ACRA

Methodology for Credit Ratings Assignment to Regional and Municipal Authorities of the Russian Federation

August 7, 2020

Table of Contents

1 Scope of the Methodology

The Methodology for Assigning Credit Ratings to Regional and Municipal Authorities of the Analytical Credit Rating Agency (hereinafter, ACRA or Agency) in the Russian Federation is used to assess the creditworthiness of, and assign credit ratings to, the authorities of Russian Federation constituent entities and Russian Federation municipal entities (hereinafter, the rated entity). This methodology is used to assign credit ratings on ACRA's national rating scale for the Russian Federation.

The main criteria for applying this methodology is whether the rated entity has the right and ability to develop and implement its own budget and regulate budget relationships within its territory on the basis of powers shared by the higher-level authorities.

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 pursuant to the requirements of the Federal Law No. 222-FZ, of July 13, 2015, on the Activities of Credit Rating Agencies in the Russian Federation, Amending Section 76.1 of the Federal Law on the Central Bank of the Russian Federation (Bank of Russia), and Declaring Individual Provisions of Legislative Instruments of the Russian Federation to Be No Longer in Force, and in accordance with ACRA's internal documents, but no later than 182 days from the date the credit rating is assigned or last revised (par. 9 Art. 12 of Federal Law dated July 13, 2015 No. 222-FZ).

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

- more than three deviations from this methodology in a quarter, when performing rating actions;
- need to review based on the results of methodology application monitoring by the staff of the methodology group;
- identifying noncompliance with the requirements of the Federal Law No. 222-FZ, of July 13, 2015, on the Activities of Credit Rating Agencies in the Russian Federation, Amending Section 76.1 of the Federal Law on the Central Bank of the Russian Federation (Bank of Russia), and Declaring Individual Provisions of Legislative Instruments of the Russian Federation to Be No Longer in Force;
- immediate review of the methodology is requested by ACRA's Compliance and Internal Control Service.

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

When using this methodology, any deviation from it is documented and disclosed by ACRA on its official website at www.acra-ratings.ru when publishing a credit rating or a credit rating outlook, stating the reason for the deviation.

In case 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 it in accordance with the procedures established in ACRA. 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 at www.acra-ratings.ru.

If the proposed changes to this methodology are material (such as modification of individual factors or the wording of the methodology) and affect or can affect the existing credit ratings, ACRA will:

1) provide the Bank of Russia with information about the proposed changes in the methodology applied, stating the reasons for, and implications of, such changes, including the effect on credit ratings assigned in accordance with the methodology, and also post such information on its official website at www.acra-ratings.ru;
2) no later than within six months of the day of amending the methodology applied, assess whether it is necessary to review all the credit ratings assigned in accordance with this methodology;
3) no later than within six months of the day of amending the methodology applied, review credit ratings, if the need to review them is discovered based on the conducted assessment.

2 Sources of Information Used to Assign a Credit Rating

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

1) Sources of information used to assess budget metrics:
   - budget execution report of the rated entity;
   - the budget of the rated entity for the current year and the forecast period, as approved in a law (or a different regulatory legal instrument), together with any approved amendments to it.
2) Sources of information used to analyze the financial debt of the rated entity:
   - extracts from the debt book of the rated entity;
   - repayment schedule for the rated entity's debt.
3) Sources of information about the condition of the economy, industries, and businesses of the region, and about social metrics of the rated entity:
   - statistical reports of official bodies maintaining and collecting information;
   - information and analytics from departments (ministries) of socioeconomic development, finance, and other subject-matter units;
   - financial reporting statements of enterprises and business companies;
   - macroeconomic and industry forecasts by ACRA's internal units.

4) Questionnaires on ACRA's form, completed by the rated entity.
5) Information obtained during a rating meeting or further to a request by ACRA.
6) Contractual documentation on credit agreements.
7) Issuance documentation for issues of securities.
8) Other information available.

In the course of rating analysis, ACRA uses the latest public data available. Given delays in publication of certain official data, analyses may also include internal estimates by government offices or forecasts by ACRA's internal units.

Failing sufficient information to apply the methodology, ACRA refrains from assigning a credit rating. If ACRA identifies that there is no sufficient information to maintain the existing credit rating, ACRA withdraws the credit rating, with no further action taken in respect of the credit rating. The actions taken are reflected in a publication of information about the rating action in respect of the rated entity.

Sufficiency of information is defined by the possibility to conduct rating analysis in accordance with ACRA's general principles of rating process [1]. The main criteria of information sufficiency:

- the possibility is provided to perform quantitative and qualitative analysis of the financial and economic situation of the rated entity;
- the possibility is provided to analyze external and internal risk factors that can affect the creditworthiness of the rated entity;
- the possibility is provided for a comparative analysis against comparable entities to which credit ratings are assigned.

3 Default of a Regional or Municipal Authority

ACRA determines a default on the part of a regional or municipal authority in accordance with the Key Concepts Used by the Analytical Credit Rating Agency within the Scope of its Rating Activities.

In addition, in the context of this methodology, default is understood to mean failure to pay, within the stipulated time period and in the stipulated amount, the coupon, interest, or principal on a direct financial obligation or on an obligation subject to an unambiguous, irrevocable and unconditional guarantee from a regional or municipal authority.

If a regional or municipal authority announces the restructuring of financial obligations that are market-related in nature, ACRA generally gives it a credit rating of C(RU), which is indicative of a high probability of default. ACRA will maintain the issuer's rating at that level until the restructuring is completed. Upon completion of the restructuring, ACRA assigns the rated entity a credit rating within the D category or the SD category depending on the share of restructured debt.

The following is not considered default under this methodology:

[1] Described in the document entitled "Rating Actions Procedures and General Principles of the Rating Process of the Analytical Credit Rating Agency (Joint-Stock Company)."

- failure to perform obligations that are not market-related in nature (e.g., failure to perform obligations owed to the federal government under loans);
- restructuring of obligations (e.g., bank loans) following changes in the market situation;
- failure to perform obligations that are contested in court.

4 Main Principles of the Methodology and the Procedure for Assigning a Credit Rating

The creditworthiness of a regional or municipal authority is analyzed, and a credit rating assigned, on the basis of assessing the ability of the rated entity to ensure timely service and repayment of financial obligations proceeding from the given parameters: the economic basis, budget parameters, debt load, and available liquidity sources.

