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METHODOLOGY FOR ASSIGNING CREDIT RATINGS TO DEBT INSTRUMENTS (SEPARATE ISSUES) – FULL VERSION

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1. General definitions

1.1 Scope of Methodology

This methodology is applicable for debt instruments (separate issue/issues) issued by the entities, whose creditworthiness can be assessed by the Agency on the basis of the valid versions of the methodologies published on the web-site of the Agency.

Depending on the current status of the debt issue, the Agency can assign credit rating to the debt issue, as well as expected credit rating to the debt issue.

Credit rating of a debt instrument (separate issue / issues) represents the opinion of Rating-Agentur Expert RA GmbH on the ability of the entity (issuer / guarantor) to fulfill its financial liabilities on this/these instrument/ instruments fully and in a timely manner. The credit rating shall be assigned, only if the debt issue was registered in accordance to the relevant regulation.

Expected credit rating of a debt instrument (separate issue / issues) represents the opinion of Rating-Agentur Expert RA GmbH on the ability of the entity (issuer / guarantor) to fulfill its financial liabilities on instrument/ instruments, planned for the issue, fully and in a timely manner. The credit rating shall be assigned, only if the debt issue was registered in accordance to the relevant regulation. The expected credit rating shall be assigned on the basis of the project of the debt issue prospect.

The logic schemes and the structures of the analysis for the assignment of a credit rating to a debt instrument and expected credit rating to a debt instrument are the same. When the debt instrument having an expected credit rating, is finally issued (the relevant documents on the debt issuance are received), it should be assigned with a credit rating. The expected credit rating previously assigned shall be directly transferred to the credit rating and withdrawn, if the issue conditions remained unchanged.

This methodology is not applicable for debt instruments (separate issue/issues) that can be characterized as structured financial instruments (for example, covered bonds).

1.2 Default definition

The default definition is different for the debt instruments, covered by the surety / guarantee; debt instruments having a covenant of public offer to purchase in case of issuer's default; and debt instruments not having such coverage or not having such covenant.

For the debt instruments not covered by the surety / guarantee and debt instruments not having a covenant of public offer to purchase in case of issuer's default, any of the following cases are considered as default on the bond issue by the Agency:

- Non-fulfillment of financial liabilities on debt instruments after the end of the period of technical default (more than 10 business days / less than 10 business days if such conditions are determined by the bond prospect), including: failure to pay interest (coupon) on bonds; non-redemption of the nominal value of bonds; non-fulfillment of liability to purchase bonds (if such liability is included to the issuing covenants (offer to purchase));
- License withdrawal or non-prolongation of the license, issued for the term period, which will cause the rated entity to stop providing its key services. If the rated entity legally initiated a process of license revocation and the bank fulfilled all its financial

liabilities on time and in a full amount, this case is not considered as default by the Agency;

- If the rated entity's debt liabilities were restructured within the last two months and, after this, creditors have worse conditions as compared with what was initially mentioned in the agreements (for instance, if the current agreement on subordinated debt includes the option of converting this debt to equity shares of the entity, this is not considered as default by the Agency);
- Default of the issuer of the rated debt instrument in accordance to the relevant methodology.

According to the Agency's definition, the date of default is the date of the end of the corresponding period after the first case of non-fulfillment of liabilities listed by the Agency. If the Agency did not state the default of the entity before the date of license withdrawal, the date of license withdrawal is to be considered as the date of default.

For the debt instruments covered by the surety / guarantee, the Agency considered as a default the following case: non-fulfillment by the guarantor its liabilities on the debt issue within the period determined in the agreement, after the guarantee case raised and beneficiary claimed discharge of an obligation to the guarantor.

For the debt instruments, having a covenant of public offer to purchase in case of issuer's default, the Agency considered as a default the following case: an offeror didn't fulfill its liabilities on the offer within the period determined by the offer after the liabilities were not fulfilled by the issuer, and the debt holder claimed an offeror to fulfill the offer conditions (to purchase debt instruments).

