's methodology committee.

Credit ratings assigned under this methodology are reviewed according to the requirements of Federal Law No. 222-FZ, dated July 13, 2015, "On the Activities of Credit Rating Agencies in the Russian Federation, On the Amendment to Article 76.1 of the Federal Law 'On the Central Bank of the Russian Federation (Bank of Russia)' and the invalidation of certain provisions of legal acts of the Russian Federation," as well as ACRA's internal documents, but no later than one calendar year (for sub-sovereign issuers, no later than 182 days) from the date of the latest rating action.

To keep the methodology up to date, ACRA may review and amend it on the following grounds:

- More than three deviations from this methodology identified in one quarter throughout the course of rating actions;
- Results of monitoring methodology application by the methodology group staff;
- Noncompliance of this methodology with the requirements of Federal Law No. 222-FZ, dated July 13, 2015, "On the Activities of Credit Rating Agencies in the Russian Federation, On the Amendment to Article 76.1 of the Federal Law 'On the Central Bank of the Russian Federation (Bank of Russia)' and the invalidation of certain provisions of legal acts of the Russian Federation;"
- Immediate review of the methodology requested by ACRA's Compliance and Internal Control Service.

ACRA reviews this methodology in accordance with its internal documents no later than one calendar year from the date of the last review. Based on the review, the methodology may be amended or left unchanged.

ACRA documents and discloses any deviation from this methodology on its official website (www.acra-ratings.com) when publishing a credit rating or a credit rating forecast, stating the reason for the deviation.

If any errors are found in this methodology that have affected or can affect credit ratings and/or credit rating outlooks, ACRA will analyze and review them according to its established procedures. Information about such actions and a new version of the methodology will be provided to the Bank of Russia in the manner set forth by the Bank of Russia. If the identified methodology errors affect previously assigned ratings, ACRA discloses that information on its official website (www.acra-ratings.com).

If the proposed changes to this methodology are substantial (e.g., modification of individual factors and the wording of the methodology) and affect or could affect the existing credit ratings, ACRA will:

1) Provide the Bank of Russia with information about the proposed changes, state the reasons for and implications of such changes, including the effect on credit ratings assigned according to the methodology, as well as post this information on its official website (www.acra-ratings.com);

2) Carry out a prospective and retrospective analysis of possible changes to rating assessments assigned according to this methodology within six months of the amendment date;

3) Review credit ratings within six months of the amendment date if the need is identified based on the conducted assessment.

2 Information Sources

The main sources of information used to assign credit ratings (credit estimates) to individual financial instruments are:

- Draft issuance documentation;
- Issuance documentation registered in the manner set forth by law;
- Information on the proposed use of funds received from placing the securities issue;
- Financial outlook or financial model (if any) of the issuer;
- Credit ratings (credit estimates assigned according to relevant ACRA's methodologies and used as source data to assign credit ratings (credit estimates) to individual financial instruments;
- Documents in relation to the financial liabilities of third parties (including government bodies) that confirm guarantees, sureties and other compensatory mechanisms for reimbursing losses and/or lost income by investors on a financial instrument.

This list is not exhaustive.

3 Short Overview of Rating Analysis Structure

The key feature of debt obligations in the non-sovereign sector is that debt structure is very heterogeneous in terms of subordination and other characteristics that affect investor recovery rates on various financial instruments in the event of issuer default. To account for various recovery rates on individual financial instruments, the Agency identifies six recovery rate categories (see Table 1). These categories do not represent projected recovery rates on certain financial instruments of the issuer, but serve as a tool to subjectively rank debt obligations based on a relative degree of investor recovery rates.

Table 1. Creditor recovery rate categories

Recovery rate category	Credit rating (credit estimate) adjustment notches	Typical description
I	0 to +1	Secured obligations[2] or obligations implying higher investor recovery rates than the average rates for this type of issuers.
II	0	Average recovery rates for this type of issuers.
III	-1	Low recovery rates for investors, including cases of subordination mechanisms (if any).
IV	-2	Very low investor recovery rates, including cases of subordination mechanisms (if any).
V	-3	Minimal recovery rates for investors. Obligations structurally subordinated to secured and senior unsecured debt of the issuer.
VI	-5 notches from the SCA, but no lower than C(RU) (in the absence of a failure to comply with obligations under the instrument)	Instruments featuring a high degree of structural subordination, under which the failure to pay generally does not mean default for the issuer.