Given that debt repayment and servicing obligations are stated in the regulatory legal instrument concerning the rated entity's budget for the period in question, willful avoidance of repayment and servicing of debt actually constitutes a violation of the current legislation. When conducting an analysis, the Agency proceeds from the premise of an unfailing compliance by the rated entity with all legal regulatory provisions and, accordingly, does not consider a possibility of intentional failure by the rated entity to comply with its debt obligations as a rating factor.

In the course of assessing rating factors and assigning a credit rating, the Agency proceeds from the proposition that the submitted information at its disposal is true to facts and does not contain any willful distortions. In the course of rating analysis, the Agency reserves the right to interpret the information provided in accordance with its own assessment of socioeconomic development of the rated entity and its budget and debt metrics.

The creditworthiness of a regional or municipal authority is determined on a long-term basis. Economic cycle fluctuations (phases of industry cycles) and political events (governmental elections) are assessed from the perspective of their long-term effect on the creditworthiness of the rated entity regardless of the current political and economic landscape.

A credit rating is assigned based on the assessment of the following factors:

- assessment of the economic profile of the rated entity for its classification into one of five assessment categories on the basis of several economic development metrics;
- assessment of the financial profile of the rated entity for its classification into one of fifteen assessment categories on the basis of a scorecard.

ACRA proceeds from the proposition that the economic basis of a regional or municipal authority serves as the foundation for building the budget revenue basis and also affects the need for budget spending. Revenues and expenses of a subfederal or municipal entity are hereinafter understood to mean the budget metrics of the rated entity without taking into account lower-level budgets. Thus, the creditworthiness of the rated entity is dependent on the level of regional economic development.

A credit rating is assigned to the rated entity based on all possible combinations of assessment scores for the economic profile and the financial profile on a 17-step scale corresponding to ACRA's national scale (assessment range from AAA(RU) to CCC/C(RU), inclusive), as per table 1.

The rated entity's assessment score of 3 corresponds to a moderate level of economic development. This level encompasses the whole list of ratings on the national rating scale, except the highest (the AAA(RU) category) and the lowest (the CCC/C(RU) category). A rated entity with an economic profile assessment score higher than "three" (in case of the same assessment score for the financial profile) may be assigned a higher (including the highest) rating. A rated entity with an economic profile assessment score lower than "three" can receive a lower (including the lowest) rating.

The assessment of the **economic profile** is built on the averaged values[2] for the last four years. The forecast value of a current year's metric may be used in assessment. In that case, the assessment is built on averaged values for the three years that have passed and the value of the metric, as expected in the current year. The forecast value represents the value in the official forecast by the rated entity or the opinion of the Agency.

Depending on the date of analysis, the assessment of **financial profile** metrics is built on the averaged values for the last four or three years and the values expected in the current year and the year next following the current year. For certain metrics in the financial block, ACRA uses the current year's value or the worst of the values for the current year and the next year after the current year.

If the forecast values for financial profile metrics change considerably in the period next after the current one or if the budgeting process for the next year is completed (or is in the active stage), assessment may take into account the values for those years. The forecast value represents the value in the official forecast by the rated entity or the opinion of the Agency.

Where the value of a metric approaches one of the range boundaries or where the forecast values of the metric for the next three periods exceed the boundaries of ranges, assessment of economic and financial profile metrics may involve borderline-value adjustments (hereafter, BVAs).

[2] Data averaging technique is hereinafter understood to mean the weighted average, with the latest observations assigned a greater weight. The following combinations of weight are applied depending on whether it is necessary to use an averaged forecast period value in calculations:
$\frac{1}{15}X_{t-3}+\frac{2}{15}X_{t-2}+\frac{4}{15}X_{t-1}+\frac{4}{15}X_t+\frac{4}{15}X_{t+1}$ or $\frac{1}{15}X_{t-3}+\frac{2}{15}X_{t-2}+\frac{4}{15}X_{t-1}+\frac{8}{15}X_t$.

Table 1. Assigning a credit rating on the national scale

Financial profile assessment: / Economic profile assessment:	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
1	AAA(RU)	AAA(RU)/ AA+(RU)[3]	AA+(RU)	AA(RU)	AA−(RU)	A+(RU)	A(RU)	A−(RU)	BBB+(RU)	BBB(RU)	BBB−(RU)	BB+(RU)	BB(RU)	BB−(RU)	B+(RU)
2	AAA(RU)/ AA+(RU)	AAA(RU)/ AA+(RU)	AA(RU)	AA−(RU)	A+(RU)	A(RU)	A−(RU)	BBB+(RU)	BBB(RU)	BBB−(RU)	BB+(RU)	BB(RU)	BB−(RU)	B+(RU)	B(RU)
3	AA+(RU)	AA(RU)	AA−(RU)	A+(RU)	A(RU)	A−(RU)	BBB+(RU)	BBB(RU)	BBB−(RU)	BB+(RU)	BB(RU)	BB−(RU)	B+(RU)	B(RU)	B−(RU)
4	AA(RU)	AA−(RU)	A+(RU)	A(RU)	A−(RU)	BBB+(RU)	BBB(RU)	BBB−(RU)	BB+(RU)	BB(RU)	BB−(RU)	B+(RU)	B(RU)	B−(RU)	CCC/C(RU)
5	AA−(RU)	A+(RU)	A(RU)	A−(RU)	BBB+(RU)	BBB(RU)	BBB−(RU)	BB+(RU)	BB(RU)	BB−(RU)	B+(RU)	B(RU)	B−(RU)	CCC/C(RU)[4]	CCC/C(RU)

Source: ACRA

[3] When a combination of assessment scores allows the Agency to assign a credit rating of AAA(RU)/AA+(RU), the baseline assessment shall be AAA(RU), however, the Agency may assign a rating of AA+(RU) if there are additional arguments in favor of such a decision of the rating committee.

[4] When a combination of assessment scores allows the Agency to assign a credit rating in the range of CCC(RU)/C(RU), the baseline assessment shall be CCC(RU), however, the Agency may assign CC(RU) or C(RU) if there are additional arguments in favor of such a decision of the rating committee.

