

INCREASED RISKS SUPPORT INTEREST IN INSURANCE AMID FUNDAMENTAL MARKET CHANGES

**ALEXEY BREDIKHIN**

Director, Financial Institutions Ratings Group

+7 (495) 139 04 83

alexey.bredikhin@acra-ratings.ru

ALLA BORISOVA

Associate Director, Financial Institutions Ratings Group

+7 (495) 139 04 80, ext. 153

alla.borisova@acra-ratings.ru

Media contact:

SVETLANA PANICHEVA

+7 (495) 139 04 80, ext. 169

svetlana.panicheva@acra-ratings.ru

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INSURANCE MARKET CHANGES HAVE AFFECTED ABOUT 50% OF INSURANCE RISKS**MODERATE GROWTH OF THE INSURANCE MARKET AND FUNDAMENTAL CHANGES IN HOW IT OPERATES**

- **Companies and the population have not turned their backs on insurance services** and the insurance market is not declining, even despite the sharp change to economic conditions. Over nine months of 2022, the total volume of insurance premiums fell by 2.1% compared to the same period in 2021. ACRA forecasts that total insurance premiums paid in 2022 will amount to just below RUB 1.8 tln, which is 0.6% lower than in 2021.
- **ACRA expects the insurance market to record moderate growth in 2023, approximately 12%.** This is largely due to an expected increase of insurance premiums in the credit insurance and non-credit life insurance segments, which will be supported by further lowering of the key rate and resumed growth of consumer lending. Regulatory actions of the Bank of Russia aimed at protecting consumers of insurance services may pose certain risks to these segments.
- **Motor insurance, private health insurance (PHI) and property insurance will record sluggish growth.** The projected performance of these types of insurance is under pressure from various factors, including ACRA's weak outlook for the car market, tough competition among insurers, foreign companies' exit from the Russian market, and Russian citizens leaving the country. Besides this, ACRA expects that the Bank of Russia will take a break from broadening the rate band and making other changes to the motor third-party liability (MTPL) insurance segment.
- **Legal restrictions on reinsurance operations entail fundamental changes to the conditions for the insurance market.** According to ACRA's estimates, these restrictions affect about 50% of insurance risks and almost 100% of catastrophic risks. The inaccessibility of traditional reinsurance centers has led to higher concentration in this segment, as well as to the strengthening of the role and responsibility of Russian National Reinsurance Company (ACRA rating **AAA (RU)**, **outlook Stable**), a subsidiary of the Bank of Russia.

