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METHODOLOGY FOR ASSIGNING CREDIT RATINGS TO BANKS – SHORT PUBLIC VERSION

The Methodology presented is a short public version.

1. General definitions

This methodology describes a system of factors and weights used in the process of assigning credit ratings to banks having license(s) for banking activities issued by the **Central Bank of the Russian Federation** and operating in accordance with the Russian standards of banking regulation and supervision.

Bank creditworthiness – the ability of a bank to fulfill its financial obligations with creditors in full amount and in a timely manner[1].

Credit rating (rating of creditworthiness) – the opinion of the Rating Agency on the ability of the bank to fulfill its financial obligations in full amount and in a timely manner.

Stand alone credit rating (stand alone rating of creditworthiness) – the opinion of the rating agency on the ability of the bank to fulfill its financial obligations in full amount and in a timely manner without taking into account external factors (support from the owners or Government, planned future changes in the regulation, etc.).

During the process of the rating assignment, the Rating Agency uses national (only for internal purposes) and international scales. The credit rating assigned by Rating-Agentur Expert RA GmbH is defined by allocating the bank into one of 11 rating classes (international scale).

The ratings assigned in accordance with the national scale (both stand alone and final) shall be transferred to the international scale through the adjustment for Country credit environment rating (CCE) in foreign currency (according to the «Instruction for transferring ratings from national to international scale»). Rating-Agentur Expert RA publishes **only final ratings in accordance with the international scale** (stand alone rating may be published only upon specific request from the rated entity).

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[1] Creditors here include all persons who provide loan funds to the bank in any form (individuals or legal entities, including depositors and buyers of debt securities).

2. Sources of information

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

- Questionnaire filled by the bank according to the Agency's form

- Forms of reporting according to the national accounting standards for the last two years

- Annual IFRS reporting certified by an auditor (including the auditor's report and notes) for the last two complete years

- Articles of Association of the bank in their current version

- Documents regulating risk management of the bank

- Documents determining development plans of the bank

- Documents regulating corporate governance of the bank

- Data obtained during interviews with managers of the bank

- Information from the mass media and other public sources

2.2 The Rating Agency is neither responsible for controlling the accuracy of accounting and statistical forms and forms provided by the company to the supervisory authorities, nor for the authenticity of information included in these forms.

3. Structure of the rating analysis

3.1 The Bank's rating is based on the analysis of three types of factors:

- ***Stand alone creditworthiness***

- ***Significance of internal support-factors and exposure to internal stress-factors***

- ***Significance of external support-factors and exposure to external stress-factors***

According to the analysis of the stand alone creditworthiness the responsible expert determines a preliminary rating of the bank. In order to get the **stand alone rating**, the expert shall make the adjustments for the internal stress- and support-factors. In order to get the **final rating score**, the expert shall make the adjustments for the external stress- and support-factors. At the final stage, the expert shall transfer the assigned rating from the national scale[2] to the international rating scale.

3.2 The stand alone bank's creditworthiness is defined as the weighted sum of the assessment of three sections: ***market position of the bank (1); financial risks (2);***

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[2] Rating according to the national scale is assigned by the Agency for internal purposes only and is not disclosed to the rated entity or general public.

corporate governance and risk management (3).

3.3 The section "***market position of the bank***" includes the analysis of the following integral factors: *history and reputation of the bank, specialization and captivity, geographic reach, the competitive position of the bank.*