1.3 Key rating assumptions

There are following rating assumptions:

1. There is a stable cause-effect relationship between the level of creditworthiness (hereinafter referred to rating level) of the debt instrument and the qualitative and quantitative factors, listed in this methodology;
2. The special characteristic of debt instruments is their diversity in terms of subordination, which influences the order of creditors' claim fulfillment in case of the entity's default. The presence of subordination means that the debt issue can be assigned with a lower rating, as compared to the credit rating of the issuer / guarantor / offeror of this issue. If there is a collateral on the debt issue, it can have a positive impact of the credit rating of the issue;
3. All macro risks are covered by the relevant assessment of the systematic risks for the specific type of entity.

1.4 General provisions and regulations

In accordance with the Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies and further amending or supplementing regulation (hereinafter – the CRA regulation) Rating-Agentur Expert RA GmbH strictly follows the requirements regarding the maintenance of its methodologies:

- The Agency uses the methodologies that are rigorous, systematic and continuous.

- The Agency discloses on its website information on the methodologies, models and key rating assumptions accompanied with the explanation of assumptions, parameters, limits and uncertainties surrounding the models and rating methodologies.
- Methodologies, models and key rating assumptions such as mathematical or correlation assumptions used for determining credit ratings are properly maintained, up-to-date and subject to a comprehensive review on a periodic basis.
- There are internal procedures established for regular review of methodologies in order to be able to properly reflect the changing conditions in the underlying asset markets.
- The Agency monitors and reviews its methodologies on an ongoing basis and at least annually, in particular where material changes occur that could have an impact on a rating. The Agency monitors the impact of changes in macroeconomic or financial market conditions on ratings.
- There is a review function responsible for periodically reviewing the Agency's methodologies and any significant changes or modifications thereto as well as the appropriateness of those methodologies, where they are used or intended to be used for the assessment of new financial instruments.
- The Agency publishes the proposed material changes or proposed new rating methodologies on its website, together with a detailed explanation of the reasons for and the implications of the proposed material changes or proposed new rating methodologies, inviting stakeholders to submit comments within a period of one month.
- The Agency notifies ESMA of the intended material changes to the rating methodologies or the proposed new rating methodologies when the proposed changes or proposed new rating methodologies are published on its website. After the expiry of the consultation period, the Agency notifies ESMA of any changes due to the consultation.
- When the rating methodologies are changed, the Agency immediately discloses the likely scope of ratings to be affected, informs ESMA and publishes on its website the results of the consultation and the new rating methodologies together with a detailed explanation thereof and their date of application. The affected ratings are reviewed as soon as possible and no later than six months after the change, in the meantime placing those ratings under observation. The Agency re-rates all ratings that have been based on those methodologies if, following the review, the overall combined effect of the changes affects those ratings.
- Changes in ratings are issued in accordance with the Agency's published methodologies. The Agency ensures that the ratings and the outlooks it issues are based on a thorough analysis of all the information that is available to it and that is relevant to its analysis according to the applicable rating methodologies. The information the Agency uses in assigning ratings and outlooks is of sufficient quality and from reliable sources. The Agency issues ratings and rating outlooks stipulating that the rating is the Agency's opinion and should not be regarded as a

recommendation to buy, hold or sell any securities or assets, or to make investment decisions.

- Changes in the quality of information available for monitoring an existing rating are disclosed with the rating review and, if appropriate, a revision of the rating is made.
- If the Agency becomes aware of errors in its methodologies it shall immediately notify ESMA about those errors and all affected rated entities, explaining the impact the on ratings and indicating the need to review issued ratings. If errors have an impact on ratings, the Agency shall publish them on its website and correct the errors in the methodologies.

2. Sources of information

While assigning a rating, the following sources of information are used:

- Bond issuance prospectus (if any) / preliminary bond prospectus;
- Report on the bond issuance (if any);
- Presentation for investors (if any):
- Plan for the using of funds, raised through the debt instrument issuance;
- Issuer's statute;
- Contracts/ agreements for the guarantee, which covers the fulfilment of financial liabilities of the debt issue (if any);
- Conditions of the public offer for purchase of debt instruments in case of issuer's default (if any);
- Financial outlook or financial model of the rated entity (if any);
- Credit rating of the issuer / guarantor / offeror or their rating classes, which are used as a basis for the assignment of the credit rating to the debt issue;

The Agency can request and use other information, necessary for deeper analysis of the debt instrument's reliability.

In addition, for the assessment of the issuer's creditworthiness the Agency uses the current methodologies applicable for specific type of entity (which performs as an issuer / guarantor of the rated debt instruments), as well as all sources of information listed in such methodologies.