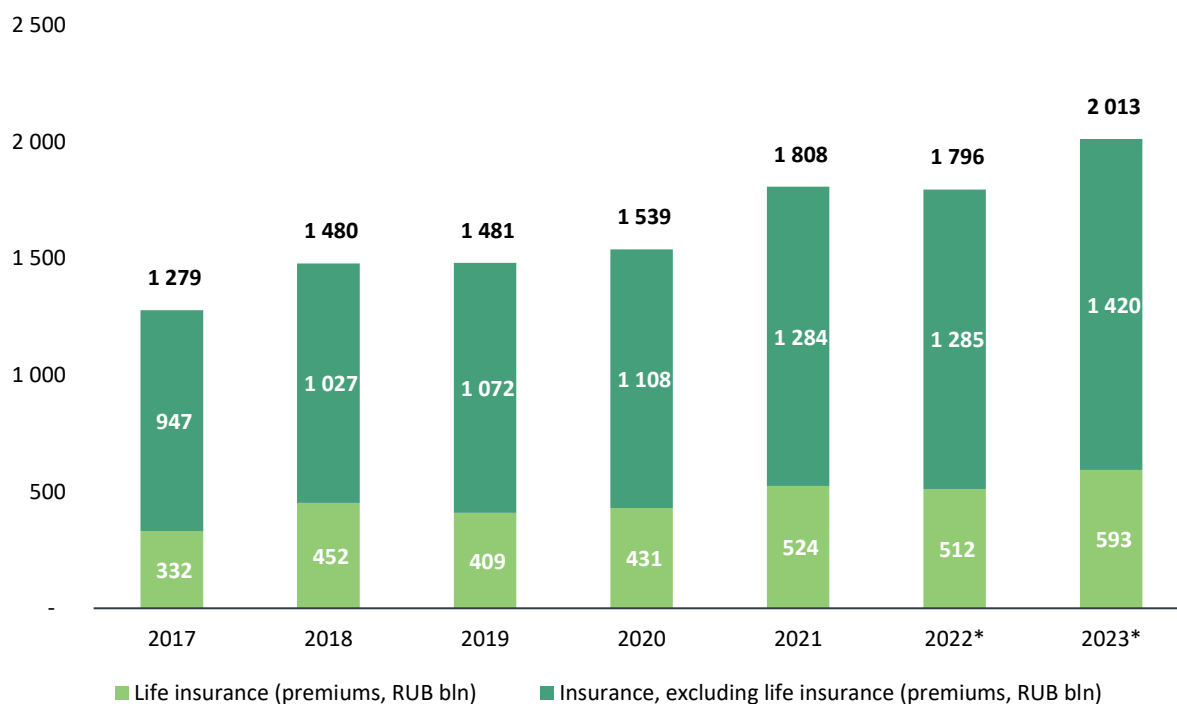
INSURANCE PREMIUMS ARE EXPECTED TO GROW BY 12% IN 2023

Sanctions introduced by certain countries and other restrictions imposed on Russian legal entities and individuals in 2022 significantly altered the conditions for Russia's economic development. The volume of imports of equipment, components and materials decreased significantly, which led to a general increase of prices. In order to curb inflation and stabilize the ruble exchange rate, the Bank of Russia sharply increased interest rates, which in turn led to a reduction of the bank loan segment. However, exports from Russia remained high and consequently, the ruble demonstrated a considerable strengthening. In response to the blocking of part of international assets owned by the state, Russian citizens and companies, the President and Government of the Russian Federation, as well as the Bank of Russia, took a number of measures, including internal currency exchange restrictions and a ban on transactions involving shares owned by foreign investors. The Russian stock market declined significantly on the back of these developments.

The insurance sector felt the full impact of the changes. In particular, the decline of banks' lending activities was accompanied by lower premiums for related types of insurance (mainly borrower life insurance and accident insurance). Higher interest rates diluted policyholders' interest in endowment life insurance (ELI) products. Against the backdrop of limited supplies of cars to the Russian market, there was a decrease in the number of auto insurance contracts concluded and an increase in the size of the average insurance premium. The Bank of Russia made substantial changes to regulatory requirements (new conditions for the functioning of the Russian insurance market will be covered in more detail later) to maintain the stability of the sector and reduce the risks of cross-border transactions. The most important thing is the fact that insurance continues to be one of the key elements of the risk management system, and its importance is growing in the current conditions. Companies and citizens have not stopped entering into insurance contracts, and the state is taking measures to support the insurance sector.

Total insurance premiums fell by 2.1% over nine months of 2022 compared to the same period last year. This was largely due to a considerable decline of insurance premiums in the credit insurance segment, which includes borrower life insurance and accident and illness insurance (premiums in the segment declined by 24%). Premiums also decreased in the segments of non-credit life insurance and other types of insurance — by 2.6% and 2.5%, respectively.

ACRA assumes that the downturn in the credit insurance segment will shrink to 17% by the end of 2022 amid the recovery of consumer lending. At the same time, the total amount of insurance premiums for the market as a whole will total RUB 1,797 bln, which is only 0.6% less than the previous year. According to ACRA's estimates, the market will be supported by MTPL, PHI, and insurance of other property of legal entities, with growth at 10.3%, 8.4%, and 8.4%, respectively.

Figure 1. Moderate growth of the insurance market is expected in 2023

* 2022 is an estimate (taking into account data for 9M), 2023 is a forecast.
Sources: Bank of Russia, ACRA

It is difficult to predict how the insurance market will perform in 2023 because there is a lack of detailed statistics, the publication of which was suspended by the Bank of Russia in order to reduce the risks of application of sanctions. In addition, the Russian economy in general and the insurance section in particular, continue to face a high level of uncertainty. The base case scenario used by ACRA to predict the dynamics of the insurance market in 2023 takes into account the following key assumptions:

- GDP in fixed prices falling by 2.8% by the end of 2023, consumer inflation slowing to 6.9% and the key rate being reduced to 6.5% (for further details, see ACRA's macroeconomic forecast [Eight Questions About Russia's Economy in 2023–2024](#) from December 1, 2022);
- Bank lending to consumers to grow by 13–18% compared to 2022;
- No additional regulatory restrictions on life insurance and credit insurance.

The outlook for 2023, based on the above assumptions, envisages moderate growth of insurance premiums (by 12%) next year. This is largely due to an expected 36% increase of premiums in the credit insurance segment. In addition, faster growth of premiums (by 14%) is predicted for non-credit life insurance. It seems that the performance of other segments will be less impressive.