Source: ACRA

A credit rating (credit estimate) is assigned to an individual financial instrument after analyzing the debt structure of the issuer and other participants in the deal expected to follow the placement of said instrument. In this context, an analysis of the new debt structure may result in a rating action with respect to the issuer or other participants in the deal, or some of their financial obligations.

Because of low recovery rates in the case of default, the credit ratings (credit estimates) of individual financial obligations of the issuer (whose failure results in the issuer's default) may be decreased by three notches depending on their type, structure, security, and the issuer's credit rating (credit estimate).

In exceptional cases, ACRA's rating committee may decide on a positive adjustment of no more than one notch if, in the Agency's opinion, either liquid and reliable collateral is available allowing almost full recovery of losses or other structural features are present (for example, compensatory mechanisms for reimbursing losses and/or lost income by investors from third parties with high credit quality) that result in a higher recovery rate than the average rate for senior unsecured creditors. In that case detailed analysis is carried out of legal risks associated with the bankruptcy procedure and potential claims from other creditors/with being placed in the general bankruptcy estate of collateral as part of the bankruptcy procedure.

If the borrower's failure to fulfill certain financial obligations featuring debt characteristics does not result in the issuer's default (e.g., on convertible bonds or perpetual bonds if the issuer has the right to unilaterally refuse to pay interest and in the absence of compensatory mechanisms for reimbursing losses and/or lost income by investors from third parties), the credit rating (credit estimate) of these financial obligations is set five notches lower than the issuer's SCA but not lower than C(RU) (in the absence of a failure to comply with obligations under the instrument). This approach is due to the minimal possibility of recovery on those obligations in

[2] ACRA assesses debt security based on expert opinion.

view of the substantial deterioration of the creditors' position after the conversion of their claims. The SCA is used instead of the final credit rating (credit estimate) because ACRA's relevant methodologies assessing support take into account extraordinary support, not regular support, which will most likely not be provided upon the exercise of a debt conversion provision. As such, the SCA plays a key role in assessing such financial obligations. Credit ratings are not assigned to these financial instruments if it is not possible to determine the SCA.

Financial obligations (including perpetual bonds), which do not provide for the possibility of debt write-off and the issuer's right to unilaterally refuse interest payment, or compensatory mechanisms are provided to reimburse losses and/or income lost by investors from third parties with a credit rating (credit estimate) that is no lower than the credit rating of the issuer, are part of the III–V categories of compensation for losses, depending on the terms of the issue. In particular, ACRA may assign a credit rating to a financial instrument that is 1–3 notches lower than the issuer's credit rating if the terms of the issue bear additional risks associated with investors not receiving income.

The availability of guarantees/suretyships for the entire amount of the rated (assessed) obligations means that these obligations will be assigned credit ratings (credit estimates) based on the credit rating (credit estimate) or SCA (for the relevant category of compensation) of the guarantor/surety according to one of the following scenarios:

1. A guarantee by government or regional authorities (this scenario assumes increasing the credit rating (credit estimate) of the instrument to match that of the government of the Russian Federation, or the credit rating (credit estimate) of the regional authority).
2. A suretyship issued by a Russian legal entity with a credit rating (credit estimate) from ACRA (this scenario assumes assigning a credit rating (credit estimate) of the instrument based on the credit rating (credit estimate if there is no assigned credit rating) of the surety).

One of the basic rules for assigning credit ratings (credit estimates) to individual issues of financial instruments is that the issuer or the entity providing suretyship on the obligation must have a credit rating (credit estimate). An exception to this rule may be that the perimeter of the deal involves subsidiary companies — whether as issuers or sureties — which have a strong relationship with the parent company. When assessing the relationship, operating flows/income and other factors are taken into account which indicate the willingness of the parent company to support the subsidiary. In this case, the credit rating (credit estimate) of the parent (holding) company, which is assigned based on said consolidated statements and the appropriate methodology, may be used to assign a credit rating (credit estimate) to the financial instrument.