3.4 The section ***"financial risks"*** includes analysis of the following integral factors: *capital adequacy and capital quality, concentration of active operations on large customers, quality of assets and off-balance sheet liabilities at risk, profitability of operations, resource base structure[3], liquidity, market risks.*
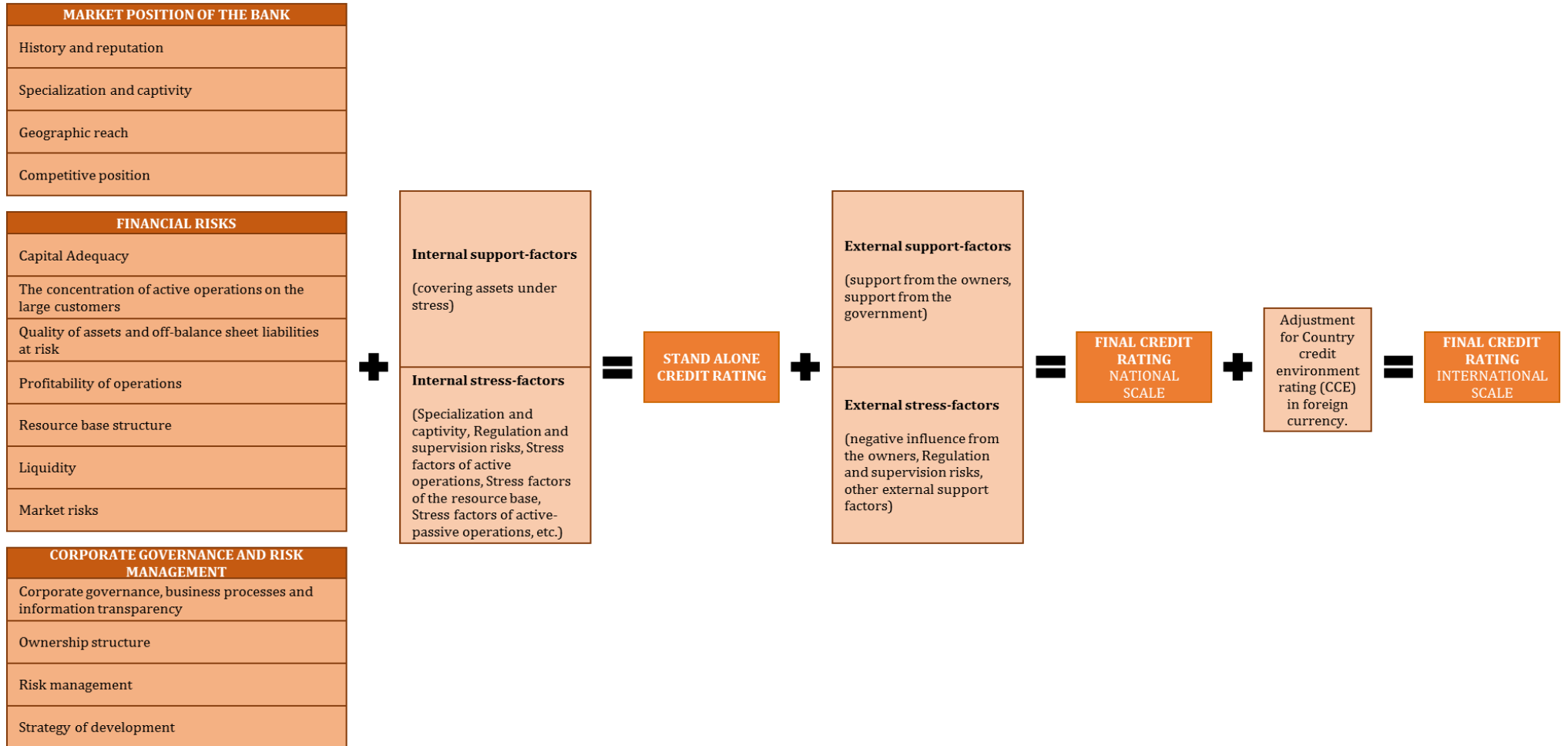
3.5 The section "***Corporate governance and risk management***" includes the analysis of the following integral factors: *the quality of corporate governance, business processes and information transparency of the bank, ownership structure, risk management and the strategy of development.*

3.6 After assessing the factors of the bank's stand alone creditworthiness, the responsible expert shall assess internal support- and stress-factors. Depending on the value of these factors, a "penalty" or a "bonus" shall be added to the rating score of the stand alone creditworthiness. If a moderate stress-(support-) factor is detected, the expert shall deduct (add) 0,1 from (to) the rating score. If a strong stress-(support) factor is detected, the expert shall deduct (add) 0,2 from (to) the rating score. If several stress (support) factors are detected, "penalties" and "bonuses" shall be summed up (except when factors are of the same type). Then, the responsible expert shall adjust the rating score for the stand alone creditworthiness (which already includes internal stress- and support-factors) for external stress- and support-factors. This is the final rating score according to the national scale.

3.7 The ratings assigned in accordance with the national scale (both stand alone and final) shall be transferred to the international scale through the adjustment for Country credit environment rating (CCE) in foreign currency (according to the «Instruction for transferring ratings from national to international scale»).

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[3] Resource base of a bank shall mean its equity capital and monetary funds raised from legal entities and individuals, on a repayable basis. These funds are raised by the bank as a result of passive operations, which are used by it for the execution of active operations. **This section of the methodology includes only analysis of raised funds.**

Logic scheme:

MARKET POSITION OF THE BANK
History and reputation
Specialization and captivity
Geographic reach
Competitive position

FINANCIAL RISKS
Capital Adequacy
The concentration of active operations on the large customers
Quality of assets and off-balance sheet liabilities at risk
Profitability of operations
Resource base structure
Liquidity
Market risks

CORPORATE GOVERNANCE AND RISK MANAGEMENT
Corporate governance, business processes and information transparency
Ownership structure
Risk management
Strategy of development

+

Internal support-factors

(covering assets under stress)

Internal stress-factors

(Specialization and captivity, Regulation and supervision risks, Stress factors of active operations, Stress factors of the resource base, Stress factors of active-passive operations, etc.)