ENDOWMENT LIFE INSURANCE HAS REACHED A 66% SHARE OF THE NON-CREDIT LIFE INSURANCE MARKET

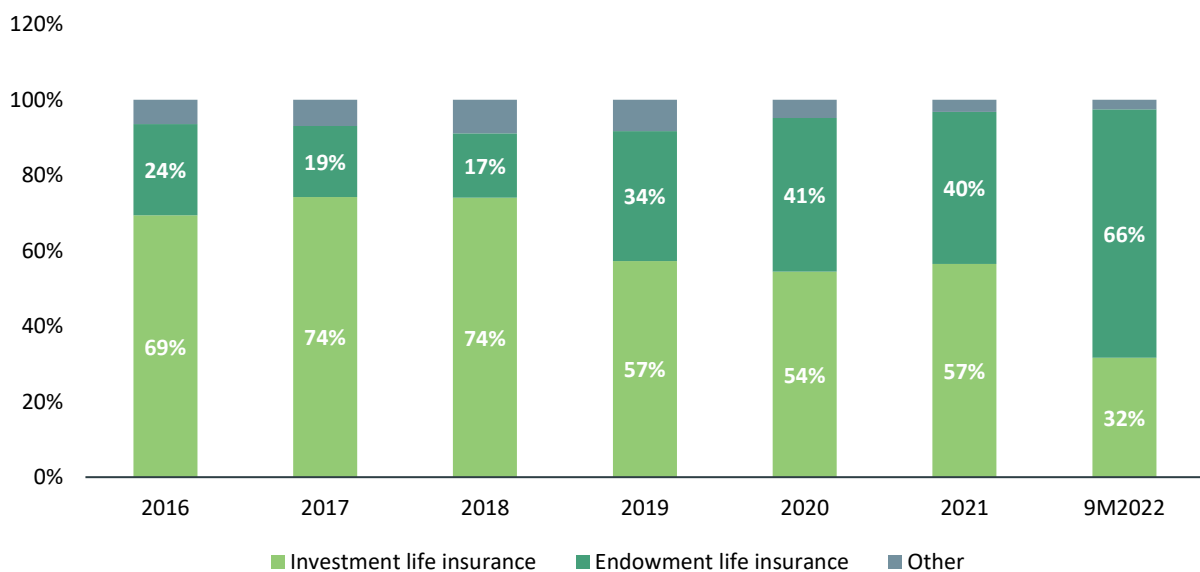
In the Russian market, life insurance products are divided into two categories in the terminology used in the Bank of Russia's analytical reviews: credit life insurance and non-credit life insurance. The first includes life insurance contracts for borrowers. The dynamics of premiums for them is mainly determined by the volume of retail lending and will be discussed in the next section. The second is dominated by endowment and

investment insurance products (ELI and ILI, respectively), which are more in line with the classical form of life insurance.

From 2012 to 2021, non-credit life insurance recorded rapid growth, with the sole exception of 2019. In 2016–2021, the volume of premiums in this segment grew by 2.2 times, while the sales performance of individual products was mixed. From 2012 to 2018, non-credit life insurance growth was driven mainly by the development of ILI, which in 2018 accounted for almost three-quarters of all premiums. However, the structure of this product, as well as the methods for selling it, have raised concerns among the regulator and analysts. Regulatory measures were applied at the end of 2018 to address violations committed when selling ILI policies, which resulted in a substantial decline of insurance premiums for this product and the segment as a whole.

The further performance of ILI premiums was driven by additional regulatory restrictions, as well as clients' disappointment with low levels of profitability under concluded contracts. In 2022, these factors were supplemented by the blocking of assets acquired under ILI contracts in the accounts of Western financial institutions. Under these conditions, a large share of income became inaccessible to policyholders. It also became impossible to enter into new contracts tied to foreign assets, which previously accounted for the lion's share of ILI premiums. As a result of these factors, in the nine months of 2022, investment life insurance experienced the largest reduction in premiums in its history, by 45%.

Figure 2. The share of investment life insurance is steadily declining



Sources: Bank of Russia, All Russian Insurance Association, ACRA

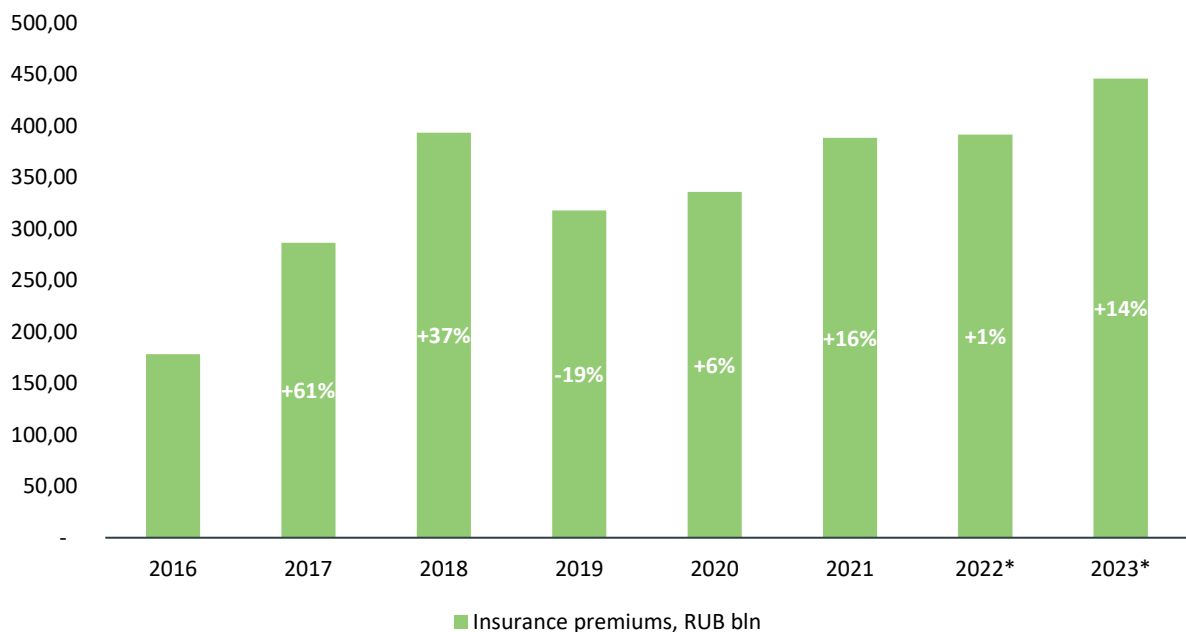
ACRA expects ILI's share in the structure of premiums for non-credit life insurance to continue declining in the future. It will be partially replaced by endowment insurance, as well as by a new insurance product — shared life insurance. Unlike ILI, endowment life insurance has lower but more stable growth. A much simpler product structure compared to ILI reduces the risks of dishonest sales practices and subsequent disappointment of customers (however, according to the Bank of Russia, ELI ranks second in terms of complaints about sales violations after ILI).

