

## **Request for comments**

*Bank methodological cycle – July 2017*

Rating-Agentur Expert RA GmbH invites market participants to provide comments on the proposed changes in the Methodology of assigning ratings to banks (hereinafter – the Methodology). During the methodological committee meeting held on the 19<sup>th</sup> of July 2017 a package of changes in the Methodology of assigning ratings to banks was discussed and approved by the independent members of the Advisory board which will lead to the following changes in the short version of the methodology:

- 1) **We propose to change the algorithm for the calculation of the factor called “Geographic reach”. Instead of using “the investment rating of the regions where the bank’s branches operate” as one of the criteria for this factor, we propose to use “country credit environment (CCE) rating of the countries where the bank operates”.**

*Rationale:*

Taking into account the fact, that the banks operating in different regions but within one country are still exposed to the specific country’s risks (such as, changes in the regulation, macroeconomic shocks, etc.), we moved our geographic concentration assessment from the “regions-based approach” to the “country-based approach”, keeping exemptions for big countries with federal system and high level of economic development disproportions among the regions. In the new algorithm we propose to use country credit environment (CCE) ratings, as a measure of the operating environment risks of specific country (the full description of CCE ratings is provided in the current version of Methodology of assigning sovereign government credit ratings and country credit environment ratings).

- 2) **We propose to delete the following example, mentioned in the description of factor “Competitive position”: “e.g. those who have a strategic importance to the defense industry and the security of Russia”.**

*Rationale:*

In order to make our methodology fully applicable for banks regardless its jurisdiction and geographical location, we decided to modify/ eliminate criteria applicable only for Russian banks, as well as delete all Russian-specific adjustments, sources of information as well as examples. The latest is applicable for the mentioned example for the factor “Competitive position”.

- 3) **We propose to change part of the description of the factor called “Provision policy”. Instead of the following description “It can be positively evaluated if a bank does not decrease the actual reserves by using collateral from I and II quality category when it is available”, we propose the updated version: “It can be positively evaluated if a bank does not decrease the actual reserves by using collateral when it is available”.**

*Rationale:*

Following by the purpose mentioned in the point №2 of this document, we decided to eliminate the reference to the collateral quality categories, that are described in the Central Bank of Russia regulation and do not have analogues in all countries.

- 4) **We propose to change part of the description of the factor called “Quality of assets and contingent liabilities at risk”. Instead of the following description “High quality of a credit portfolio (low level of overdue and rescheduled loans, as well as low level of loans having low quality category) has a positive impact on the bank’s rating”, we propose the updated version: “High quality of a credit portfolio (low level of overdue and rescheduled loans) has a positive impact on the bank’s rating”.**

Rationale:

Following by the purpose mentioned in the point №2 of this document, we decided to eliminate the reference to the loan quality categories, that are described in the Central Bank of Russia regulation and do not have analogues in all countries.

- 5) **We propose to change one of the criteria for the assessment of the factor “Profitability of operations”. Instead of the mentioning that “Profitability indicators are calculated following both Russian (RAS) and IFRS standards” we propose to include the following: “Profitability indicators are calculated following IFRS standards (or, if not available, local GAAP standards)”.**

Rationale:

Following by the purpose mentioned in the point №2 of this document, we decided to use only one set of indicators, instead of assessing profitability for both IFRS and local GAAP financial statements. The proposed approach set a rule that all profitability indicators shall be calculated on the IFRS quarterly reports. However, the Agency can use local GAAP standards with some adjustments, if IFRS reports are not available or do not cover the necessary time periods.

- 6) **We propose to change the description of the factor called “Ownership structure”. Instead of the mentioning that “Stable transparent ownership structure of a bank, absence of offshores in the chain of ownership and a small number of connected companies until the ultimate controlling shareholder are positively evaluated” we propose to include the following: “Stable transparent ownership structure of a bank, absence of companies registered in “tax havens” and (or) in countries with relaxed information disclosure requirements in the chain of ownership and a small number of connected companies until the ultimate controlling shareholder are positively evaluated”.**

Rationale:

Following by the conservative approach in the rating assessment, we decided to replace the presence offshore jurisdictions by wider conditions in our list of negative characteristics for the assessment of the bank’s ownership structure. In particular, the bank not having the offshore companies in its ownership structure, but having the entities from the countries with relaxed information disclosure requirements, is still heavily exposed to reputational and regulation risks as well as has low level of transparency.

- 7) **We propose to eliminate one internal support-factor called “safety buffer”.**

Rationale:

Support-factor for “safety buffer” was given only to banks having simultaneously enough capital to withstand the materialization of large credit risks and enough “liquidity” to

withstand the withdrawal of a substantial amount of funds. Taking into account that this support-factor included the indicators used in other sections of the methodology (capital adequacy, sensitivity of the capital to credit risks realization, liquidity) and following by the Agency's conservative approach, we decided to eliminate this support-factor in order to reduce the cases of indicators double counting in our methodology.

- 8) **We propose to introduce several changes regarding the structure of the document and its formatting in order to comply with the Agency's standard structure and format of the methodologies disclosed on the Agency's web-site. In particular, these changes include (1) adding potential users of the methodology; (2) deleting repeated definitions or definitions mentioned in other documents; (3) adding the rules of different sources of information using; (4) summarizing the full structure of the analysis in the first paragraph of the section "Structure of the rating analysis"; (5) introducing the term "preliminary credit rating" instead of "credit rating according to the national scale"; (6) standardization of the document's formatting;**

*Rationale:*

From this methodological review cycle forward, we are starting the process of the standardization of the format and structure of the methodologies disclosed on the Agency's web-site. This led to several changes in the methodology of assigning ratings to banks described above.

- 9) **Based on the changes mentioned above we propose to change the logic scheme of the methodology and the list of factors in the annex 1 in order to make the methodology consistent;**

*Rationale:*

The changes proposed in the previous sections of this document led to the changes in logic scheme of the methodology and the list of factors in the annex 1.

Please submit your comments to: [info@raexpert.eu](mailto:info@raexpert.eu) or [compliance@raexpert.eu](mailto:compliance@raexpert.eu) by the 19<sup>th</sup> of August 2017. Your response to this consultation will be published unless confidentiality is requested.