When assigning ratings, the Agency can reclassify some accounting entries, on the basis of their economic meaning. For example: long-term liabilities can be reclassified to the short-term liabilities if the creditor has a right to call for early repayment. In this case, financial ratios are adjusted in order to provide comparability of different rated objects.

The Agency can take into account future changes in the financial statements on the basis of the forecasts of the Agency, plans of the issuer / guarantor / offeror and (or) if the Agency has reliable information on changes in the structure of assets and liabilities, as well as cash flow. In this case, the Agency can recalculate the ratios and financial indicators taking into account potential / expected changes. For instance, if the Agency knows that the issuer /

guarantor / offeror has plans to raise debt, the debt ratios can be adjusted taking into account such plans and taking into account the nature of assets, that are planned to purchase by the entity using the raised funds.

If the information provided by the rated entity is not enough for the analysis, the Agency has to refuse from assignment / maintaining current credit rating. If the rated entity has existing rating in this situation, this rating is withdrawn without confirmation.

Adequacy of the information for the assignment of the credit rating is determined on the basis of ability / or disability to make an assessment in accordance with this methodology. The main criteria used to determine the adequacy of the information are following:

- Ability to make an analysis of the debt instrument on the basis of factors, listed in this methodology (see Section 5), as well as ability to make an analysis of the issuer guarantor / offeror on the basis of factors, listed in the correspondent section of the methodology relevant for this type of entity;
- Ability to make an analysis of all stress- and support-factors, listed in this methodology.

If the mentioned criteria are satisfied, but the Agency was not provided with the full set of information requested, the Agency has a right to assign a rating taking into account adjustments for the score of some factors, which are approved by the rating committee. As a general rule, such adjustments are conservative (have negative influence). Absence of information is considered as negative information by the Agency.

The Agency checks the reliability of the financial statements and other information provided by the issuer / guarantor / offeror in accordance with the internal procedure of the Agency. If the Agency detects signs of significant non-reliability of the financial statements and other information provided by the company, the Agency refuses the assignment / maintenance of the current rating. If the company has the current rating in this situation, this rating is withdrawn without confirmation.

If the Agency detects signs of minor manipulation with the financial statements and other information provided by the issuer / guarantor / offeror, the Agency can reduce the score for some factors (for instance, the score for corporate governance), or assign “other” stress-factor.

If two or more sources of information contradict each other and the issuer / guarantor / offeror does not provide proper explanation of these contradictions, the source of information that better and more conservatively reflects the risks of the rated object is used.

If the issuer / guarantor / offeror has radical changes in its business model and there is no representative information about risks of the new business model, the Agency refuses the assignment / maintenance of the current rating. If the company has current rating in this situation, this rating is withdrawn without confirmation.

3. Rating classes

The debt instruments of the entity can be classified into one of the following rating classes:

International scale

Class AAA: The highest level of creditworthiness

In the short-run the entity will ensure timely fulfillment of all its financial liabilities within the framework of the debt instrument issue with exceptionally high probability. In the mid-run there is a significant probability that the liabilities will be fulfilled even in case of significant unfavorable changes in the macroeconomic and market indicators.

Class AA: Very high level of creditworthiness

In the short-run the entity will ensure timely fulfillment of all its financial liabilities, within the framework of the debt instrument issue with very high probability. In the mid-run there is a significant probability that the liabilities will be fulfilled if the macroeconomic and market indicators remain stable.

Class A: High level of creditworthiness

In the short-run the entity will ensure timely fulfillment of all its financial liabilities within the framework of the debt instrument issue with high probability. In the mid-run the probability of fulfilling the liabilities requiring significant payments depends greatly on the stability of the macroeconomic and market indicators.

Class BBB: Moderately high level of creditworthiness

In the short-run the entity will ensure timely fulfillment of all its current financial liabilities within the framework of the debt instrument issue, as well as small- and medium-sized contingent liabilities, with high probability. The probability of financial difficulties in case of other liabilities requiring significant lump-sum payments is considered as moderately low. In the mid-run the probability of fulfilling the liabilities within the framework of the debt instrument issue depends on the stability of the macroeconomic and market indicators.