Shared life insurance is a comprehensive insurance product that combines insurance coverage and a potentially higher level of income compared to ELI, which is achieved by investing in open-end mutual funds. The prospects of this product in the Russian market are not entirely clear. On the one hand, similar insurance products are quite popular in other countries (in the EU they account for 20% of all life insurance

premiums), yet on the other hand, given the lack of capital protection and the negative experience of ILI policyholders, this product may be treated with suspicion in Russia.

Over nine months of 2022, premiums for non-credit life insurance contracts declined by 2.6% compared to the same period in 2021. The intra-annual performance of premiums is due to significant changes to the Bank of Russia's key rate. The sharp hike of the key rate in Q1 2022 led to corresponding growth of bank deposit interest rates, resulting in a marked decrease in demand for long-term life insurance products. A further reduction of the key rate contributed to the recovery of demand and the growth of premiums for non-credit life insurance. According to ACRA's estimates, the total amount of these premiums by the end of 2022 will be approximately the same as last year and stand at RUB 392 bln.

Figure 3. ACRA's base case scenario foresees further growth of non-credit life insurance premiums in 2023



* 2022 is an estimate (taking into account data for 9M), 2023 is a forecast.
Sources: Bank of Russia, ACRA

Gradual normalization of interest rates will help restore the volume of non-credit life insurance. The total volume of premiums in this segment in 2023, according to ACRA, may amount to about RUB 446 bln.

The main areas of development of the financial market in 2023–2025 suggested by the Bank of Russia indicate the important role that life insurance plays for the economy and determines incentives for its development. Primarily, plans have been laid to create a guarantee system for life insurance contracts that is similar to the system for bank deposits. In addition, the focus is on the development of shared life insurance. In ACRA's opinion, these measures will promote interest in life insurance, but a boom in this segment is not likely. The Agency believes that stable growth of life insurance can only be gradual — it will take place as Russia's citizens gain positive experience and conditions stabilize for long-term saving.

FOLLOWING GROWTH OF RETAIL INSURANCE, CREDIT INSURANCE PREMIUMS WILL GROW BY 36% IN 2023

In this research, credit insurance includes life insurance for borrowers and accident and illness insurance. Contracts with bank borrowers account for the vast majority of insurance premiums for the second of these insurance types, so the volume of insurance premiums for this type of insurance depends on the conditions in the retail lending market.

The sharp increase in the key rate in Q1 2022 and increased uncertainty in the economy led to a significant reduction in retail lending. For the first time in the last five or more years, in Q2 2022, the amount of bank loans issued to individuals decreased, as did credit insurance premiums — the total amount of premiums in H1 2022 was 35% lower than in the same period of 2021.

In Q3 2022, the growth of retail lending resumed, which was facilitated by the reduction of the key rate by the Bank of Russia and the gradual adaptation of the population and banks to the new economic realities. Credit insurance premiums also began to rise, almost reaching the level of 2021.

Figure 4: After a drop in H1 2022, credit insurance premiums may recover to last year's level