When analyzing the priority of financial obligations within a group of companies, the debt of the parent (holding) company is considered as subordinated to the debt of operating companies. This is because the debt of a parent (holding) company is serviced using the dividends from operating companies, the payout of which may be hampered by insufficient cash flows. If the rated (assessed) financial obligation of a parent (holding) company is not covered by suretyship provided by the operating companies, the Agency analyzes this debt as subordinated debt, according to the rules set out in the sections of this methodology for each type of issuers.

The next important step after determining the recovery rate category is to analyze in detail the structure of specific issues of debt obligations. All key structural aspects are taken into account, including (but not limited to) maturity and repayment schedule, interest periods, presence and scope of financial covenants, ban on disposal of assets, and other terms. If any specifics of the structure are identified that may affect the recovery rate in contrast to other investors (e.g., no cross-default provision, long grace or interest periods, etc.), the Agency reserves the right to additionally decrease the credit rating (credit estimate) of individual financial obligations by one notch.

If the debt structure changes due to the repayment or issuance of new borrowings, the Agency reserves the right to revise the credit ratings (credit estimates) assigned to the financial instruments irrespective of whether the issuer's credit rating (credit estimate) has been revised.

4 Application of the Methodology to Banking Organizations

When assigning credit ratings (credit estimates) to financial instruments of banking organizations, ACRA divides them into three classes:

- Senior unsecured debt;
- Debt instruments with signs of subordination included in core capital in accordance with the methodology of the Bank of Russia (or expected to be included in the future in accordance with the Bank of Russia's criteria);
- Debt instruments with signs of subordination included in supplementary capital in accordance with the methodology of the Bank of Russia (or expected to be included in the future in accordance with the Bank of Russia's criteria).

In the case of assigning a credit rating (credit estimate) to secured (including in the case of provision of collateral by third parties) bonds issued by a bank, ACRA analyzes the sufficiency and liquidity of collateral and reserves the right, based on this analysis, to assign the given bond issue a credit rating (credit estimate) exceeding the issuer's credit rating (credit estimate) by no more than one notch in exceptional cases. At the same time, a detailed analysis is carried out of the legal risks of investors associated with the bankruptcy procedure and potential claims from other creditors/with being placed in the general bankruptcy estate of collateral as part of the bankruptcy procedure.

Table 2 sets out the Agency's approach to assigning credit ratings (credit estimates) to debt obligations of banking organizations.

Table 2. Approach to assigning credit ratings (credit estimates) to debt instruments

Class of instrument	Loss recovery category	Credit rating (credit estimate) level adjustment	Reason
Secured bonds	I	0 or +1 notch to the final credit rating (credit estimate) of the bank.	Decision of the rating committee, taking into account the assessment of the sufficiency and liquidity of collateral (including received from third parties) for the bonds, and also the risk of possible claims on the collateral from other creditors in the event of default.

Senior unsecured debt	II	Corresponding to the final credit rating (credit estimate) of the bank.	Senior unsecured debt traditionally reflects the probability of default of the bank itself.
Supplementary capital instruments or subordinated obligations	V	−3 notches from the final credit rating (credit estimate) of the bank.	Instruments whose seniority is significantly lower than senior unsecured debt. An example of subordinated obligations may be the senior unsecured debt of a parent (holding) company not involving a suretyship by operating assets contributing no less than 80% of operating revenue, capital, and total assets.
Core capital instruments	VI	−5 notches from the SCA, but no lower than C(RU) (in the absence of a failure to comply with obligations under the instrument) −5 to −7 notches from the SCA, but no lower than C(RU) (in the absence of a failure to comply with obligations under the instrument) if capital adequacy is assessed as "Weak" or "Critical"[3]	Quasi capital of a banking organization that often taking the form of an equity instrument if there is a threat to the stability of the banking organization, and also carries the risk of write-off for investors. If capital adequacy is assessed as "Weak" or "Critical," the rating committee decides on the number of notches by which to adjust the credit rating (credit estimate) level within the above range based on the expert assessment of the probability of default on the instruments in question.