Class BB: Sufficient level of creditworthiness

In the short-run the entity will ensure timely fulfillment of all its current financial liabilities within the framework of the debt instrument issue, as well as small- and medium-sized contingent liabilities, with high probability. The probability of financial difficulties is considered as moderate in case of other liabilities requiring significant payments. In the mid-run the probability of fulfilling the liabilities within the framework of the debt instrument issue depends on the stability of the macroeconomic and market indicators.

Class B: Moderately low level of creditworthiness

In the short-run the entity will ensure timely fulfillment of almost all of its current financial liabilities within the framework of the debt instrument issue with high probability. The probability of not fulfilling contingent liabilities is moderately high. In the mid-run the probability of fulfilling the liabilities within the framework of the debt instrument issue depends on the stability of the macroeconomic and market indicators.

Class CCC: Low level of creditworthiness

In the short-run the probability of not fulfilling financial liabilities of the entity within the framework of the debt instrument issue is high.

Class CC: Very low level of creditworthiness (close to default)

In the short-run the probability of not fulfilling occurring financial liabilities of the entity within the framework of the debt instrument issue is very high.

Class C: The lowest level of creditworthiness (partial default)

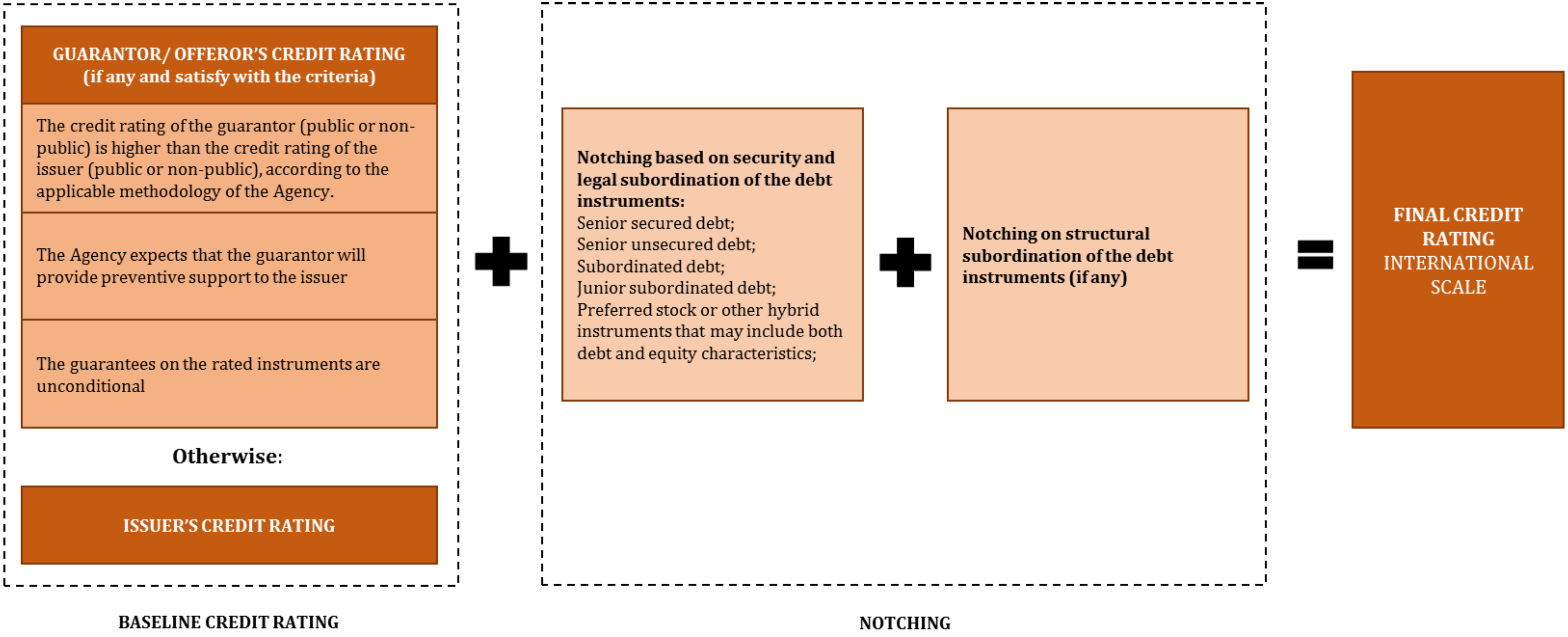
The entity is not ensuring timely fulfillment of some financial liabilities within the framework of the debt instrument issue.