In the course of rating assessment, the Agency proceeds from the provisions of the current legislation (including the Constitution[5] and the Budget Code[6]) and does not take into account extraordinary assistance by the federal government, as it is usually only provided to regional authorities when force-majeure circumstances arise and is nonrecurrent. Regular intergovernmental remittances (subsidies, subventions, grants, or other intergovernmental transfers) are regulated by the current legislation and are taken into account when determining the credit rating. In addition, when assessing the creditworthiness of lower-level authorities (municipalities) making part of the rated entity, ACRA make take into account the budget condition of the higher-level authority and its creditworthiness.

The maximum value of a rated entity's credit rating on the national scale is limited to the level of sovereign credit rating on the national scale (AAA(RU), the credit rating of financial obligations of the Russian Federation Government). The basis for this is that the federal government is able to set the debt load, regulate crossborder financial and trade flows, distribute tax proceeds between different budget system levels, and control the activities of corporations and financial institutions connected with the government. Accordingly, the Government as the highest federal authority possesses the ability to redistribute fiscal and other financial flows for its benefit, thus ensuring an unfailing inflow of funds to the federal level of the budget system for timely servicing and repayment of debt.

The maximum value of the credit rating of a lower-level authority (municipality), on the contrary, is not limited to the value of the credit rating of the constituent entity, in whose territory it is situated. This is due to the actual inequality in the level of economic development of territories within the constituent entity and the associated differentiation in the creditworthiness of local authorities. The Agency admits the possibility of assigning a higher credit rating to municipal authorities than the credit rating of the constituent entity, on the condition that the municipal authority’s own (tax and nontax) revenues (hereinafter, TNRs) are independent of the regional authority.

If it is impossible to assess the economic profile of the municipal entity or some of its elements, the Agency may use the corresponding data for the constituent entity in whose territory that municipal entity is situated. If necessary, ACRA may adjust those data, relying on other economic metrics in accordance with subsection 5.1 of this methodology.

---

[5] Pursuant to paragraph 4 of section 5 of the Russian Constitution, all constituent entities of the Russian Federation have equal rights in their relationships with federal government authorities.

[6] According to section 102 of the Russian Federation Budget Code:

Para. 2. The Russian Federation is not liable for the debt obligations of Russian Federation constituent entities or municipal entities, unless such obligations have been guaranteed by the Russian Federation.

Para. 3. A Russian Federation constituent entity is not liable for the debt obligations of the Russian Federation, other Russian Federation constituent entities, or municipal entities, unless such obligations have been guaranteed by that Russian Federation constituent entity.

Para. 4. A municipal entity is not liable for the debt obligations of the Russian Federation, Russian Federation constituent entities, or other municipal entities, unless such obligations have been guaranteed by that municipal entity.

ACRA’s methodology does not provide for assessing separately the regional or municipal authority’s efficiency of administration. In the Agency’s opinion, budget profile assessment directly reflects the quality of budget administration.

5. Determining the Credit Rating

This section of the methodology describes the main rating analysis factors, the extent to which they affect the credit rating of a regional or municipal authority, and the method for taking them into account when determining the credit rating of a constituent entity.

5.1. Assessing the Economic Profile of the Rated Entity

5.1.a. General Principles of Economic Profile Assessment

In analyzing the economic profile of the rated entity under the Agency’s methodology, the main focus is on the following factors:

- absolute value of the gross regional product (hereinafter, the GRP);
- value of GRP per capita;
- salary of employees in organizations;
- subsistence level;
- unemployment rate;
- concentration of tax proceeds received by the budget system.

The economic profile of the rated entity is assessed in two steps. The first step involves assigning an **initial assessment score** for the economic profile, based on a combination of the assessment score for the GRP and the assessment score for salary adjusted for the subsistence level.

In the second step, the initial assessment: score is adjusted, if the rated entity’s economy features high unemployment or high tax base concentration around a certain industry, and then the **final assessment score** is assigned for the economic profile.

An exhaustive list of factors is used to calculate the metrics defining the rated entity’s economic profile. The Agency reserves the right to adjust the final profile assessment score by upgrading or downgrading it by no more than 1 point. The adjustment is possible where the dynamics of the metrics used are not, in the Agency’s opinion, fully reflective of the economic development situation of the rated entity. For example, a high GRP growth rate, natural population increase, and availability of quality transport or social infrastructure are mostly assessed positively, while stable and considerable population outflow or closing of large businesses, mostly negatively.

5.1.1. Initial Economic Profile Assessment

The initial assessment score is formed taking into account the assessment score for the GRP and the assessment score for salary adjusted for the subsistence level in accordance with table 2.

Table 2. Initial economic profile assessment

Salary: / GRP per capita:	1	2	3	4	5
1	1	1	2	3	3
2	1	2	2	3	4
3	2	2	3	3	4
4	3	3	3	4	4
5	3	4	4	4	5

Source: ACRA

5.1.2. Algorithm Used for GRP Assessment

One of the key measures of the rated entity's economic situation is the value of GRP and the value of GRP per capita. A high GRP per capita rate means the presence of a developed tax base and, generally, corporate profit tax proceeds, which provides the rated entity with considerably wider opportunities in financing budget expenditures[7]. The GRP is assessed in two steps.

In the first step, the averaged GRP per capita is adjusted for the averaged national value and assessed using a score from 1 to 5, with 1 being the best score and 5 being the worst score in accordance with table 3.

Table 3. Assessing the GRP per capita metric

Metric	Metric assessment score				
	5	4	3	2	1
Ratio of GRP per capita to average national GRP per capita	<40%	>=40% & <80%	>=80% & <120%	>=120% & <160%	>=160%

Source: ACRA

Where the value of the metric approaches one of the range boundaries or where the forecast values of the metric exceed the boundaries of ranges, analysts may apply BVAs at their discretion.

Example of making a BVA. With the following dynamics of the average weighted value of the GRP per capita, adjusted for the average national level: X_{t-3} = 78%; X_{t-2} = 75%; X_{t-1} = 76%; X_t= 81%, the assessment score for this metric in the year T will be 3. The analyst may make a BVA *to the metric, following which the metric assessment score in the year T will be 4 instead of 3.*

Ranging by the GRP and average per capita GRP metrics may be very different for various constituent entities. In view of extremely low (or, on the contrary, high) population numbers, the per capita GRP metric is mostly overvalued (or undervalued) and does not constitute a

[7] The budget proceeds of municipal entities generally include no profit tax. However, the initial assessment of economy of municipal entities is also based on assessing the GRP as a measure of development of the rated entity's economic base.

relevant basis to assess the economic situation. To take such situations into account in an adequate manner, the second step involves comparing the GRP decile[8] against the average per capita GRP decile to discover any material variances.