Source: ACRA

The provisions of this section also apply to the assignment of credit ratings (credit estimates) to financial instruments of organizations whose activities are close to banking in terms of their economic substance. The decision on whether it is possible to apply this methodology to the financial instruments of such organizations is up to ACRA's rating committee.

5 Application of the Methodology to Insurance Companies

When assessing recovery rates in the insurance sector, ACRA follows the provisions of Section 7.2 (Detailed approach) of this methodology, taking into account the specific regulatory aspects of financial rehabilitation and bankruptcy procedures for insurance companies.

6 Application of the Methodology to Regional and Municipal Authorities

ACRA considers the bond issues of regional and municipal authorities to be senior unsecured debt. Therefore, the second recovery rate category is set as the basic category for them.

Current budget legislation does not provide for security on the obligations of regional and municipal authorities. Therefore, no credit rating (credit estimate) adjustment is made to account for the increased protection of secured creditors.

[3] According to the Methodology for Credit Ratings Assignment to Banks and Bank Groups Under the National Scale for the Russian Federation.

If a federal budget guarantee is in place, the credit rating (credit estimate) of the debt obligation may be increased to correspond to the credit rating (credit estimate) of the guarantor.

7 Application of the Methodology to Nonfinancial Companies

To assess recovery rates in the nonfinancial sector, ACRA identifies the following categories of debt obligations:

I Secured obligations. The most reliable obligations backed by the borrower (or third parties) providing security over tangible assets (buildings, structures, core equipment, etc.), or liquid financial assets. These obligations fall under recovery rate category I and involve assigning a credit rating (credit estimate) to the instrument corresponding to the credit rating (credit estimate) of the issuer or increasing it by one notch in exceptional cases depending on the sufficiency and liquidity of collateral. In that case detailed analysis is carried out of the legal risks associated with the bankruptcy procedure and potential claims from other creditors/with being placed in the general bankruptcy estate of collateral as part of the bankruptcy procedure.

II Senior unsecured obligations. The most common type of obligation for nonfinancial companies. They include unsecured debt obligations featuring no structural subordination on other unsecured debt obligations of the issuer. These obligations may fall under recovery rate categories I–V and involve assigning a credit rating (credit estimate) to the instrument corresponding to the credit rating (credit estimate) of the issuer or decreasing it by as many as three notches depending on recovery rate.

III Obligations featuring a high degree of structural subordination. The failure to pay under these debt obligations generally does not mean default for the issuer (e.g., convertible bonds or perpetual bonds if the issuer has the right to unilaterally refuse interest payment and in the absence of compensatory mechanisms for reimbursing losses and/or lost income by investors from third parties). These obligations fall under recovery rate category VI and involve assigning a credit rating (credit estimate) five notches lower than the issuer's SCA but no lower than C(RU) (in the absence of a failure to comply with obligations under the instrument).

ACRA uses two approaches to assess recovery rates on the senior unsecured obligations of nonfinancial companies:

1) **Simplified approach:** for issuers with the credit ratings (credit estimates) at BBB−(RU) or higher with a relatively low probability of default;
2) **Detailed approach:** for issuers with the credit ratings (credit estimates) at BB+(RU) or lower.

If the rated (assessed) financial obligation of a parent (holding) company is not covered by suretyship provided by operating companies, contributing no less than 80% of operating cash flow/revenue, capital and total assets, based on the consolidated statements of the group, the Agency applies the detailed approach regardless of the parent (holding) company's credit rating (credit estimate).

7.1. Simplified approach

Although debt load is, in ACRA's opinion, one of the most important indicators of the issuer's creditworthiness, it is not an exhaustive creditworthiness assessment metric. Issuers with the credit rating (credit estimate) at BBB−(RU) or higher typically feature more stable financial flows, better payment discipline, and a more consistent financial policy compared to nonfinancial companies with lower ratings. Moreover, it is typical for such organizations to have a higher share of unsecured debt obligations in their total debt structure. Accordingly, in ACRA's opinion, the credit rating (credit estimate) of senior unsecured debt obligations corresponding to the issuer's credit rating (credit estimate) reflects the relative credit risk of those obligations most effectively.