Class D: Default

The entity is not ensuring the fulfillment of almost all its financial liabilities within the framework of the debt instrument issue.

One of the above rating levels that can be assigned to the issue (excluding AAA and ratings below CCC) may be supplemented with (+) or (-) sign depending on the value of the rating score.

4. Scheme of the analysis process



GUARANTOR/ OFFEROR'S CREDIT RATING (if any and satisfy with the criteria)

The credit rating of the guarantor (public or non-public) is higher than the credit rating of the issuer (public or non-public), according to the applicable methodology of the Agency.

The Agency expects that the guarantor will provide preventive support to the issuer

The guarantees on the rated instruments are unconditional

Otherwise:

ISSUER'S CREDIT RATING

BASELINE CREDIT RATING

+

Notching based on security and legal subordination of the debt instruments:
Senior secured debt;
Senior unsecured debt;
Subordinated debt;
Junior subordinated debt;
Preferred stock or other hybrid instruments that may include both debt and equity characteristics;

+

Notching on structural subordination of the debt instruments (if any)

NOTCHING

=

FINAL CREDIT RATING
INTERNATIONAL SCALE

5. The order of rating assignment

5.1 Determination of the credit rating of the issuer or guarantor

The starting point of the rating process for the assignment of the credit rating to the debt instrument (issue/ issues) is determination of the credit rating of the issuer or the entity performing as guarantor / offeror on the rated instruments on the basis of the methodology applicable for this type of entity.

If there is a guarantor / offeror for the rated instruments, the Agency shall check if the guarantor / offeror and its relationships with the issuer satisfy with the following conditions:

1. The Agency expects that the guarantor / offeror will provide preventive support to the issuer (support before the technical default on the rated issuance as well as on other liabilities, if default on such liabilities can be a reason for the bonds' holders to call for prescheduled fulfilment of liabilities);
2. The guarantees on the rated instruments are unconditional, e.g. do not include any covenants that can prevent the provision of financial support to the issuer;
3. The credit rating of the guarantor / offeror (public or non-public) is higher than the credit rating of the issuer (public or non-public), according to the applicable methodology of the Agency. In order to check the fulfillment of this condition, the Agency shall perform the credit rating analysis of the guarantor/ offeror and the issuer according to the applicable methodology/ methodologies and on the basis of the publically available and requested information. If the Agency has no sufficient information to assign a credit rating to a guarantor / offeror according to the applicable methodology, this condition is considered as not satisfied.

If the guarantor / offeror exists and satisfies with all mentioned conditions, the Agency uses the credit rating of the guarantor / offeror as a baseline credit rating for the assessment for the credit rating of the debt instrument (issue/ issues). Otherwise, the Agency uses the credit rating of the issuer as a baseline credit rating.

5.2 Notching based on security and legal subordination of the debt instruments

Due to the fact that the expected loss severity and therefore loss recovery rate can vary significantly for different debt instruments issued by the same issuer, the Agency uses adjustments (notching) for the baseline credit rating (issuer's or guarantor / offeror's credit rating) in order to assign credit rating to specific debt instrument /issue.

The analyst shall use the notching guidance shown in Table 1 to make rating distinctions arising from security and legal subordination of debt instruments.

