Creditreform Rating AG Rating Methodology

Government-Related Companies

Methodology for Performing Corporate Ratings for the Sub-Group of Government-Related Companies

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Version 1.1

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This document (version 1.1) is an update, which contains no material changes to the previous version. Aside editorial changes, the definitions have been extended, clarifications regarding the application logic and explanatory examples for better comprehensibility have been added. This update is dated May 2023.

1 Introduction

1.1 Background of the methodology

In order for companies, investors, and the general public to better understand a rating opinion issued by Creditreform Rating AG (CRA), the present supplementary rating system (sub-system) "Government-Related Companies" (GRC) for the rating of corporate entities is disclosed. The rating methodology will be updated in the event of changes to the applicable systems for the preparation of ratings. Each rating by CRA is based on defined fundamentals and principles (e.g. rating process, basic procedures, defined rating scales and supplements). This sub-system, the fundamentals and principles, and the CRA Code of Conduct are freely available on the website at www.creditreform-rating.de.

1.2 Definitions

1.2.1 Government-Related Company

We define government-related companies as corporations whose credit quality (corporate issuer rating) is influenced by one or more public sponsors. In the following, the terms “affiliation with the state”, “government-related”, or “affiliation with a public sponsor” are used broadly synonymously. Affiliation with the state can also result indirectly from sub-participations or group relationships. For example, a company may be considered government-related if the parent company has been classified as such. It may occur that CRA does not maintain its own rating with respect to the relevant public sponsor. In these cases, CRA will rely on other own assessments or publicly available assessments, if necessary.

1.2.2 Public corporations / Public sponsors

Public corporations / public sponsors are defined as national (sovereign), regional or local (sub-sovereign) governments or authorities and related institutions. These can primarily be states, federal states, cities and municipalities and their governments, as well as their institutions (e.g. the German "Kreditanstalt für Wiederaufbau (KfW)" or the French "Caisse des dépôts et consignations (CDC)".

2 Scope of application

The sub-system presented here for the **rating of corporates (corporate rating) / Government-related companies** by CRA refers to a specific, economically active company to which the CRA attributes affiliation with a public sponsor / state, or to a public institution respectively government. The present rating methodology defines the supplementary framework for methodical analysis in performing a corporate rating for government-related companies (sub-system).

We examine a company with regard to its affiliation with a public sponsor within the framework of this methodology if the company is wholly or partially, directly or indirectly owned by a public sponsor, or if the company fulfills a public mandate. Other aspects, such as high systemic relevance (e.g., companies maintaining critical infrastructure) or state aid having already been granted (in the event of stress), can also determine or reinforce this.

The assumption is made that a government-related company can benefit from extraordinary support from the respective public sponsor in the event of economic and / or financial stress. This is particularly the case if, in the opinion of CRA, it can be assumed that the company will receive support for business development, financing, or the timely and complete servicing of its payment obligations. Government guarantees or sureties may also constitute a close link to the public sponsor (e.g., a government). This can have an impact on the company's credit rating.

Affiliation with a government can also have a negative effect on the stand-alone corporate rating. CRA does not classify every company that is granted state support measures as being government-related. CRA makes an assessment of the degree of affiliation with the state which is appropriate according to the situation, and explains any affiliation with the state that has been found to exist.

3 Rating method

3.1 Rating process

As part of the overall analysis for the corporate rating, it is determined whether there is any potential affiliation between a public sponsor and the company being assessed. If this is the case, the extent of the company's relationship with the public sponsor is determined and, depending on the result, this relationship is verified. The effects on the stand-alone corporate rating are derived integratively. The basis for the stand-alone rating of the company is the rating process as described in CRA's rating system "Rating of Corporates (Corporate Ratings)".

Please refer to the above-mentioned document, which can be viewed on the CRA website (www.creditreform.rating.de).

Our assessment of the relevant public sponsor influences the corporate rating. We also consider whether the sponsor in question is willing and able to provide financial support, or whether there are restrictions to be taken into account with regard to support. If there are several public sponsors, this is taken into account appropriately in the assessment, e.g., on the basis of participation rates or interest and financial support capacities.

3.2 Criteria for verifying government relation

3.2.1 Basic procedure

Once the analysts have determined that a company is to be classified as potentially government-related, the extent of its relationship is determined based on two quantitative and three qualitative criteria. CRA assesses each of the five criteria on the basis of four intensity levels (low, moderate, high, and very high). The assessments are weighted and combined into a score. The level of the score determines the affiliation to the state.

