Parent-Subsidiary Considerations in the Determination of Corporate and NBFI Credit Ratings

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1. ABOUT THIS METHODOLOGY

Scope

This criteria note outlines CI's treatment of parent-subsidiary considerations in the determination of an individual entity's issuer credit ratings (ICRs) and is applicable to corporate issuers and non-bank financial institutions (NBFIs).

The criteria is used to determine the degree of rating linkage between a parent company and its subsidiary, based primarily on the likelihood of intra-group financial support in the event of need.

The criteria apply specifically to issuer credit ratings, particularly long-term foreign and local currency ratings. Additional group-related notching considerations may apply to issue ratings (e.g. for structural subordination or explicit guarantees).

We do not use this criteria when rating banks and bank subsidiaries or insurance companies. Similar considerations are captured in our Bank Rating Methodology and Insurance Rating Methodology, specifically in our framework for determining extraordinary support levels.

2. OVERVIEW AND ANALYTICAL APPROACH

This rating criteria is generally applicable whenever a rated corporate or NBFI is: (i) linked to another legal entity through ownership and control; and (ii) the type – business, financial, legal – and strength of relations/linkages between them suggest that the rated entity is likely to receive (or provide) financial support from (to) the other entity during periods of distress when the risk of failure is elevated.

Our analytical focus is therefore on the following:

(a) Whether, in the event of financial distress, a rated subsidiary would likely receive sufficient and timely financial support from the parent company (or group more generally) to enable it to avert a payments default and continue servicing its financial obligations on time and in full.

We call this type of temporary assistance 'extraordinary support'. It is not factored into a company's standalone credit profile – our opinion of which is summarised in the Entity Standalone Assessment (ESA) – and is different to the 'ordinary support' that a subsidiary might receive from its parent during the normal course of business, such as an increase in equity to facilitate business growth or to meet changes in regulatory requirements. Ordinary financial support, as well as the operational and business benefits (and risks) that may accrue to an entity from being part of a larger group, is reflected in a company's ESA.

(b) Whether, in the event of financial distress being experienced by the parent (or another member of the same corporate group), the credit strength of the rated subsidiary could be weakened or impaired by having to provide – at the behest of the parent – substantial financial assistance or resources to the troubled entity (including through special cash dividends, asset stripping, or by being transferred its liabilities).

The application of the criteria in this report may result, *inter alia*, in:

- A subsidiary's ICR being notched above its standalone level (i.e. the level it would have reached in the absence of parental/group assistance) due to the likelihood of such extraordinary support from a stronger parent (or group).
- A subsidiary's ICR being constrained by the rating of a weaker parent due to group interference risk even though it may be the stronger of the two entities on a standalone basis (interference risk aside).
- A subsidiary's ICR being set higher than the rating of the parent due to greater standalone strength and limited linkages, which may include effective constraints on potentially harmful parental interference. If linkages are limited and autonomy high, a company's default risk may be largely (or wholly) unaffected by stress at the parent level or elsewhere within the group. Consequently, its ICR will largely depend on its standalone strength and may potentially be notched above (or decoupled from) the actual or notional rating of the parent/group.

The analytical process we follow is summarised below.

Step 1

If a corporate issuer or NBFI is a member of a group (either as a parent or subsidiary), we establish whether its relationship with other group members is sufficient to warrant the application of this criteria.

If we deem the criteria not to be applicable – and in the absence of any considerations concerning sovereign risk or sovereign support – the company's ICR will generally be the same as its ESA (i.e. it will be rated on a standalone basis, separately from its parent).

If the criteria is applicable, we:

Step 2

(a) Establish the Group Standalone Assessment (GSA) and the Group Rating Assessment (GRA) – which provide a measure of the credit strength of the group on a standalone and support-enhanced basis, respectively, as well as (b) the rated company's ESA.

Step 3

(a) Evaluate the strength of the rated company's interconnections and interdependencies with other group members, and (b) determine the relative strategic importance of the company to the group and the likelihood of the parent (or group) extending extraordinary support to the rated company in the event of need.