At the same time, ACRA's rating committee may, in the cases stated below, decide to adjust the credit rating (credit estimate) of senior unsecured debt obligations for a non-financial company with a credit rating (credit estimate) at BBB−(RU) or higher, if:

1. The "Debt Load," "Debt Servicing," or "Issuer Liquidity" factors are in category IV or V;

- If more than 50% of the physical assets or liquid financial assets of the issuer are pledged on debt obligations (excluding securities issued by the issuer or another member of the group).

In such cases, the Agency reserves the right to decrease the credit rating (credit estimate) by as many as two notches (depending on the occurrence of either one or both conditions mentioned above or the category of assessment for "Debt Load," "Debt Servicing," and "Issuer Liquidity" factors).

For perpetual bonds, the level of the credit rating (credit estimate) depends on the coupon payment terms according to Table 3.

Table 3. Approach to assigning credit ratings (credit estimates) to perpetual bonds

Coupon payment conditions	Adjustment of credit rating (credit estimate)
The issuer does not have the right to unilaterally refuse interest payment without the occurrence of a default event, or compensatory mechanisms are envisaged for reimbursement of the income not received by investors from third parties with a credit rating (credit estimate) not lower than the issuer's credit rating.	Final credit rating (credit estimate) - 1 notch
The issuer has the right to postpone interest payments for up to 1 year, and In case of postponement of payments, there is a restriction on the payment of dividends to shareholders until interest is fully repaid.	Final credit rating (credit estimate) - 2 notches
The issuer has the right to postpone interest payments for up to 1 year.	Final credit rating (credit estimate) - 3 notches

The issuer has the right to unilaterally refuse interest payment, or The issuer has the right to postpone interest payments for more than 5 years without dividend payment restriction, or It is possible to write off the debt.	SCA - 5 notches, but no lower than C(RU) (in the absence of the fact of default on the instrument)

Source: ACRA

7.2. Detailed approach

The credit rating (credit estimate) of a financial obligation corresponds to the issuer's credit rating (credit estimate) if the below conditions are met simultaneously:

2. Current debt structure only features senior unsecured obligations;
3. No changes to the debt structure are expected (including either using the existing assets as collateral for new or existing loans or issuing subordinated obligations).

If the above conditions are met, no further analysis is conducted and no adjustments to the instrument's credit rating (credit estimate) are made relative to the issuer's credit rating (credit estimate).

If any of the above conditions are not met, ACRA conducts a more detailed analysis of the funds available for distribution and the priority of payouts to creditors in the case of default in order to determine the recovery rate on obligations.

To assess senior unsecured debt following a detailed approach, ACRA assesses the projected recovery rate based on the expected investor recovery rate of the rated (assessed) financial obligation. The expected rate is determined by assessing the total volume of funds available for distribution to investors if a default occurs and the priority of paying out the obligation.

Assessing funds available for distribution to investors

To assess investor recovery rates, it is first necessary to determine the volume of funds available for distribution to investors if a default occurs. For these purposes, the Agency may use the assessment of either the business as a whole, or the value of assets based on a liquidation approach. The Agency assumes that the most common practice in the case of a default is to sell the business as a whole, rather than selling off individual assets.

The Agency may assess the value of a business using either of the following methods:

1. **Discounted cash flow method:** the Agency assesses the value of a business by discounting the issuer's future cash flows;
2. **Multiples method:** the Agency assesses the value of a business by determining the parameters of the issuer's earnings from operations if a default occurs (generally, EBITDA or FFO before net interest payments and taxes according to the stress scenario of the financial model) and applying the average market multiple to them. This is determined based on comparable deals involving the sale of companies undergoing bankruptcy procedures or based on discounted average multiples for the industry.

If the liquidation approach is applied, the Agency assesses the liquidation value of the issuer's assets, which is calculated by applying the appropriate discounts to the book value of the assets. The ranges of applied discounts are shown in Table 4.