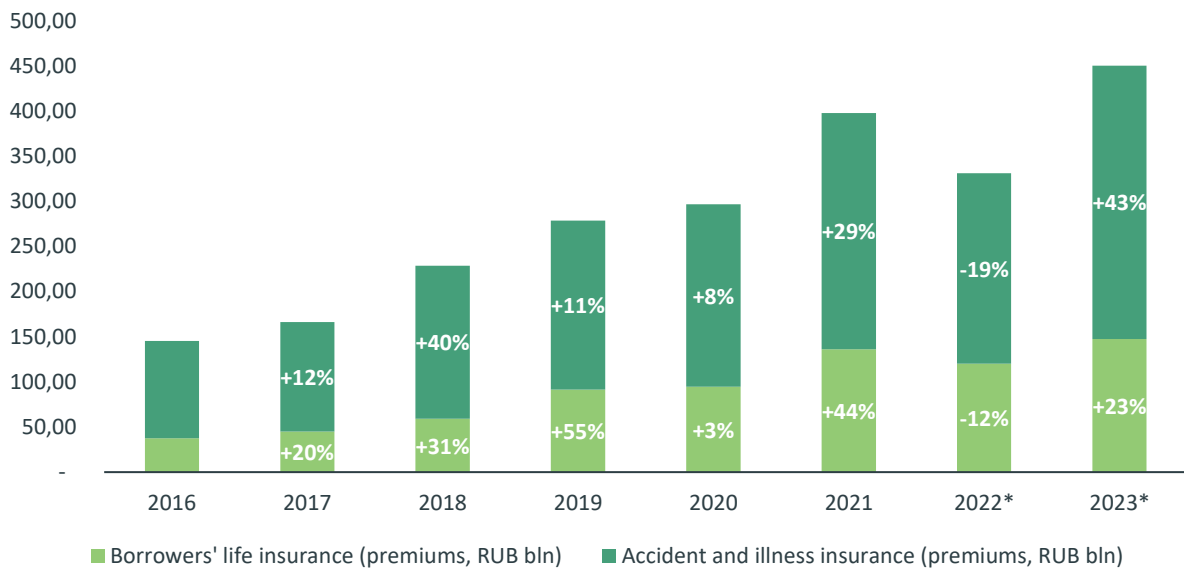


* Q4 2022 is a forecast.

Sources: statistics of the Bank of Russia, ACRA

The volume of credit insurance premiums in Q4 2022 is expected to be almost equal to the one that was observed in Q3 2022. The subsequent trend will depend on the growth rate of retail lending until the end of 2023 (about 13–18%, according to ACRA's forecast). Given the above, the Agency expects credit insurance premiums to grow significantly next year on the back of the low base of 2022.

Figure 5. In ACRA's base case scenario, credit insurance premiums will resume growing in 2023**



* 2022 is an estimate (taking into account data for 9M), 2023 is a forecast.

** Each percentage value shows annual increase in a relevant indicator.

Sources: Bank of Russia, ACRA

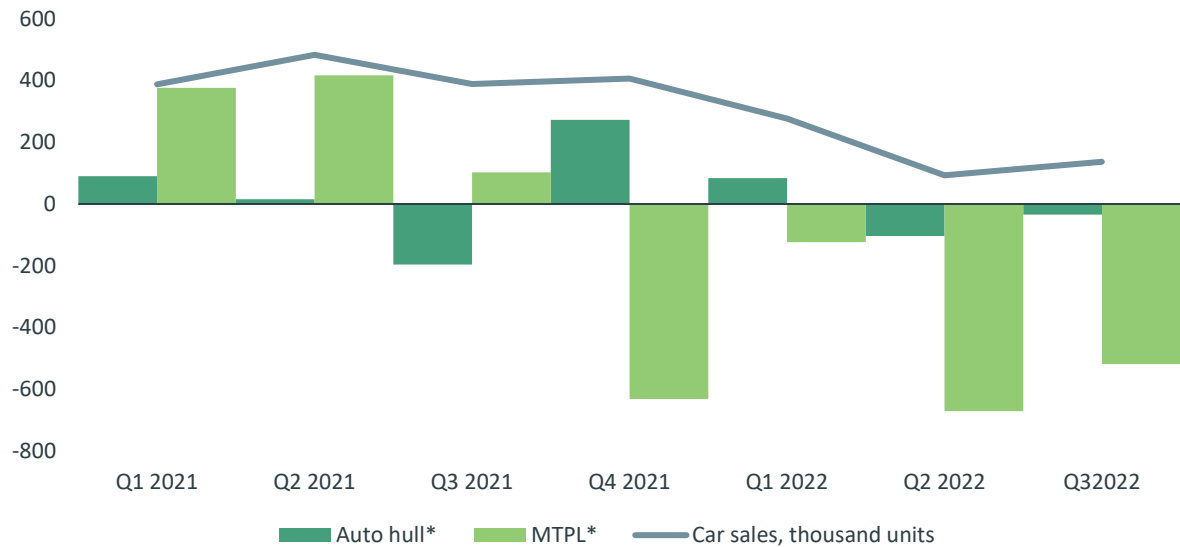
However, the Agency remains concerned that consumers do not value credit insurance and the risks of regulator intervention in this segment. The level of compensations paid from 2018 to 2021 did not exceed 10% of the amount of premiums, which is extremely low for a mass type of insurance. At the end of 9M 2022, the ratio of compensations to premiums in credit insurance was 17%, which is explained mainly by the low amount of premiums observed in this period. The level of compensations is expected to return to its previous values with the resumption of growth of credit insurance premiums.

The Bank of Russia's policy is aimed at increasing the customer value of insurance products. On October 1, 2022, minimum requirements for insurance coverage and information disclosure for life and health insurance of borrowers applying for a consumer or mortgage loan were introduced. Justifying the need for these measures, the Bank of Russia referred to the low level of compensations. It is currently difficult to assess to what extent these requirements will affect the level of credit insurance compensations and premiums.

AUTO INSURANCE PREMIUMS ARE NOT FALLING, DESPITE THE WEAK CAR MARKET

In 2022, the Russian automotive market faced the most significant drop in sales in its history. Due to the refusal of Western manufacturers to supply and manufacture cars in Russia, sales of new cars and light commercial vehicles decreased by 59.8% year-on-year in the first nine months of 2022, according to the Association of European Businesses.