If the arithmetic difference between the assigned deciles is 5 or more, the variance between the GRP and the GRP per capita is considered material. In such case, it is recognized that the average per capita GRP metric does not adequately reflect the economic situation and is assigned a score of 3 regardless of the calculated value. Such adjustment may either improve or worsen the calculated value.

An example of adjusting the GRP per capita metric. The averaged GRP per capita metric for the rated entity is 400% of the average national level. The same year, the averaged absolute GRP value for the rated entity is 30% of the average national level. The per capita GRP falls within decile 10 of the distribution, and the absolute GRP, within decile 3 of the distribution. So long as the modulus of the difference between the deciles of both metrics is 7 units (exceeding the set threshold of 5 units), that rated entity's assessment score for the GRP per capita metric is adjusted and constitutes 3 (with a calculated assessment score of 1).

If a municipal entity is unable to provide information about the share of the GRP attributed to its territory, the per capita GRP of its region will be used as the base for that metric. If necessary, ACRA may adjust its calculated value, taking into account an analysis of the businesses situated within the municipal entity, the structure of products shipped, and the share of population attributed to the municipality.

5.1.3. Algorithm Used for Assessment of Salary

As a salary assessment metric, ACRA uses the average monthly nominal salary accrued for employees in organizations that is paid in the region in question. Salary is the source of one of the main types of the regions' own revenues, personal income tax (hereinafter, PIT), and a metric of the general standard of living in the constituent entity or the municipality.

PIT builds up the budget system's revenues and, consequently, creates—together with other types of revenue—a base for budget spending. The need to spend the funds varies from region to region, as the purchasing power of money is different in each region. This is partially visible in the volume of budget spending (where the cost of a product or service is lower, the relative budget spending is lower, and vice versa). To assess the population's standard of living, this metric is adjusted for the subsistence level[9]. The averaged metric is distributed into five categories, with 1 being the best score and 5 being the worst score in accordance with table 4.

BVAs may be used in assessment.

[8] A decile characterizes a distribution of values in a set, where nine decile values divide the set into ten equal parts. Any of those ten parts constitutes a ⅒ of the whole set. Thus, 10% of constituent entities with the lowest GRP or average per capita GRP metric are assigned decile 1, and 10% of constituent entities with the highest GRP or average per capita GRP metric are assigned decile 10.

[9] To obtain the annual value, quarter data are averaged using the simple average method.

Table 4. Assessing the metric of salary adjusted for the subsistence level

Metric	Metric assessment score				
	5	4	3	2	1
Value of the ratio of salary to the regional subsistence level	<2	>=2 & <2.5	>=2.5 & <3	>=3 & <3.5	>=3.5

Source: ACRA

5.1.4. Final Economic Profile Assessment

At this stage, the initial assessment is adjusted taking into account the penalties for economy concentration and unemployment rate in the rated entity's territory, determined in accordance with the algorithm described below. In this way, high concentration of tax proceeds from the public sector of the economy adjusts the initial economic profile assessment score by 1 point; high concentration of tax proceeds from the other sectors of the economy adjusts the initial economic profile assessment score by 1 point; and a high unemployment rate adjusts the initial assessment score by 1 point. The sum of penalty adjustments (for economy concentration and unemployment rate) may not exceed 1 point. The adjusted (final) assessment score may not exceed 5 points.

An example of assigning an economic profile assessment score. The initial economic profile assessment score was 3, with the averaged unemployment rate of 9%, and 45% of tax proceeds from one economy sector; no BVAs took place. The final economic profile assessment score is 4.

5.1.5. Algorithm Used to Assess the Level of Concentration in the Economy

Industry structure of the regional economy defines the risks affecting the creditworthiness of the regional or municipal authority. Predominance of only one sector or enterprise makes the budget of the rated entity dependent on the financial condition of a group of taxpayers or a single business. Such economic structure directly transfers any fluctuations in the markets for the dominant sector or the taxpayer enterprise onto the financial situation of the rated entity, the latter not being able to balance out the negative consequences.

Concentration is assessed based on data about the volume of taxes and charges making up the revenues of the rated entity. ACRA proceeds from the assumption that the aggregate of the regional part of profit tax, the regional part of PIT, property tax and transport tax coming from enterprises in one economy sector[10] allows for making a conclusion about exposure to tax base concentration. For these purposes, ACRA uses information published by the Federal Tax Service (hereinafter, the FTS) and/or data provided by the rated entity. When assessing constituent entities being the cities of federal importance, the aggregate of taxes and charges also includes local taxes. Municipal entities are assessed on the basis of data provided by the client.

[10] For certain codes in the All-Russian Classification of Types of Economic Activity, ACRA uses detailing down to more specific codes (subcodes).

Concentration is assessed based on an averaged metric (without using a forecast) in accordance with table 5.

Table 5. Assessing the tax base concentration metric

Metric	Penalty value	
	0	1
Rate of concentration around nonpublic sectors of economy	< 40%	>= 40%
Rate of concentration around the public sector of economy	< 25%	>= 25%

Source: ACRA

If it impossible to assess economy concentration based on the industry structure of tax proceeds, it may be excluded from analysis (with no penalty applied in such case) or replaced with an analysis of economy concentration based on available data (e.g., the structure of products shipped).

ACRA classifies certain economy sectors as public, i.e. financed with funds from budget system levels (e.g., public administration and military security; social security, education, activities in the field of health care and social services, activities in the field of culture, sports, leisure and entertainment management). With rare exceptions, these sectors do not contribute significantly to tax proceeds of the rated entity and are mostly financed with budget funds. ACRA believes that concentration around the public sector is usually a sign of generally weak economic development of the rated entity. Accordingly, concentration of tax proceeds from the public sector generally reduces the economic profile assessment score of the rated entity. In this context, high concentration will mean a level of concentration that is relatively low compared to the level of concentration around nonpublic sectors of economy.

Where the value of the metric approaches one of the range boundaries or where the forecast values of the metric exceed the boundaries of ranges, analysts may apply BVAs at their discretion.

