



What an ARC Ratings Credit Rating Is All About

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LOCAL EXPERTISE, SHARED INSIGHT,
BETTER JUDGMENT

I. INTRODUCTION

ARC Ratings, S.A. (ARC Ratings) is an international credit rating agency based in Europe and registered as a Credit Rating Agency (CRA) with the European Securities and Markets Authority (ESMA). ARC Ratings' mission is to provide an expert credit risk opinion from an independent and multifaceted standpoint, while constantly monitoring the evolution and validity of such an assessment through time. ARC Ratings' opinion is the end-result of a global and local research effort assembling evidence focused on the ability and propensity by the rated entity to honour its commitments. The general principles of such an approach are embodied in ARC Ratings' Rating methodologies, which in themselves are quite dynamic and constantly evolving. ARC Ratings performs an annual reappraisal of all its methodologies in terms of their practical efficacy and may review them anytime sooner if any significant matter requires such action in order to make sure that the final outcome will always be a clear, precise and forward-looking assessment of every rated entity's financial strength and about the overall credit quality of any rated obligation.

ARC Ratings is a multicultural and geographically polycentric credit rating agency established under the initiative of prominent local credit rating agencies from four different continents (and open to new partners in the future), whose aim is to consolidate and strengthen a global information and collaboration network for the benefit of more accurate and superior-quality credit risk assessments to investors, without any geo-ethnic or idiosyncratic biases. ARC Ratings focus on all credit rating segments, including those risks stemming from intermediate and medium size non-financial corporations and financial institutions which are usually not covered by incumbent rating agencies.

II. WHAT AN ARC RATINGS CREDIT RATING IS ALL ABOUT

The purpose of a solicited credit rating is to thoroughly inform investors of ARC Ratings' opinion concerning the ability and willingness of an entity to honour, on a full and timely basis, the financial commitments (capital and interest) subject to that rating. Such rating may include:

- the full range of senior and unsecured (explicitly so or established by law and/or regulation) short-term financial instruments with an initial maturity period up to one year and/or medium and long-term financial instruments, with initial maturity period exceeding one year; and
- certain financial commitments (issuer's short-term and/or medium and long-term rating).

Typically a strong linkage exists between short and medium and long-term ratings. However, as the rating process is dynamic, this linkage may be broken under certain circumstances, at the discretion of the Rating Panel.

A particular issue may either rank senior or subordinate to other claims, and, consequently, such an issue may either receive a higher or lower rating than that of the entity's own issuer credit rating. An issue may be

supported by specific collateral that may secure a higher credit rating than that of the overall issuer's credit rating. Additionally, specific clauses in the underlying legal agreements related to a financial commitment, such as collective action clauses or *pari passu*, may also influence the rating level of specific issues of an entity as may the jurisdiction under which all legal aspects of the rated issue are governed.

ARC Ratings final opinion is translated into a letter-grade rating along a rating scale¹. ARC Ratings' rating assignments conform to an underlying **Stable Rating Principle**, which means the clear and uncompromising adoption by its Rating Panel of a long-term perspective for any rating assignment, with an analytical foresight travelling along the whole economic cycle in order to fully assess the ability of the rated entity to honour a claim under every conceivable circumstance. Thus any assigned rating is supposed to remain stable throughout the ups and downs of the economic cycle. The **Stable Rating Principle** by ARC Ratings is anchored in the classic tradition of analytical reliability, which once was the major pillar of this industry so that investors may make investment decisions as well as expected return calculations.

At the time of ARC Ratings' rating's assignment events may be occurring or very likely to happen whose outcomes may have an influence on the assigned rating. The rating outlook is used to indicate the direction of this influence.

The date of an initial public assignment of a credit rating by ARC Ratings will serve as a predictable schedule for its formal review. All monitored credit ratings are subject at least to annual review, with the rating panel option to determine a more frequent review or as events warrant, except Sovereign Ratings, which are subject to review a maximum of three times a year (with a maximum period of six months between each review). ARC Ratings will generally only publish any new rating assessment upon such dates. If a previously unforeseen and very significant event does occur or is about to occur with the potential to disrupt the logic of any standing rating assignment, ARC Ratings' Rating Panel may decide to upgrade or downgrade an initial rating assignment outside of the periodic review schedule, while issuing an explanation of the underlying rationale for such a rating change.