Table 4. Discounts applied under the liquidation approach

Type of asset	Liquidation discount[4]	Notes
Cash	100%	Generally, no cash is available the moment default occurs.
Property, plant, and equipment	25%–75%	In bankruptcy procedures, property, plant, and equipment are disposed of through a sale process, usually at a substantial discount.
Receivables	50%–100%	The collection rate on receivables is typically rather low in the case of bankruptcy procedures and is associated with rather long collection periods. In some cases, however, counterparties with high credit quality can be debtors under receivable claims.
Inventories	50%–100%	Inventory assets generally are not very liquid and are sold at a substantial discount. Moreover, it is often the case that inventories cannot be sold if the issuer defaults. The inventories of issuers engaged in the Residential Construction industry may be included, in full or in part, in the Property, Plant, and Equipment category based on the expert judgement of the analyst.
Financial investments	25%–100%	The assessment of financial investments is based on their fair value and liquidity.
Intangible assets	75%–100%	In case of bankruptcy, intangible assets such as licenses, trademarks, software, etc., are sold at minimum prices or not at all.
Goodwill	100%	It is possible that goodwill has no inherent value upon liquidation, as it represents the surplus of the actual price of the purchased assets over their book value.
Other assets	0%–100%	This category includes other assets, the potential sale price of which is determined on a case-by-case basis.

Source: ACRA

Assessing the priority of payouts

The legal basis for the priority of paying out various obligations in the case of the issuer's bankruptcy procedures are governed by the legislative and regulatory documents of the relevant jurisdictions, and also by the contractual terms of relationships between the issuer and the corresponding category of investors. In addition, the Agency's assessment of the payout priority, is, as a rule, specific to each issuer and may account for other significant aspects affecting the order of discharging the claims of the issuer's creditors (including customary business practices, relations with affiliated structures, terms of security agreements, the structure of such security, etc.). In some cases, the order identified by ACRA may differ from the order provided for in legislative and regulatory documents (e.g., ACRA may define, within the fourth rank of creditors, several subcategories of priority for unsecured obligations or payables).

[4] In exceptional cases, the rating committee may decide to apply other discounts if it is justified.

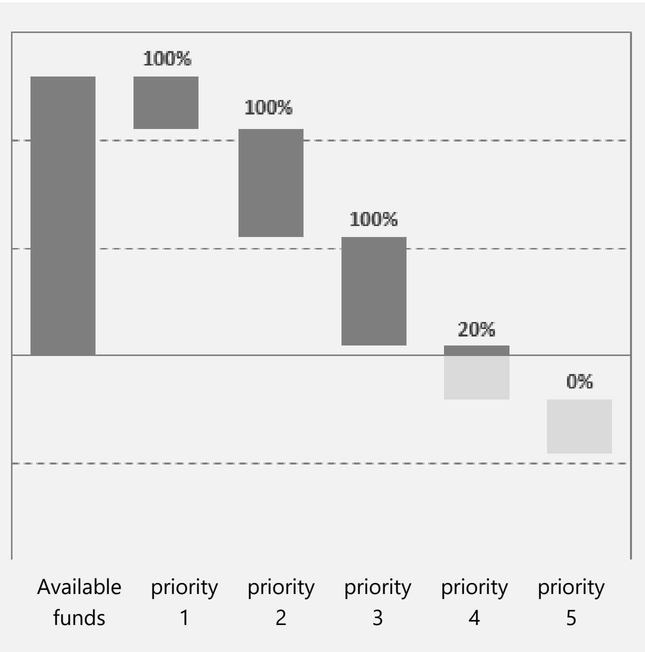
The Agency regards the obligations of parent (holding) companies as subordinated to the obligations of operating companies. This is because the debt of a parent (holding) company is serviced using the dividends from operating companies, the payout of which may be hampered by insufficient cash flows. In the case of shareholder loans or affiliated payables, the assessment of payout priority may also depend on the level of corporate governance and the issuer's loyalty to the corresponding category of investors, as payouts may be made before or after senior unsecured debt depending on the case.