Step 4

Consider the rated company's ESA in relation to the relevant group assessment (GRA or GSA) as follows:

(a) If the ESA is lower than the relevant group assessment, whether the company's ICR should be notched up for extraordinary support and, if so, by how much; or

(b) If the ESA is higher than the relevant group assessment, whether the company's ICR should be constrained at the level of the group assessment, or whether the company should be rated higher and, if so, by how much.

3. CRITERIA APPLICABILITY (STEP 1)

This criteria is generally applicable whenever a rated entity is owned and controlled by another corporate entity to a sufficient degree to suggest that the credit quality of one might be materially affected or influenced by the credit quality of the other, particularly during periods of financial stress.

Sufficiency in this context is based primarily on effective control – i.e. if a parent is able to direct (and not just influence) a subsidiary's operating and financial policies, including distributions to shareholders, we would normally apply this criteria as part of the rating process.

This is generally the case when the parent holds more than 50% of the subsidiary's ordinary equity (giving it more than half of the voting rights), and is typically reflected in the consolidation of the subsidiary in the parent's (group) financial statements.

Less commonly, we may also apply this criteria in cases where the parent has a lower equity share (and may classify the entity as an affiliate), but we nevertheless believe it has the power to control the rated entity's strategy and to access its cashflows and/or is likely to provide extraordinary financial assistance to the entity, for example for reputational or strategic purposes. In rare cases, we might also apply the criteria to unconsolidated entities to which the parent is connected through strong business ties (e.g. a critical supplier or operational service provider) and which we believe would likely be supported in a stress situation.

The criteria is not generally applicable to those types of investment holding companies that take mainly non-controlling stakes in investee companies and where there is no expectation of support in the event of financial distress. It may, however, be applied to operating companies controlled by investment holding companies, particularly where business, financial or legal linkages are material and there is the possibility of extraordinary support or credit risk transfer between group entities.

4. GROUP AND ENTITY ASSESSMENTS (STEP 2)

(a) Group Standalone Assessment and Group Rating Assessment

The GSA and GRA summarise our view of the creditworthiness of the group (i.e. the parent company and its subsidiaries) on a standalone and support-enhanced basis, respectively.

If the parent company is rated by CI, the GRA is usually the same as the parent's ICR since a parent's credit ratings typically reflect the overall credit profile of the group. Otherwise, the GRA (and GSA) are based on an internal evaluation, although unlike credit ratings they do not have outlooks.

The GRA establishes a ceiling for the ICRs of subsidiaries that are notched above the standalone level based on extraordinary support since we would not expect a parent to provide assistance to a troubled subsidiary when it is itself in, or close to, default.

In line with our standard analytical framework for corporates, the GRA may be notched higher than the GSA when we believe it likely that the parent would receive extraordinary external support in the event of financial distress. Extraordinary support in this case is most likely to come from the sovereign, reflecting, for example, the parent's systemic importance or strong links to the government, although we may also attribute shareholder support, especially where this has been demonstrated in the past. For many private sector corporates and NBFIs, extraordinary support to the group is unlikely to be a significant rating consideration and therefore we would expect the GSA and GRA to be set at the same grade most of the time.

The GRA typically draws on the parent's consolidated financial statements (if available or unless they provide an inaccurate representation of the debt-servicing capacity of the parent, for example as in the case of investment holding companies) and takes into account the key rating factors relevant to the industries/sectors in which the parent and its principal subsidiaries operate (including entity-specific factors and operating environment risks). The GRA also incorporates any group credit benefits arising from the diversification of business activities and revenue, as well as contingent

liability risks from group members.

By examining the group as if it were a single economic and legal entity, we are able to assess the financial obligations of the group as a whole against the financial resources available. However, in some cases an assessment of the group based on consolidated financials may under- or over-state the credit strength of the parent.

This could be because of weak linkages (business, financial and legal) between the parent and a subsidiary that is both financially weak and unlikely to be supported, or because the group includes subsidiaries that are largely autonomous or protected (ring fenced) from the parent and whose assets are not necessarily fungible or transferable to other group members. Regulated subsidiaries, for example, are generally more constrained in their ability to provide financial assistance to the parent company and other group members (or from the perspective of a parent in need, are a more restricted source of cash).