The Stable Rating Principle, coupled with constant monitoring and a periodic formal review for every rated issue and issuer is designed to reinforce the market stabilisation target implicitly embodied in the credit rating technique. Such technique was originally and appropriately conceived to provide investors with a higher degree of assurance about the "true" risk profile of any investment by accurately and, if possible, timely providing the market with an independent and forward-looking assessment thereof. As circumstances evolved to produce less competition among the prevalent rating agencies, such rating reassessments to new and supposedly unforeseen events have become a mere *reaction* to consummated realities. The informative price-forming value of a reactive

¹ The 2008 financial crisis and the quick (and unforeseen) deterioration in the credit quality of entities across the full rating spectrum obfuscated the classic definition of a rating. Instead, the ratings by the large incumbents have become "benchmark-related" to a rather unclear concept of a "best quality peer". ARC Ratings avoids such confusion by not assigning a "best-in-class" rating just for this mere distinction. In other words, if no issuer or issue among a set of entities (sovereigns, non-financial corporations or financial institutions) will qualify for its highest AAA rating, ARC Ratings will not assign it.

rating assignment is null, if not negative, given the chain market reactions that a delayed rating provokes.

ARC Ratings will generally only act upon the discipline of the ratings' periodic reviews, that is, ARC Ratings will only change a rating following such periodic and scheduled review, except in cases of previously unforeseen and significant events, which have the potential to disrupt the logic of any standing rating assignment. By producing a list of "periodic review schedules" for each and every rating, ARC Ratings' market surveillance will help foster an orderly assessment of credit risks worldwide. Enhanced investor assurance is likely to provide the basis for safe credit expansion, thus contributing to a new financial order as well as to a more vigorous and reliable global economic recovery.

III. ARC RATINGS' RATING'S ASSIGNMENT PROCESS

The main stages to ARC Ratings' rating process are:

- 1) Initiation of rating process at the issuer's request.
- 2) In depth analysis and evaluation:
 - Analysis and evaluation of credit risks, based on publicly available as well as confidential information; and
 - Due diligence meetings with management/leadership.
- 3) Assignment of the rating by an independent and multi-perspective rating panel.
- 4) Delivery of the Public Report Proposal and the assigned rating by ARC Ratings to the respective issuer.
- 5) Issuer's decision to give permission to ARC Ratings to publish the Report as well as the corresponding rating. If issuer does not give such permission the Report and its corresponding rating will remain strictly confidential unless applicable laws provide otherwise.
- 6) Continuous monitoring and formal follow-ups.

ARC Ratings' ratings and ratings' outlooks assigned are opinions based on a thorough, rigorous, systematic, quantitative, qualitative and comparative analysis of a number of factors and are based on information gathered from a wide range of sources, with emphasis given to the entity whose financial commitments are subject to a rating, including confidential information. By including confidential information of the entity whose commitments are subject to a rating, ARC Ratings' ratings allow a strong reduction of the information asymmetry that typically exists between the issuer and the investors. At the same time, the confidentiality of the issuer's information is preserved, since this information is weighted in the rating and outlook assigned, but not made public.

The analytical tools employed by ARC Ratings will differ from case to case depending upon the idiosyncrasies of the entity, but it will always include a series of fairly common quantitative and qualitative factors for each rating segment and typically a minimum of five years of historical analysis. The specific adjustments for each particular case are fully disclosed in the report that underpins the rating.

Prior to issuing or revising a credit rating, ARC Ratings provides to the entity whose financial commitments are being rated, the documents that substantiate the credit rating to be attributed i.e. the Draft Report thus affording that entity the opportunity to clarify or correct factual inaccuracies or inclusion of confidential information and allowing the credit rating produced to be as accurate as possible. The comments made by that entity are taken into account by ARC Ratings in the assignment of the credit rating.