5.1.6. Algorithm Used to Assess the Unemployment Rate

The unemployment metric is also a parameter affecting the creditworthiness of a regional authority, as high unemployment restricts tax revenues of the rated entity (to the extent of PIT) and increases the rated entity's expenditures (for contributions to the Compulsory Health Insurance Fund relating to compulsory health insurance for population). In its analysis, ACRA uses the average unemployment rate for population aged 15–72 years in Russian Federation constituent entities, as calculated by Rosstat (Russian Federal Public Statistics Service). The metric is assessed in accordance with table 6. For municipal entities that do not provide calculations for this metric, ACRA may use a reconstructed unemployment rate based on the ratio of recorded unemployment in the municipal entity to recorded unemployment in the constituent entity (or other estimates). Own estimates by the municipal entity may be also used.

Table 6. Assessing the unemployment metric

Metric	Penalty value	
	0	1
Unemployment rate	< 8%	>= 8%

Source: ACRA

5.2. Assessing the Financial Profile of the Rated Entity

5.2.a. General Principles of Financial Profile Assessment

In analyzing the financial profile of the rated entity under the Agency's methodology, the main focus is on the following blocks within the scorecard:

- budget profile assessment;
- debt profile assessment;
- liquidity profile assessment.

Each block comprises several metrics. The sum of weights of separate blocks in the scorecard is 100%. The sum of weights of the metrics within each block is 100% The final weights of scorecard metrics are calculated as the product of the weights of separate blocks by the weights of metrics within blocks.

The assessment scores of the metrics making up blocks, multiplied by their final weights, form the aggregate score, according to which the rated entity's financial profile is classified into one of the fifteen assessment categories.

The final number of metrics assessed within a scorecard is 12, including 3 qualitative metrics.

5.2.1. Algorithm Used for Budget Profile Assessment

To assess the metrics being part of the budget profile assessment, the following concepts are introduced:

Current revenues means the sum of TNRs (excluding the revenues from sale of assets, revenues from placement of budget funds, and revenues from provision of budget loans) and current transfers. Current revenues include a part of revenues that can be allocated to capital expenditures (e.g., own revenues of the road fund).

Current expenditures means the sum of expenditures for salaries, noncapital purchases, noncapital social security amounts, noncapital transfers, etc.

Current operations balance (hereinafter, COB) means the difference between the current revenues and the current expenditures. The COB represents free budget funds after current expenditures have been made. The COB is a resource available for capital expenditures, debt repayment, and other spending.

Capital revenues means revenues from sale of assets and transfers provided to the rated entity for capital purposes.

Capital expenditures means the sum of capital purchases, capital social security amounts, capital investments in assets being government or municipal property, capital transfers made by the rated entity, etc.

Interest income means income from budget funds deposited by the rated entity and budget loans granted by the rated entity.

Interest expense means expenses for servicing the state/municipal debt of the rated entity.

Modified free cash flow (hereinafter, MFCF) means the COB after accounting for interest revenue and expense, capital expenditures, and capital transfers received.

Modified budget deficit (hereinafter, MBD) means the region's need for debt financing after accounting for all revenues and expenditures, and after accounting for deficit financing sources not entailing changes in debt other than changing account balances.

Metrics used in assessing the rated entity's budget profile:

1) **Operational efficiency**. The averaged ratio of COB to current expenditures is used for assessment.

The metric can take either a positive or a negative value. A steadily negative ratio in an analyzed period is possible with a negative COB (the rated entity's current revenues are insufficient to cover current expenditures). The debt raised under such circumstances would be allocated to financing of current expenditures.

A steadily high positive ratio shows that not only current expenditures, but also capital expenditures can be financed with the current revenues of the rated entity.

A rated entity having high operational efficiency can obtain a higher credit rating compared to a rated entity having low operational efficiency or a negative ratio.

2) **Share of own budget revenues**. For assessment, ACRA uses the averaged ratio of TNR to total revenues (without taking into account subventions and other revenues allocated to finance the powers delegated to the rated entity).

The volume of TNR directly depends on the level of economic development of the constituent entity and the ability of regional authorities to regulate the current rates of regional taxes and fees to increase budget proceeds or decrease the tax burden to stimulate the economy of the region.

A rated entity with a budget where its own revenues prevail can obtain a higher credit rating compared to a rated entity whose budget largely depends on remittances form a higher budget system level.

3) **Assessing the flexibility of budget spending**. An assessment of budget spending flexibility involves quantitative and qualitative analysis.

Quantitative analysis: calculation of the share of capital expenditures in total budget expenditures excluding subventions. Capital expenditures of the budget system affect the economic and social development of the region (they help develop infrastructure), and they act, to some extent, as a reserve helping reduce budget expenditures if budget revenues go down. While reduction of capital expenditures is more probable than reduction of current expenditures, ACRA takes into account the fact that it may be technically impossible or unpractical to stop financing certain assets. Nevertheless, a high share of capital expenditures usually means greater possibilities to reduce them in favor of current expenditures. Based on the averaged value for four years, the share of capital expenditures is assessed on a scale of 1 to 5 in accordance with table 7.

Table 7. Quantitative analysis of budget spending flexibility

Metric	Metric assessment score				
	5	4	3	2	1
Share of capital expenditures in total budget expenditures excluding subventions	<4%	>=4% & <6%	>=6% & <11%	>=11% & <18%	>=18%

Source: ACRA

Qualitative analysis is conducted based on the need for, and independence in, financing capital expenditures. Depending on whether the flexibility of budget spending is considered low, moderately low, moderate, moderately high, or high, it is assigned a score from 5 to 1, respectively.

Budget spending flexibility is qualitatively assessed as *low*, where it is evident that most expenditures are made using transfers from a higher budget system level; if expenditures are made with own funds, but it is not evident whether it is possible to reduce them; if objective need for capital expenditures is considerably higher than the spending that takes place.

If the above characteristics are partially valid with respect to capital expenditures, then budget spending flexibility is qualitatively assessed as *moderately low*.

Budget spending flexibility is qualitatively assessed as *high*, where it is evident that most expenditures are made using own budget funds; or if it is evident that funds from a higher budget system level prevail because of the implementation of a federal-level program. Flexibility may be considered high despite a low share of capital expenditures if infrastructure quality does not require regular large-scale investments.

If the above characteristics are partially valid with respect to capital expenditures, then budget spending flexibility is qualitatively assessed as *moderately high*.

In other cases, budget spending flexibility is usually assessed qualitatively as *moderate*.