Table 1. Notching guidance for security and legal subordination

Debt Type	Notching to / from the baseline credit rating	Additional criteria for notching
Senior secured debt	+2	All following conditions are satisfied: 1. Collateral is secured in legal terms in case of the issuer's bankruptcy, i.e. it shall be separated from the bankrupt's estate; 2. The Agency considers that the bankruptcy commissioner in case of the issuer's default can insure the fulfillment of bankrupt's liabilities on the rated issue (debt instrument) fully; 3. Collateral is liquid and can be sold in the short-run; 4. The fair value of collateral at the moment of the assessment guarantees the fulfillment of liabilities on debt instruments fully when collateral is sold, and there are no reasons to expect significant decrease of the fair value of collateral before the redemption of debt liabilities; 5. Collateral is formed by assets rated BBB- (or equivalent) or higher from the rating agency having a good reputation (or the Agency assigned BBB- credit rating or higher (public or non-public) to these assets on the basis of applicable methodology and sufficient information);
	+1	All following conditions are satisfied: 1. Collateral is secured in legal terms in case of the issuer's bankruptcy, i.e. it shall be separated from the bankrupt's estate; 2. The Agency considers that the bankruptcy commissioner in case of the issuer's default can insure the fulfillment of bankrupt's liabilities on the rated issue (debt instrument) fully; 3. Collateral is liquid and can be sold in the short-run; 4. The fair value of collateral at the moment of the assessment guarantees the fulfillment of liabilities on debt instruments fully when collateral is sold, and there are no reasons to expect significant decrease of the fair value of collateral before the redemption of debt liabilities;
Senior unsecured debt	0	-
Subordinated debt	-1	The following conditions are satisfied: The issuer / guarantor / offeror was rated BBB- or higher by the Agency;
	-2	The following conditions are satisfied: The issuer / guarantor / offeror was rated BB+ or lower by the Agency;
Junior subordinated debt	-2	The following conditions are satisfied: The issuer / guarantor / offeror was rated BBB- or higher by the Agency;
	-3	The following conditions are satisfied:

		The issuer / guarantor / offeror was rated BB+ or lower by the Agency;
Preferred stock or other hybrid instruments that may include both debt and equity characteristics	-3	-

The notching guidance in Table 1 represents actual notching in most but not all cases. When assessing the specific debt instruments, the analyst shall take into account all significant characteristics of the rated issue, issuer (or guarantor), economic environment in the jurisdiction of the issuer. For instance, covenants might trigger earlier default and affect recovery rates, and therefore shall be taken into account while making notching. There are following most common (but limited) examples, where the notching may differ from the guidance shown in Table 1:

- unbalanced capital structures where the rated issue forms a very small or large share of total debt of the issuer;
- complexity in the legal structure of the corporate organization or in the terms of the debt instruments;
- poor, non-predictable or unstable bankruptcy regulation in the country;
- significant mismatch between bankruptcy regulation and its practical implementation in the country;
- historically low loss recovery rates in case of entity's defaults in particular country;
- specific characteristics of the issue not covered by this methodology.

The Agency is not limited in its final notching decision by the described guidance and list of exceptions. In addition, the Agency can use specific guidance for different types of the debt instruments in specific sectors, such as banks, insurance, non-financial companies and others.

5.3 Notching based on structural subordination of the debt instruments

When analyzing the prioritization of the financial liabilities within the group of companies, the debt of the parent holding company shall be considered as subordinated to the debt of operating companies, included to group of companies. This statement is based on the fact that the debt servicing for the debt of the parent holding company is performed from the dividends of operating companies, the payment of which can be difficult in case of insufficient cash flow. In addition, usually debt at parent holding company has only a residual legal claim on the assets and cash flow of the operating companies. Therefore, debt of the parent company usually has higher expected loss severity as compared to debt of operating companies.

The Agency applies structural subordination to the debt instruments, only if the holding corporate structure is simplified, where the sole activity of the parent company is to hold shares of the operating company or few operating companies. The Agency does not apply structural subordination, if the holding corporate structure was considered as complex by the Agency (for example, when the parent company performs many other activities apart from holding shares of operating companies), or if the parent company is owned by the stronger entity, that can provide financial support to the whole group of companies.

If the structural subordination is applicable according to the Agency's opinion, the following algorithm is used:

1. Based on the applicable methodology, consolidated financial statements of the group of companies and using assumptions that the group performs as a single entity, the Agency shall assign a credit rating to the whole group of companies (only for internal purposes);
2. Once the rating was assigned, the Agency attributes this rating to the legal entity that forms a majority of the debt of the whole group of companies;
3. Then the Agency performs a notching of the rated debt instrument (issue), on the basis of the following rule: junior subordinated debt of the operating company is generally rated one notch higher than the senior unsecured debt of the parent company.

This general algorithm can be modified when assigning credit ratings within the more complex corporate structures, but when the structural subordination is still applicable. In this case, the Agency takes into account all significant characteristics of the particular debt instruments, as well as characteristics of the legal and financial relationships within the holding corporate structure and evaluate potential differences in the expected loss severity among all debt issued within the group. For instance, if the debt issue is issued by the SPV of the unregistered holding company, and raised funds are transferred directly to the higher corporate level, this should be treated as a structural subordination.