In such cases the GRA/GSA is established by determining a baseline GRA/GSA using the consolidated approach and adjusting the outcome – up or down, typically by one or two notches – to arrive at the final GRA/GSA.

The consolidated approach may also be less appropriate when the members of a group are active in very different industries or sectors. In this case we may base the GSA on the weighted average ESAs of the group entities that matter most (positively or negatively) for the group's overall creditworthiness, and then notch up for extraordinary support (if relevant) to determine the GRA.

Group assessments also take into account any rating constraints posed by sovereign credit risk and sovereign interference risk. Similar to our general approach to credit ratings, a group's GRA will often be no higher than the credit rating (formal or shadow) of the sovereign of the country in which the parent is domiciled, but in some cases may exceed this, typically up to the country limit implied by our sovereign interference risk assessment.

In some cases, it may be more relevant to assess parent-subsidiary relations at a sub-group level, in particular where two or more entities with a direct ownership and control relationship share common credit characteristics (e.g. related to jurisdiction or regulatory frameworks) and where business and financial links to other parts of the group are relatively weak (e.g. the sub-group may be insulated from the ultimate parent group).

(b) Entity Standalone Assessment

The ESA reflects our opinion of a group member's ability to meet its financial obligations on an ongoing basis without requiring extraordinary support and in the absence of extraordinary interference, including government-imposed transfer and convertibility restrictions (i.e. sovereign interference risk).

The baseline ESA for a rated entity is determined using the relevant industry- or sector-specific rating criteria and will usually draw on the entity's standalone financial statements (where available). The ESA also takes into account intra-group links and associated risks and benefits (other than extraordinary support).

While we do not automatically constrain the ESA of a subsidiary by the GSA, the ESA and ICR will usually be capped at the level of the GRA due to contagion risk and group interference risk (see Step 4 (b)(i)), unless we consider the subsidiary to be an autonomous entity that meets our criteria for being rated above the GRA (see Step 4 (b)(ii)).

The ESA is less relevant as a step in our analytical process – and therefore may not necessarily be established – for core group companies which we believe are highly likely to be supported by the parent/group and/or are so highly integrated with their parent that standalone analysis would not be particularly meaningful. The ICRs of such core entities would typically be assigned at the same level as the GRA (or GSA) under our standard notching guidelines (see below).

5. DETERMINING EXTRAORDINARY SUPPORT (STEP 3)

(a) Parent-Subsidiary interdependence, integration and strategic importance

To determine the likelihood of extraordinary support, we first examine the type and strength of linkages between the rated company and other members of the same group (e.g. the parent company). We consider whether the relationship between the parent and subsidiary makes it more (or less) likely that the former would be willing (or obligated) to provide financial support to the latter should it be at risk of failing, and vice versa.

Since extraordinary support is often implicit in nature (rather than legal or contractual), assessments tend to involve the weighing of a number of largely qualitative considerations. The main determining factors are identified below. The list is not exhaustive but, in CI's opinion, covers those factors that are likely to create an economic incentive and/or moral obligation to provide support or, more generally, to increase the willingness to aid a group member in distress.

Key Types of Parent-Subsidiary Linkages

Business and operational linkages

Alignment or integration of business lines or business activities (e.g. reflected in vertically or horizontally integrated processes or activities, buyer-supplier type commercial relationships, high intra-group commercial payables and receivables, shared customer base etc).

Parent control of, and active involvement in, the subsidiary's management (e.g. appointment of common directors and officers or enterprise-wide corporate policies).

Shared business infrastructure, such as treasury (centralised cash management), risk management, IT systems or purchasing and procurement.

Intra-group financing arrangements (e.g. borrowing and on-lending by parent) or common sources of funding (contributing to correlations in market access and capital-raising capabilities).

Franchise and strategic linkages

Shared brand, operating name or identity and consequent risk of harm to the parent/group's reputation (and possibly franchise and market access) should the subsidiary fail financially.

Subsidiary's relative importance to the franchise strength, earnings performance, and future business prospects of the parent (and group).

Ownership and group policy

Degree of ownership and control (e.g. full versus majority).