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STAND ALONE CREDIT RATING

+

External support-factors

(support from the owners, support from the government)

External stress-factors

(negative influence from the owners, Regulation and supervision risks, other external support factors)

=

FINAL CREDIT RATING NATIONAL SCALE

+

Adjustment for Country credit environment rating (CCE) in foreign currency.

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FINAL CREDIT RATING INTERNATIONAL SCALE

4. System of indicators

4.1 Section *"Market position"*

- History and reputation of the bank
- Specialization and captivity
- Geographic reach
- Competitive position

4.2 Section *"Financial risks"*

- Capital adequacy and capital quality
- The concentration of active operations on large customers
- Quality of assets and off-balance sheet liabilities at risk
- Profitability of operations
- Resource base structure
- Liquidity
- Market risks

4.3 Section *"Corporate governance and risk management"*

- Corporate governance, business processes and information transparency
- Ownership structure
- Risk management
- Strategy of development

5. Rating score adjustments

5.1 On the basis of the preliminary rating score obtained from analyses of the market position, financial risks, corporate governance and risk management, the rating score for **stand alone creditworthiness** shall be determined using the following formula:

***Rating score for stand alone creditworthiness** = preliminary rating score plus the sum of bonuses for the detected internal support-factors minus the sum of penalties for the detected internal stress-factors.*

5.2 Rating-Agentur Expert RA GmbH uses the following **internal stress-factors**[4]:

- Specialization and captivity
- Geographic reach
- Regulation and supervision risks[5]
- Stress factors of active operations
- Stress factors of the resource base
- Stress factors of active-passive operations
- Other internal stress factors

5.3 There is only one type of **internal support-factors**:

- Covering assets at risk (CAS)[6]

5.4 On the basis of the rating score for stand-alone creditworthiness obtained after adjustment for the effect of internal support-factors and internal stress-factors the final rating shall be determined using the following formula:

***Final rating score** = rating score for the stand alone creditworthiness plus the sum of bonuses for the external detected support-factors minus the sum of penalties for the detected external stress-factors.*

5.5 Rating-Agentur Expert RA GmbH uses the following **external stress-factors**[7]:

- Negative influence from the owners
- Regulation and supervision risks[8]
- Other external stress factors

5.6 Rating-Agentur Expert RA GmbH uses the following **external support-factors**:

- Support from the owners
- Support by the government authorities

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[4] The purpose of detecting stress factors is to take into account the internal factors whose effect in the current external conditions is so destructive (it may result in closing up the business, default, licence revocation), that even the maximum penalty ("-1") by the relevant component is insufficient (according to the expert opinion).

[5] Internal stress-factor of regulation and supervision risks includes violation of normative ratios, violation of law, insufficient provisioning, funds withdrawal, low level of equity.

[6] This support-factor can only be moderate.

[7] The purpose of detecting stress factors is to take into account the external factors, whose effect in the current external conditions is substantially harmful (it may result in closing up the business, default, licence revocation), that even the maximum penalty ("-1") by the relevant component is insufficient (according to the expert's opinion).

[8] External stress-factor of regulation and supervision risks includes planned changes in bank regulation (prescriptions, instructions by CBR, etc.) will significantly deteriorate the financial position of the Bank and the stability of its business model.

Annex 1. List of indicators and corresponding weights

Factor	Weight
I. Market position	**17,0%**
History and reputation	
Specialization and captivity	
Geographic reach	
Competitive position	
II. Financial risks	**70,0%**
Capital adequacy and capital quality	
The concentration of active operations on large customers	
Quality of assets and off-balance sheet liabilities at risk	
Profitability of operations	
Resource base structure	
Liquidity	
Market risks	
III. Corporate governance and risk management	**13,0%**
Corporate governance, business processes and information transparency	
Ownership structure	
Risk management	
Strategy of development	
IV. Internal Stress factors	
Specialization and captivity	
Regulation and supervision risks	
Stress factors of active operations	
Stress factors of the resource base	
Stress factors of active-passive operations	
Other internal stress factors	
V. Internal Support factors	
Covering assets under stress (CAS)	
TOTAL – STAND ALONE RATING	
VI. External Stress factors	
Negative influence from the co-owners	
Regulation and supervision risks	
Other external stress factors	
VII. External Support factors	
Support by owners	
Support by the government authorities	
TOTAL – FINAL CREDIT RATING	

*See Point 5 "Rating score adjustment" in the description above.