Figure 6. Lower sales of new cars and light commercial vehicles resulted in a decline of the number of new motor insurance contracts



* Year-on-year variation in the number of new contracts (thousand contracts).
Sources: Association of European Businesses, the Bank of Russia, ACRA

The decline of car sales was accompanied by a reduction in the number of new contracts in two main auto insurance segments: motor hull insurance and MTPL. At the same time, the dynamics of auto hull insurance contracts turned out to be better than ACRA's expectations, which, in the Agency's opinion, can be explained by higher demand for insurance coverage from car owners facing limited supplies of new cars and spare parts, as well as a significant increase of their prices. The dynamics of the number of new MTPL contracts is more volatile: besides the volume of new car sales, it is also affected by a decrease of the number of sales of used cars due to limited possibilities for their replacement. Another significant factor influencing the number of new insurance contracts could be the expansion of the insurance rate band by the Bank of Russia. Against the backdrop of rising insurance prices, some classes of car owners could refuse to purchase an MTPL policy.

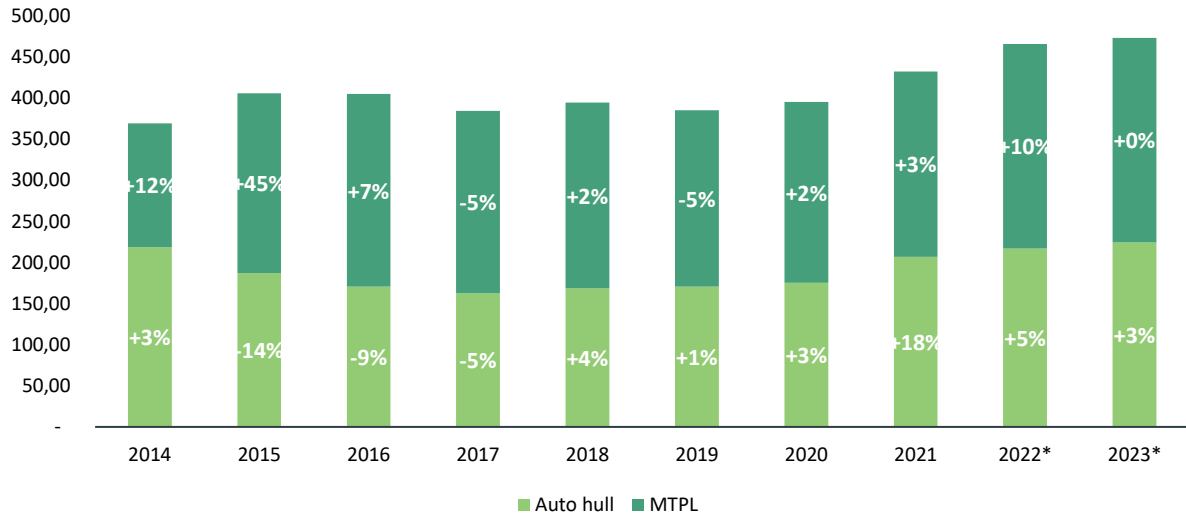
However, despite the decrease of the number of new contracts, the total amount of insurance premiums for auto hull insurance and MTPL for 9M 2022 increased by 8.5% year-on-year and 11.2% year-on-year, respectively. The main reason for this was a significant increase of the prices of cars and parts, following which the average insurance premium per one auto hull insurance contract increased by 10% (the increase was 16% for MTPL).

Further dynamics of motor hull insurance premiums will depend, in ACRA's opinion, on a number of factors. The Agency expects average car prices to stabilize after the recent surge, the market share of domestic cars to grow and the share of premium brands to shrink. At the end of 2022, according to ACRA's estimates, the total amount of auto hull insurance premiums will be about RUB 217 bln, which is 5% more than in 2021. ACRA believes that there will be a further decrease in the number of new contracts in 2023 (mainly due to the high base of Q1 2022). In addition, competition between auto insurers will curb a potential increase of rates. As a result, the total increase of auto hull insurance premiums will be about 3%, which, in absolute terms, is equal to RUB 224 bln.

In the MTPL segment, according to ACRA's forecast, insurance premiums will grow by 10% in 2022 to RUB 249 bln. In the Agency's opinion, the Bank of Russia will take a break from expanding the rate band in 2023 in order to analyze the consequences of

previous changes in this segment. Therefore, we can expect the average premium per policy to remain unchanged and the number of new contracts to stabilize (according to ACRA’s forecast, the total insurance premium in 2023 will remain at the level of 2022).