After the rating assignment by the Rating Panel, the entity whose obligations are subject to a rating can decide whether or not to publish the rating. ARC Ratings may not override such a decision, unless provided so by law.

The rating publication is accompanied by a report that supports the rating and rating outlook, encompassing the analytical factors considered most relevant by the Rating Panel for the rating and rating outlook assignments. This report is published on ARC Ratings website (www.arcratings.com) in full and for free, in addition to ratings, outlooks and press releases.

ARC Ratings carries out a constant monitoring of the progress of the entity whose financial commitments are subject to a rating over the entire period during which the rating is valid. This monitoring process is accompanied by a formal review at least annually, with the rating panel option to determine a more frequent review or as events warrant, except Sovereign Ratings, which are subject to review a maximum of three times a year (with a maximum period of six months between each review). Investors will be provided with a schedule of rating reviews, as applicable, and may, therefore, anticipate the timing of the potential rating changes or confirmations, except in cases where, prior to such scheduled review, ARC Ratings considers that a previously unforeseen and very significant event with the potential to disrupt the logic of any standing rating assignment may occur or has just occurred. Thus, investors are sure to have available updated and fully vetted information on the credit risk of the financial commitments subject to a rating at all times. Prior to the use of the rating by the investor, ARC Ratings recommends that investors confirm such ratings by consulting the public ratings list on its website (www.arcratings.com).

IV. CONCLUSION

While a thorough quantitative analysis remains unquestionably important, the qualitative characteristics of ARC Ratings' analysis cannot be overemphasised. It is critically relevant to look "beyond the numbers" and "beyond the cycle" to evaluate the intangible strengths and weaknesses of an entity. A crucial aspect of ARC Ratings' analysis is the correct understanding of the entity, as highlighted above. Ultimately, ARC Ratings' emphasis is on determining how this will affect the institution's financial safety and soundness.

V. LIMITATIONS OF RATINGS

ARC Ratings is not a legal, tax or financial adviser, and only provides a credit opinion of the rated securities. For example, a rating does not cover a potential change in laws nor can it be regarded as an audit. Moreover, ARC

Ratings is not a party to the transaction documents. Users of our credit ratings should familiarise themselves with the Transaction documents / mechanics and should form their own views in this respect. They should not rely on ARC Ratings for legal, tax or financial advice, and are encouraged to contact the relevant advisers.

Ratings are assigned based on information, including confidential information, collected from a wide group of sources, and in particular from the entity whose financial commitments are being rated. ARC Ratings uses and treats this information with due care and attention. Although all due care was taken in the collection, verification and processing of the information for the purposes of the rating analysis, ARC Ratings cannot be held liable for its accuracy. The rating process is not an audit. ARC Ratings must make sure that the information has a minimum level of quality prior to assigning a rating based on such information.

In addition, ratings are based on information available at a particular point in time and cannot take into account unforeseen events, either external (some changes in legislation, natural disasters, a sudden terrorist attack from abroad, etc.) or internal (unforeseen political instability in case of a sovereign or merger, acquisition etc. in case of non-financial corporations or financial institutions). However, ARC Ratings carries out a constant monitoring of the progress of the entity whose commitments are subject to rating, over the entire period during which the rating is valid.

In the rating process, ARC Ratings adopts procedures and methodologies aimed at ensuring transparency, credibility and independence, and also that rating classifications are not influenced by situations of conflict of interests. Any exceptions to these principles are disclosed by ARC Ratings together with the rating of the financial commitment in question.

Ratings do not constitute a recommendation to buy or sell, but only one of the factors to be weighted by investors.

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ARC Ratings, S.A. is registered as a Credit Rating Agency (CRA) by the European Securities and Markets Authority (ESMA), within the scope of the REGULATION (EC) N° 1060/2009 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL, of 16 September, and recognised as External Credit Assessment Institution (ECAI).