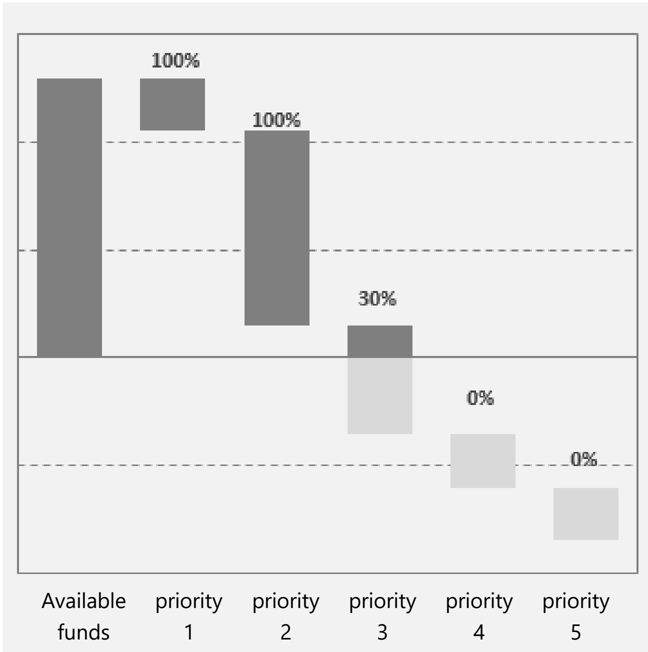
Generally, the potential recovery rate for senior unsecured obligations is inversely related to the share of obligations backed by tangible collateral, as tangible assets often serve as the main source of recovery on losses for the corresponding category of investors.

Assessment of recovery rates on obligations

After determining the volume of funds available for distribution to creditors and the priority of payouts, the Agency assesses the sufficiency of funds used to pay out the organization's debt. The calculation is made by comparing available funds to the volume of payouts to each creditor rank by the order of priority. In doing so, the sum of available funds for each subsequent creditor rank is reduced by the sum of payouts to the previous categories. The examples of using this approach are given in Figure 1.

Figure 1. Examples of distributing available funds to obligations with varying priority





Source: ACRA

Depending on the resulting recovery rate, obligations of nonfinancial companies are placed in the recovery rate categories set out in Table 5.

The debt instruments of nonfinancial companies are assigned a credit rating (credit estimate) by adjusting the credit rating (credit estimate) of the issuer in accordance with Table 5.

The assignment of a credit rating (credit estimate) to debt instruments of non-financial companies is carried out by adjusting the issuer's credit rating (credit estimate) in accordance with Table 4.

Table 5. Determining the recovery rate category

Recovery rate	Recovery rate category	Credit rating (credit estimate) adjustment notches
70%–100%	I	0 or +1
50%–70%	II	0
30%–50%	III	−1
10%–30%	IV	−2
0%–10%	V	−3

Source: ACRA

8 Application of the Methodology to Lease Financing Companies

To assess recovery rates in the financial leasing sector, ACRA follows the provisions of Section 7.2 (Detailed Approach) of this methodology, taking into account the specific regulatory aspects of financial rehabilitation and bankruptcy procedures for financial leasing companies.

9 Application of the Methodology to Assign Credit Ratings to Debt Financial Instruments with Credit Ratings under the International Scale

This methodology may be applied to assign credit ratings (credit estimates) to individual issues of financial instruments of issuers with credit ratings under the international scale and falling into the following categories:

- Banking organizations and organizations whose activities are close to banking in terms of their economic substance;
- Non-financial companies, including holding companies;
- Insurance organizations;
- Lease financing companies;
- Supranational development institutions (supranationals);
- Regional and municipal authorities.

When assigning a credit rating (credit estimate) to individual issues of financial instruments under the National Scale for the Russian Federation, the Agency uses the credit rating (credit estimate) of the issue of a given instrument assigned under the International Scale. ACRA may use the credit rating (credit estimate) of the issuer of the financial instrument under the

International Scale if there is no credit rating (credit estimate) for the issue under the International Scale, if the actual issuer is a special-purpose vehicle located in the Russian Federation and functioning in accordance with Russian legislation, or if the actual issuer is a supranational development institution with an ACRA credit rating (credit estimate) under the International Scale.

To assign a credit rating (credit estimate) under the National Scale for the Russian Federation, ACRA applies the Methodology for Mapping Credit Ratings Assigned on ACRA's International Scale to Credit Ratings Assigned on ACRA's National Scale for the Russian Federation (hereinafter, the Mapping Methodology). To determine the credit rating (credit estimate) under the National Scale for the Russian Federation, the rating committee uses standard mapping tables from the Mapping Methodology depending on the following factors: (1) ACRA's credit rating for the Russian Federation under the International Scale (credit estimate in the absence of a credit rating assigned by ACRA); (2) the credit rating (credit estimate) of the financial instrument/issuer under the International Scale. If several options are available to choose from, the rating committee follows the principles set out in the Mapping Methodology.