A rated entity with a high share of capital expenditures in budget spending, where expenditures are made with own budget funds, can obtain a higher credit rating compared to a rated entity with a low share of capital expenditures in budget spending despite a high need for them, or with a high share of capital expenditures in budget spending, where such expenditures, however, are made with special-purpose funds from a higher budget system level.

The final assessment of budget spending flexibility is made on the basis of the quantitative and qualitative assessment in accordance with table 8.

Table 8. Assessing the flexibility of budget spending

Quantitative assessment score: / Qualitative assessment score:	1	2	3	4	5
1	1	1	2	2	3
2	1	2	2	3	3
3	2	2	3	3	4
4	2	3	3	4	4
5	3	3	4	4	5

Source: ACRA

4) **Need for debt financing**. The metric is calculated as a ratio of MBD to current revenues. This metric is reflective of the need for borrowings relative to the amount of current revenues of the rated entity.

If debt load is low (if the level of debt load on the rated entity’s budget in accordance with this methodology is lower than 30%), the assessment score for the metric is adjusted by 2 or 1, irrespective of the calculated value. In case the balances on the rated entity's accounts exceed its monthly average expenses twofold or more the assessment score may be adjusted by 2 or 1, irrespective of the calculated value.

A rated entity with an insignificant need for increase in borrowings can obtain a higher credit rating compared to a rated entity having a substantial annual need for debt buildup.

5) **Qualitative assessment of the budget profile**. In addition to calculated quantitative characteristics, the budget profile is assessed qualitatively. Depending on whether the budget profile is considered weak, moderately weak, moderate, moderately strong, or strong, it is assigned a score from 5 to 1, respectively.

The budget profile is considered *weak* if, within the historically analyzed period (the three years lapsed):

- the rated entity revised its revenues frequently and considerably, or the actual performance of revenues is significantly different than the plan;
- there are recorded cases of budget legislation infringement, which may entail certain measures on the part of a higher-level regulator and are able to affect the credit profile of the rated entity;
- the rated entity does not relegate additional tax revenues to lower budget levels (not applicable if the lower budget system levels are known to have a low tax base);

- the volume of TNRs that have not been received because of providing regional tax benefits is large; the benefits provided are, in the Agency's opinion, inefficient.

If the above characteristics are partially valid, then the budget profile is considered *moderately weak*.

The budget profile is considered *strong* if, within the historically analyzed period:

- the rated entity does not revise its revenues frequently or considerably, or revision or nonperformance are due to events beyond the scope of influence of the rated entity;
- violations of budget legislation are insignificant or absent;
- the rated entity helps relegate additional tax revenues to lower budget levels;
- the volume of TNRs that have not been received because of providing regional tax benefits is not large; the benefits provided are, in the Agency's opinion, efficient.

If the above characteristics are partially valid, then the budget profile is considered *moderately strong*.

In other cases, the budget profile is usually considered *moderate*.

The assessment scores assigned to budget profile metrics are transformed into the final assessment score for the profile in question via a scorecard presented in table 9.

Table 9. Metrics being part of budget profile assessment

Metric	Metric assessment score				
	5	4	3	2	1
Operational efficiency **COB/current expenses**	<−10%	>=−10% & <0%	>=0% & <10%	>=10% & <20%	>=20%
Share of own budget revenues **TNRs/(own revenues − subventions)**	<20%	>=20% & <30%	>=30% & <60%	>=60% & <90%	>=90%
The assessment score for budget spending flexibility is determined in accordance with table 8.					
Need for debt financing **MBD/current revenues**	<−15%	>=−15% & <−5%	>=−5% & <0%	>=0% & <5%	>=5%
Qualitative assessment of the budget profile	Weak budget profile	Moderately weak budget profile	Moderate budget profile	Moderately strong budget profile	Strong budget profile

Source: ACRA

5.2.2. Algorithm Used for Debt Profile Assessment

Metrics used in assessing the rated entity's debt profile:

1) **Debt load level**. For assessment, ACRA uses the ratio of total debt at the end of the current year and this year's current revenues. To assess the ratio, ACRA may also use forecast data for the end of the year next after the current one. Debt is understood to mean the totality of debt obligations on the debt book of the rated entity: debt owed to financial organizations, debt owed to budget system levels, obligations and guarantees issued.

The amount of debt may include the obligations of enterprises in the public sector, if they are of social or systemic importance. When analyzing the obligations of such enterprises, ACRA assesses whether it is possible to finance the obligations using enterprises' own sources of liquidity. In some cases, the amount of guarantees may be adjusted (changed) depending on the terms and conditions of the guarantee. For assessment, ACRA uses the ratio as forecast for the end of the current year.

Example of choosing the metric when assessing debt load. The analysis is conducted in year T. It makes use of the forecast level of debt as the beginning of year T+1 and the forecast level of current revenues in year T.

All other conditions being equal, a rated entity with a low debt load may be assigned a higher credit rating compared to a rated entity with a higher debt load.

2) **Share of short-term debt**. To assess debt structure in terms of maturity, ACRA uses the ratio of short-term debt (expected to be repaid within 12 months) to total debt.

Based on the existing practices, many borrowers use bank loans with a maturity not exceeding three years, with the debt repayment schedule not being uniform. As a result, this metric can be volatile during the effective horizon of a rating. To improve the representativeness of the metric, the model uses the worst of the two debt structure assessment scores: the score of the current year and the score of the year next after the current one.

Short-term debt is that part of the debt formed by the beginning of the current/next year which is to be repaid within the current/next year. If there is any information about changes in the debt repayment schedule (including refinancing or repayment of the short-term part of the debt or creation of additional debt) after the last analysis debt, the Agency may assess the short-term part of the debt based on the latest information available.

Total debt means debt as at the beginning of the current year.

Example of choosing the metric when assessing short-term debt. The analysis is run in the year T. For the purposes of calculating the metric for the current year, short-term debt will be the amount of funds to be repaid within the year T as at the beginning of the year T. Total debt will be the amount of funds to be repaid as at the beginning of the year T. For the purposes of calculating the metric for the year T+1, short-term debt will be the debt to be repaid as at the beginning of the year T+1. Total debt will be the debt as forecast for the beginning of the year T.

All other conditions being equal, a rated entity with a low share of short-term debt may be assigned a higher credit rating compared to a rated entity with a higher share of short-term debt.