3.2.2 Quantitative factor: Business share / capital share

The relative share of business interests held by the public sponsor in the company plays an important role in assessing affiliation. CRA assumes that the more shares the public sponsor holds in the company, the more influence it can exert, the greater the degree of co-determination it will have, and the greater the sponsor's economic or political interests will be.

3.2.3 Quantitative factor: Share of public sponsor / entity in total revenue

The contribution of the public sponsor to the company's total revenues (e.g., through grants, government contracts, etc.) is another indicator of the sponsor's interest in the company being assessed and its willingness to support the company (financially) if necessary. It is also examined whether regulations or laws exist which oblige the public sponsor to make payments (e.g. in the form of subsidies) or to maintain solvency.

3.2.4 Qualitative factor: Probability of guarantees in relation to debt

If the public sponsor unconditionally guarantees the company's liabilities, a high degree of support by the sponsor can be assumed. The estimated probability that the public sponsor guarantees the company's debt (e.g., on the basis of the law) is the parameter chosen by CRA.

3.2.5 Qualitative factor: systemic relevance of the company

The importance of the company's products and services for the state, the public sponsor (e.g., state, city or local authority), the economy, or the population, in conjunction with its size and market position, determine its systemic relevance. For example, the importance for maintaining supply to the state, population, the economy and state facilities and institutions is considered. These can be, for example, networks for electricity, gas and water supply, the supply of raw materials, the higher-level transport system (e.g. railway and road network) or energy generation.

3.2.6 Qualitative factor: Substitutability / replaceability of the company

The question here is whether the company's products and services can be substituted or replaced. Substitutability is assessed according to a variety of criteria, such as the type and number of existing relevant competitors, specific market conditions, or entry barriers, such as the time required to implement the business model, capital requirements or concessions.

3.3 Classification as a government-related company

Using the factors mentioned under 3.2, CRA makes an assessment of how high the public sponsor's interest is in the company, under consideration and to what extent it should be prepared, within the scope of its possibilities, to provide the company with (financial) support on a regular basis and under extraordinary circumstances. For this purpose, the overall result from the five weighted criteria is compared with the four possible intensity levels of government affiliation from 0-III, and the notching (positive/neutral/negative) is determined within the specified bandwidths to derive the "stand-alone" rating for the company. In this context, "0" means that no relation to the public sponsor has been determined with regard to the company.

The overall result of the assessment of the relationship between the company and the public sponsor is thus essential to determine its influence on the corporate rating. The default risk of the government-related company thus also depends on this assessment and CRA's assessment of the public sponsor.

Notching Table – Sovereign / public sponsor rating is better than the corporate rating (stand alone)		
Intensity, State affil-iation (ascending)	Notches Upgrade on Corporate Rating	Constraints
0	0	none
I	up to 2	Max. up to the Rating of the Sovereign / Public Sponsor
II	up to 4	Max. up to the Rating of the Sovereign / Public Sponsor
III	up to the rating of the Sovereign / Public Sponsor	none
Notching Table – Sovereign / public sponsor rating is lower than the corporate rating (stand alone)		
Intensity, State affil-iation (ascending)	**Notches Upgrade on Sovereign / Public Sponsor Rating**	**Constraints**
0	no limit	Rating of the sovereign / Public Sponsor not lower than BB+ and / or company is internationally positioned
I	up to 3	Max. up to the Corporate Rating (stand-alone)
II	up to 2	Max. up to the Corporate Rating (stand-alone)
III	0 Sovereign / Public Sponsor Rating limited Corporate Rating	none

If the corresponding rating of the sovereign / public sponsor is above the determined stand-alone corporate rating, the corporate rating can, in the best case, be raised to the rating of the sovereign / public sponsor. If the rating of the sovereign / public sponsor is below the previously determined stand-alone corporate rating, the corporate rating can, in the worst case, be downgraded to the rating of the sovereign / public sponsor. In some cases, the extent of the notching to the stand-alone corporate rating also depends on the credit rating level or the rating of the ratio of the size of the public sponsor to the company.

In the case of companies that have not been identified as affiliated with a public sponsor, but whose headquarters is in a country with a sovereign rating of BB or lower, and which have no significant international presence, the company rating may be adjusted downwards. CRA reviews this on a company-by-company basis and provides reasons for its assessment.

3.4 Additional Notes

CRA may deviate from the above criteria and calculation method, or use other/additional criteria for the assessment of public sponsor affiliation, if it is convinced that this will ensure a more plausible rating assessment. The share of foreign shareholders and business generated abroad, legal provisions, or other framework conditions may, for example, induce this. The CRA will justify this and disclose it in the published documents. The classification of a potentially government-related company as such is verified and approved by the rating committee.