Disclaimer

Analytical Credit Rating Agency (Joint-Stock Company), ACRA (JSC)
75, Sadovnicheskaya embankment, Moscow, Russia
www.acra-ratings.com

The Analytical Credit Rating Agency (ACRA) was founded in 2015, with its 27 shareholders representing major Russian corporate and financial institutions and its authorized capital exceeding RUB 3 bln. ACRA's main objective is to provide the Russian financial market with high-quality rating products. Methodologies and internal documents of ACRA are developed in compliance with Russian legislation and with regard to global rating industry best practices.

The provided information, including, without limitation, credit and non-credit ratings, rating assessment factors, detailed credit analysis results, methodologies, models, forecasts, analytical reviews and materials, as well as other information placed on the ACRA website (further referred to as Information), coupled with the ACRA website software and other applications, are intended for information purposes only. Information must not be modified, reproduced or distributed by any means, in any way or form, either in whole, or in part, in marketing materials, as part of public relations events, in news bulletins, in commercial materials or reports without prior written consent from, and reference to, ACRA. Any use of Information in violation of these requirements or the law is prohibited.

ACRA credit ratings reflect ACRA's opinion about the ability of a rated entity to meet its financial obligations or about the credit risk of individual financial obligations and instruments of a rated entity at the time of publication of the relevant Information.

Non-credit ratings reflect ACRA's opinion about certain non-credit risks assumed by interested parties interacting with a rated entity.

The assigned credit and non-credit ratings reflect all material information pertaining to a rated entity and known by ACRA (including the information received from third parties), the quality and reliability of which ACRA considers appropriate. ACRA shall not be responsible for the accuracy of information provided by clients or relevant third parties. ACRA does not audit or otherwise verify the provided data and shall not be held responsible for their accuracy and completeness. ACRA conducts rating analysis of information provided by customers using its own methodologies, with the texts thereof available on ACRA's website – www.acra-ratings.com/criteria.

The only source that reflects the latest Information, including the one about credit and non-credit ratings assigned by ACRA, is ACRA's official website – www.acra-ratings.com. Information is provided on an "as is" basis.

Information shall be considered by users exclusively as ACRA's statement of opinion and must not be regarded as advice, recommendation or suggestion to buy, hold or sell securities or other financial instruments of any kind, nor shall it be viewed as an offer or advertisement.

Neither ACRA, nor its employees and persons affiliated with ACRA (further referred to as the ACRA Parties) provide any direct or implied guarantee expressed in any form or by any means regarding the accuracy, timeliness, completeness or applicability of Information for making investment and other decisions. ACRA does not act as a fiduciary, auditor, investment or financial advisor. Information must be regarded solely as one of the factors affecting an investment decision or any other business decision made by any person who uses ACRA's information. It is essential that each of such persons conduct their own research and evaluation of a financial market participant, as well as an issuer and its debt obligations that may be regarded as an object of purchase, sale or possession. Users of Information shall make decisions on their own, involving their own independent advisors, if they deem it necessary.

ACRA Parties shall not be responsible for any action taken by users based on Information provided by ACRA. ACRA Parties shall under no circumstances be responsible for any direct, indirect or consequential damages or losses resulting from interpretations, conclusions, recommendations and other actions taken by third parties and directly or indirectly connected with such information.

Information provided by ACRA is valid only as of the date of preparation and publication of materials and may be amended by ACRA in the future. ACRA shall not be obliged to update, modify or supplement Information or inform anyone about such actions, unless the latter was recorded separately in a written agreement or is required by legislation of the Russian Federation.

ACRA does not provide advisory services. ACRA may provide additional services, if this does not create a conflict of interest with rating activities.

ACRA and its employees take all reasonable measures to protect all confidential and/or material non-public information in their possession from fraud, theft, unlawful use or inadvertent disclosure. ACRA provides protection of confidential information obtained in the course of its business activities as required by legislation of the Russian Federation.