If debt load is low (if the level of debt load on the rated entity's budget in accordance with this methodology is lower than 30%), the assessment score for the metric is adjusted to 1, irrespective of the calculated value.

3) **Overall debt load level**. To calculate this metric, ACRA uses the ratio of averaged debt to the averaged GRP value. When assessing the metric for a municipal entity, the share of the GRP attributed to the municipal entity is assessed taking into account subsection 5.1.2 of this methodology.

All other conditions being equal, a rated entity with an overall debt load level exceeding 20% may obtain a lower credit rating compared to a rated entity with an overall debt load level that is less than the above value.

4) **Share of interest expense**. To assess coverage of interest payments, ACRA calculates the ratio of averaged debt service expenses (interest expenses) to averaged total budget expenditures (excluding subventions).

All other conditions being equal, a rated entity with a low share of interest expense may be assigned a higher credit rating compared to a rated entity with a high share of interest expenses.

5) **Qualitative assessment of the debt profile**. In addition to calculated quantitative characteristics, the debt profile is assessed qualitatively from 1 (best assessment score) to 5 (worst assessment score) and allocated to one of the following categories:

The debt profile is considered *very weak*, if the following characteristics are valid in most cases:

- the average weighted debt maturity (based on the obligation maturity year) is no more than two years;
- the average weighted rate on debt obligations is higher than the rate on loans issued to borrowers with a similar level of credit risk;
- debt structure mostly includes bank loans;
- the credit history is negative (there is information about public/nonpublic defaults, there is information about considerable accumulated payables overdue; there is information about forced debt restructuring—the depth of analysis in such case is usually five years);
- public sector enterprises have considerable debt obligations or a large volume of payables overdue;
- debt is primarily used to finance current expenditures (modified deficit is constantly negative);

- (for a constituent entity) municipal entities have a significant debt load and/or such load is not controlled by the rated entity;
- growth of debt load level is observed.

The debt profile is considered *weak*, if the above characteristics of a very weak debt profile are valid in most cases, but the reasons for the appearance of such characteristics have been remedied or active measures are being taken to remedy those reasons.

The debt profile is considered *very strong*, if the following characteristics are valid in most cases:

- the average weighted debt maturity (based on the obligation maturity year) is no less than 3.5 years;
- the average weighted rate on debt obligations is not higher than the rate on loans issued to borrowers with a similar level of credit risk;
- the debt structure is diversified by type of debt obligations and by creditor;
- the credit history is positive (there is no information about public/nonpublic defaults, there is no information about payables overdue (or the payables are insignificant; or the payables have been accumulated through no fault of the payer); there is no information about forced debt restructuring);
- public sector enterprises have no significant debt obligations or there are no grounds for a conclusion that there is a need for budget support for those enterprises; those enterprises have no/insignificant payables overdue;
- debt is primarily used to finance capital expenditures (modified deficit is predominantly positive);
- reduction of debt load is observed;
- (for a constituent entity) municipal entities have a low debt load that is controlled by regional authorities;

The debt profile is considered *strong*, if the characteristics of a very strong debt profile are valid in most cases, but there are grounds to expect changes in the debt policy of the rated entity, or the debt policy has been changing over the course of several years.

In other cases, the debt profile is usually considered *moderate*.

Refinancing of the principal is not considered to be a negative credit rating factor. The main criterion of expediency of refinancing is the effect from the expenditures financed with the borrowings. If borrowed financing contributes to growth of the tax base (economic development costs) or reduction of budget expenditures (improving budget sphere efficiency or infrastructure efficiency), debt refinancing is considered admissible and does not affect the credit rating assessment score. Refinancing of the principal is also admissible, if the cost of servicing the principal is reduced.

The assessment scores assigned to debt profile metrics are transformed into the final assessment score for the profile in question via a scorecard presented in table 10.

Table 10. Metrics being part of debt profile assessment

Metric	Metric assessment score				
	5	4	3	2	1
Debt load level **debt/current revenues**	>=100%	>=90% & <100%	>=55% & <90%	>=30% & <55%	<30%
Share of short-term debt **short-term debt/total debt**	>=40%	X	>=20% & <40%	X	<20%
Overall debt load level **total debt/GRP**	>=20%	X	X	X	<20%
Share of interest expense **debt service expenses/(total budget expenses – subventions)**	>=8%	X	>=4% & <8%	X	<4%
Qualitative assessment of the debt profile	Very weak debt profile	Weak debt profile	Moderate debt profile	Strong debt profile	Very strong debt profile

Source: ACRA

5.2.3. Algorithm Used for Liquidity Profile Assessment

1) **Liquidity ratio**. To assess the level of liquidity, ACRA calculates the ratio of liquidity sources to this year’s need for liquidity.

Liquidity sources include account balances, unused credit lines for a term exceeding 12 months and the size of MFCF (if positive). Need for liquidity includes the size of short-term debt and the size of MFCF (if negative).

Example of choosing the metrics to assess the level of liquidity. If liquidity assessment takes place in the year T, liquidity sources include account balances, funds in deposits and undrawn lines as at the 1st day of the year T, need for liquidity includes the debt to be repaid in the year T. MFCF used for calculations is the forecast MFCF for the end of the year T.

All other conditions being equal, a rated entity with a high liquidity ratio may be assigned a higher credit rating compared to a rated entity with a low ratio. If the rated entity makes deposits on a regular basis during the year, its liquidity ratio assessment score may be adjusted up to 1, irrespective of the calculated value.

2) **Qualitative liquidity profile assessment**. In addition to the calculated quantitative characteristics, the liquidity profile is considered weak, moderately weak, moderate, moderately strong, or strong and assigned a score from 5 to 1, respectively.

The liquidity profile is considered *weak*, if:

- a considerable number of credit line procurement cases are completed with the status of "procurement not consummated" because no participants were involved, and the analyst has no clear understanding of the reasons for such an outcome;
- the rated entity borrows short-term loans regularly (e.g., loans issued by the Federal Treasury Administration) to finance cash gaps;
- even taking into account short-term liquidity sources, the rated entity faces the problem of refinancing its obligations / performing its expenditures;
- payables have been growing over the last 12 months and/or are growing in amounts comparable with ⅓ of monthly budget expenditures or in greater amounts.

If the above characteristics are partially valid, then the liquidity profile is considered *moderately weak*.