Figure 7. Auto insurance segment will show low growth rates in 2023

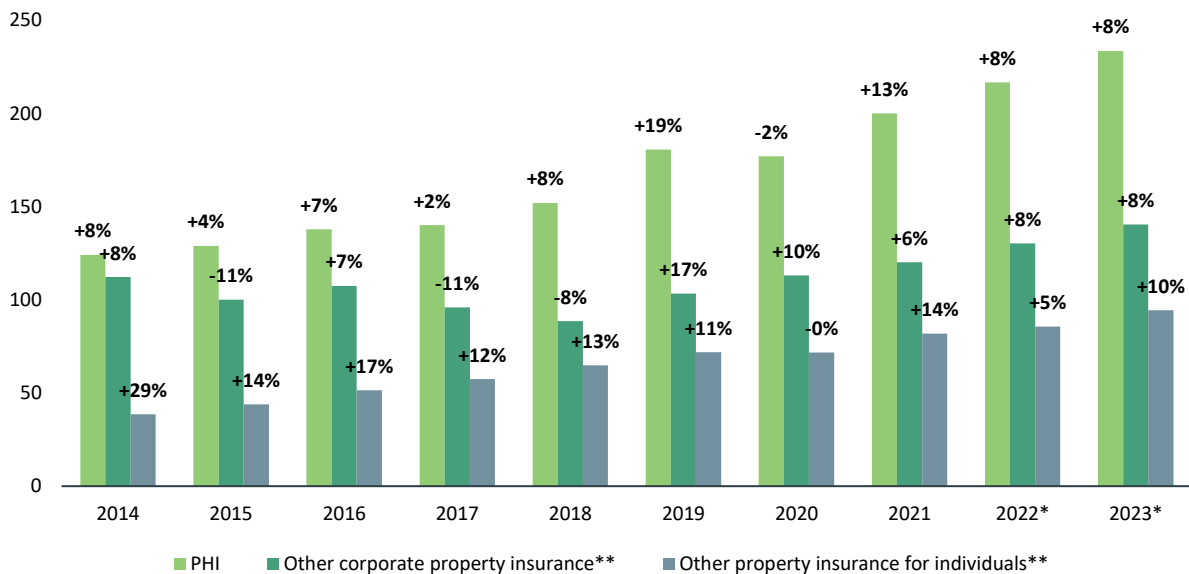


* 2022 is an estimate (taking into account data for 9M), 2023 is a forecast.
Sources: Bank of Russia, ACRA

PREMIUMS FOR PHI AND PROPERTY INSURANCE WILL GROW BY 8–10% IN 2023

The aggregate share of premiums for life insurance, credit insurance and auto insurance accounts for about two-thirds of the Russian insurance market. Among the remaining types of insurance, the largest segments are PHI, corporate property insurance, and property insurance for individuals.

Figure 8. PHI and the property insurance segments may demonstrate slight growth in 2023



2022 is an estimate (taking into account data for 9M), 2023 is a forecast.
** Excluding transportation vehicles, cargoes, and farm assets.
Sources: Bank of Russia, ACRA

In 9M 2022, the volume of PHI premiums increased by 8% year-on-year. Although ACRA still considers the PHI segment to be one of the most promising in the long term, it does not expect a significant increase in premiums in 2023 as a large number of foreign companies left Russia and some employees relocated to other countries.

In 2022, the steady growth of premiums in the segment of property insurance for individuals observed over the past ten years (with the exception of the pandemic year of 2020) slowed down. A negative impact could have been the decrease of disposable incomes and economic uncertainty. ACRA forecasts that growth rates will recover moderately in this segment in 2023.

The increase in premiums in the segment of other corporate property insurance, in the Agency's opinion, is mainly caused by inflation. Weak macroeconomic indicators forecast by ACRA for 2023 do not allow us to hope for an acceleration of the growth rates of premiums in this insurance segment next year.

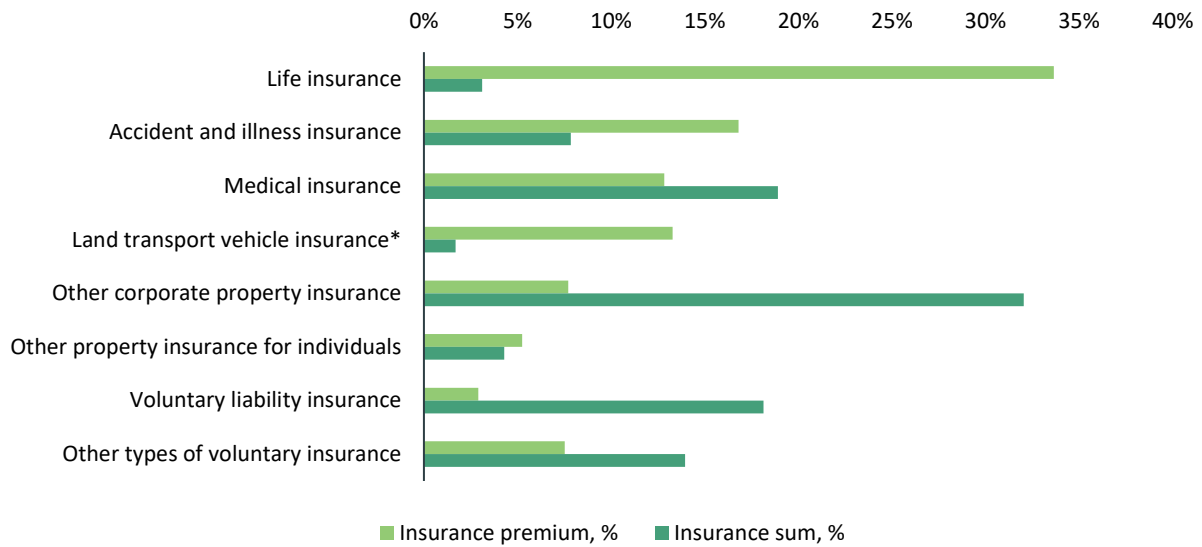
Similar considerations limit the dynamics of premiums forecast by the Agency in other types of insurance, which include various types of liability insurance, insurance of transport, agricultural, financial and business risks, and some others. In 9M 2022, premiums for these types of insurance decreased by 2.5% year-on-year. When forecasting the total premium for the segment, ACRA takes into account the overall potential of the Russian insurance market and forecasts premium growth in 2023 at the level of average market indicators (excluding credit insurance).