The liquidity profile is considered *strong*, if:

- auctions for the procurement of credit lines are declared consummated or there is a clear understanding why they will not be consummated, and remedying those reasons will not entail deterioration of the rated entity's position;
- the rated entity rarely needs to rely on the loans from the Federal Treasury Administration or revolving credit lines to finance cash gaps, and the loans borrowed from the Federal Treasury Administration are applied to cut interest expense;
- the rated entity does not build up payables because of the absence of funds required to pay its suppliers.

If the above characteristics are partially valid, then the liquidity profile is considered *moderately strong*.

In other cases, the liquidity profile is usually considered *moderate*.

The assessment scores assigned to liquidity profile metrics are transformed into the final assessment score for the profile in question via a scorecard presented in table 11.

Table 11. Liquidity profile assessment

Metric	Metric assessment score				
	5	4	3	2	1
Liquidity ratio **liquidity sources/need for liquidity**	<0.2	>=0.2 & <0.6	>=0.6 & <1.0	>=1.0 & <1.4	>=1.4
Qualitative liquidity profile assessment	Weak liquidity profile	Moderately weak liquidity profile	Moderate liquidity profile	Moderately strong liquidity profile	Strong liquidity profile

Source: ACRA

If the rated entity makes deposits, the liquidity profile may obtain a qualitative assessment score of 1 or 2 taking into account their volumes and maturities.

5.2.4. Final Assessment of the Financial Profile

The final assessment of the financial profile takes place in two steps. The first step involves forming the aggregate score for the financial profile of the rated entity in accordance with table 12.

Table 12. Weights of metrics in the scorecard

Blocks of metrics	Metrics	Weights of blocks	Weights of metrics	Final weights of metrics
Budget profile	Operational efficiency	50%	30%	15%
	Share of own revenues		30%	15%
	Flexibility of budget spending		10%	5%
	Need for debt financing		10%	5%
	Qualitative assessment		20%	10%
Debt profile	Debt load level	25%	40%	10%
	Share of short-term debt		8%	2%
	Overall debt load level		8%	2%
	Coverage ratio		8%	2%
	Qualitative assessment		36%	9%
Liquidity profile	Liquidity ratio	25%	40%	10%
	Qualitative assessment score		60%	15%

Source: ACRA

The second step involves assessing the financial profile of the rated entity based on the place of the aggregate score in one of the fifteen assessment categories in accordance with table 13.

Table 13. Assigning the assessment score for the financial profile

Financial profile assessment score	Score range
1	< 1.25
2	>= 1.25 & < 1.50
3	>= 1.50 & < 1.75
4	>= 1.75 & < 2.01
5	>= 2.01 & < 2.27
6	>= 2.27 & < 2.53
7	>= 2.53 & < 2.80
8	>= 2.80 & < 3.07
9	>= 3.07 & < 3.34
10	>= 3.34 & < 3.61
11	>= 3.61 & < 3.88
12	>= 3.88 & < 4.15
13	>= 4.15 & < 4.43
14	>= 4.43 & < 4.71
15	>=4.71

Source: ACRA

An example of assigning a financial profile assessment score. The budget profile assessment score is 1.70; the debt profile assessment score is 1.20; the liquidity profile assessment score is 1.00. The aggregate score for the financial profile is calculated as 1.70 × 0.50 + 1.20 × 0.25 + 1.00 × 0.25 = 1.40. Thus, the financial profile is classified into the category corresponding to a score of 2 (1.25 ≤ 1.40 < 1.50).

6. Assigning a Credit Rating and a Credit Rating Outlook

The final credit rating on the national scale is assigned on the basis of the assessment scores obtained for the economic profile and the financial profile. The possible combinations of the profile assessment scores form a rating in accordance with table 1.

To determine the final credit rating on the national scale, ACRA may run a comparative analysis on a group of comparable rated entities. Rated entities are comparable if they are public-law entities at the same budget system level, possessing similar characteristics in terms of economic development (e.g., the dominant sector) and a similar budget structure.

A comparative analysis takes place both in respect of quantitative and qualitative characteristics to ensure the comparability of ratings and consistency in application of the methodology. The credit rating of the rated entity may be changed by no more than one notch as a result of comparative analysis.

The rated entity’s advantage before comparable rated entities (e.g., an exceptionally low debt load level or steadily positive dynamics of a factor whose assessment score has been maintained at the highest level for a long time) may result in an increase of its credit rating.

Presence of material shortcomings (e.g., inconsistent debt policy, dependence of budget revenues on a volatile economy sector) may result in a decrease of the rated entity’s credit rating. Credit rating is increased or decreased following a comparative analysis irrespective of the assessment scores of other factors.

When determining the credit rating of a regional or municipal authority on the national scale, no support methodologies are used and no relationships with the government are analyzed. ACRA proceeds from the presumption of equality of all constituent entities of the Russian Federation, as entrenched in the legislative instruments of the Russian Federation. ACRA does not apply any adjustments proposed by methodologies analyzing relationship between rated entities and the government.

When calculating financial metrics and ratios to be used in the rating model, ACRA is not only guided by historical metrics, but also by its own forecast of changes in those metrics.

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

Pursuant to the Procedure for Disclosure of Credit Ratings and Other Related Communications of the Analytical Credit Rating Agency (Joint-Stock Company), disclosure of the following information is mandatory when ACRA performs rating actions:

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

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

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

A change in the credit rating outlook is typically associated with ACRA’s internal forecasts of possible changes in quantitative and qualitative factors and key internal and external risk factors that affect the standalone creditworthiness assessment score. At the same time, the credit rating outlook also depends on changes in relations with higher budget system levels, as anticipated by the Agency. The operating environment and economy trends are also taken into account when determining the credit rating outlook.

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

7. Credit Ratings of Debt Instruments of Rated Entities

Pursuant to the Methodology for Assigning Credit Ratings to Individual Issues of Financial Instruments on the National Scale for the Russian Federation, bond issues of regional and municipal authorities possess the status of senior unsecured debt whose credit rating corresponds to the credit rating of the rated entity.

The current budget legislation does not provide for security over obligations of regional and municipal authorities. Hence, no credit rating adjustment is made to account for a better protection of secured creditors.

If a higher-level budget guarantee is in place, the rating of the debt obligation may be raised to match the credt rating level of the guarantor.

Disclaimer

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 bn. 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.