INSURANCE MARKET CHANGES HAVE AFFECTED ABOUT 50% OF INSURANCE RISKS

Until February 2022, the Russian insurance market was developing in the context of the global insurance market. The Bank of Russia generally adhered to the policy of introducing international reporting and regulatory standards. In accordance with WTO agreements, foreign insurers were allowed to open offices in Russia, while domestic companies followed global trends in business digitalization and ESG. There is reason to believe that these trends will continue even against the backdrop of sanctions and other restrictions imposed by Western countries. At the same time, one should especially note the fundamental changes that have taken place in reinsurance, the most important aspect of integration of the Russian and global markets.

The total amount of premiums transferred to the reinsurance segment in 2021 amounted to RUB 162 bln, of which RUB 117 bln was transferred outside the Russian Federation. These amounts do not seem significant compared to the total annual insurance premium of RUB 1,808 bln (9.0% and 6.5%, respectively), but in terms of insurance risk, the picture looks different.

Figure 9. Profiles of premiums and insurance risk for voluntary insurance (percent of the total amount) differ significantly



* Excluding railway transport.
Sources: Bank of Russia, ACRA

As of September 30, 2022, the total sum insured by existing contracts in the Russian insurance market was RUB 32,771 tln. At the same time, 98% of this amount falls on the compulsory third-party liability insurance of carriers for causing harm to the life, health, and property of passengers, and it corresponds to the amount of compensations in the event of the death of all passengers transported by all types of transport in a year (provided that all vehicles are fully occupied). The total sum insured by voluntary types of insurance is RUB 647 tln, of which 32% falls on insurance of other corporate property and 18% is voluntary liability insurance. For these types of insurance, the total insurance premium for 2021 was RUB 165 bln and the total premium transferred to reinsurance amounted to RUB 98 bln (59%), including RUB 69 bln transferred outside the Russian Federation (42%).

As a rule, large risks are transferred to reinsurance, for which the insurer's own capital is insufficient to cover. The overall reinsurance capacity of the Russian market in 2021 was relatively small, with the largest risks being transferred to international reinsurers. In March 2022, a legislative ban was introduced on transactions and transfer of funds to insurance companies and reinsurers located in unfriendly countries or controlled by persons from unfriendly countries. In other words, the existing international reinsurance tools turned out to be almost inaccessible to Russian insurance and reinsurance companies, since the main global reinsurers are located in unfriendly jurisdictions. The above calculations show that the changes affected about 50% of the total insurance risk and almost 100% of the largest risks of natural and man-made disasters.

In order to maintain the efficiency of the Russian insurance market, the Bank of Russia has significantly increased the reinsurance capacity of its subsidiary, Russian National Reinsurance Company (RNRC). In addition, the mandatory assignment amount was increased to 50%, which is the share of the reinsurance premium to be transferred to RNRC (in the event of a reinsurance contract); before that, this share was 10%. The actual share of the premium transferred to RNRC is much larger since alternative reinsurance capacities remain extremely limited.

In view of these changes, RNRC was forced to assume the vast majority of reinsurance contracts on the terms and conditions that were previously in force, which was an emergency and temporary measure. As a result, RNRC became the ultimate holder of a significant share of insurance risk in Russia, which, in ACRA's opinion, cannot be called a satisfactory state of affairs. Such a high concentration of insurance risk is undesirable, as it has a negative impact on capital adequacy. Even more important is the fact that RNRC has actually become the only pricing source for a very wide range of insurance risks, which requires relevant competencies and imposes a huge responsibility on the company in the absence of alternative pricing centers.

In this regard, the Bank of Russia proposed a number of initiatives to normalize the situation in the reinsurance segment. First, it is planned to develop cooperation with reinsurers from friendly jurisdictions. Second, the Bank of Russia is ready to support the creation of a large commercial reinsurer capable of taking on part of the insurance risks. Third, issuance of catastrophe bonds is being considered, which are securities whose holders assume the risks of catastrophic events. Another initiative is to position Russian insurers as reliable participants in the global insurance market. This will increase the diversification of risks accepted by Russian insurance and reinsurance companies, as well as provide insurance coverage for Russian risks abroad. The latter may be especially relevant in connection with the sanctions on the transportation of oil and petroleum products and other insurance restrictions. Given the unavailability of international credit ratings for Russian companies, the Bank of Russia supports the idea of international recognition of ratings assigned by Russian rating agencies.

The above initiatives are long-term and, in fact, mean fundamental changes in the Russian insurance market.

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

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