Value of the parent's investment in the subsidiary (relative to both the size of its investments in other subsidiaries and to the debt of the rated subsidiary).

Demonstrated track record of the parent/group providing support to the subsidiary or a credible parent commitment to extending assistance if needed or, more generally, the parent's track record of supporting group members in distress.

Legal and contractual ties

Use of downstream, upstream or cross-stream guarantees – which could potentially result in the credit risk profiles of the companies involved being closely aligned.

Cross-default or cross-acceleration clauses in debt agreements – which may increase the incentive to support and could potentially lead to a high correlation between the default risk of a parent and its subsidiary.

Laws and regulations that provide for circumstances in which a parent may be held liable for the debts of an insolvent subsidiary, or that require a parent to support subsidiaries in financial difficulty.

(b) Likelihood of extraordinary support

We subsequently assess the likelihood of a parent supporting a subsidiary that is facing stress as very high, high, moderate, or low/uncertain based on the following:

General Likelihood of Extraordinary Support

Very High

Entity is a core group company of high strategic importance.

Its business operations are highly aligned or highly integrated with the parent/group.

It shares or is closely associated with the parent's name, brand, identity, and reputation.

It is essential to the strategy of the group and its contribution to group business objectives and consolidated earnings is expected to be significant and sustained over at least the medium term.

Importance to the group is such that divestment would be problematic, with a significant adverse impact on the group's financials and corporate strategy.

The parent's long-term commitment to the entity is strong, and there is a strong track record of ordinary and extraordinary support for strategic group subsidiaries.

The incentive to support may be heightened by comprehensive cross-default or cross-acceleration provisions and/or a significant share of the entity's debt may be guaranteed by the parent.

Very high may also be assigned where autonomy is extremely low, and the entity performs specialised group-specific functions. For example, it may operate more like a branch or may have been established as a separate legal entity solely for legal, regulatory or tax purposes. Some types of financing subsidiary may also fall under this category.

High

Entity is a strategically important group company with strong links to the parent.

It shares most of the same characteristics as a core group company, the principal differences being:

(a) a slightly lower (but still substantial) relative importance to the group's financials, franchise, and future business prospects.

(b) willingness of the parent/group to extend support to the entity may be influenced at certain times by the existence of core companies. For example, when general economic and financial conditions are stressed, the willingness to support is more likely to be influenced by (or vulnerable to) considerations of the impact on the group's financial strength and consequent capacity to assist core group companies should they subsequently require assistance as well.

Moderate

Entity is of moderate strategic importance.

Its contribution to group business objectives and consolidated financials is moderate (but meaningful) and is expected to remain so over at least the medium term.

May have moderate business, financial and legal linkages with the group or may operate more on a standalone basis but either way it is reasonably important to the group's long-term strategy.

Parent investment in the entity may be moderate in relative terms (rather than high). The parent has nevertheless demonstrated a degree of commitment to the entity, which is unlikely to be sold, at least in the medium term.

There may be some uncertainties regarding the parent/group's financial capacity to provide sufficient and timely extraordinary support.

General Likelihood of Extraordinary Support (continued)

Low/Uncertain

Entity is of little or no strategic importance.

Its activities may be peripheral to the strategic objectives of the parent/group.

Contribution to the group's financial performance may be modest and/or the entity's profitability may be weak with diminished prospects compared to the group.

The parent's long-term commitment to the entity is uncertain.

The parent/group's track record of providing ordinary and extraordinary support to non-strategic subsidiaries may be weak or uncertain, or its financial capacity to provide extraordinary support may be insufficient.

6. PARENT-SUBSIDIARY RATING DIFFERENTIALS AND NOTCHING (STEP 4)

(a) Parent stronger than Subsidiary: standard notching when ESA is below the GRA

Once the likelihood of support has been assessed, we then apply the following notching to determine the ICR in cases where the rated subsidiary's ESA is lower than the relevant parent/group assessment.

Extraordinary Support Level

Very High

Equalise the ICR with the GRA or with the GSA if the former includes an element of extraordinary support (e.g. from the sovereign) which is not expected to be available to the rated entity.

High

Set the ICR three notches above the ESA OR one notch below the relevant group assessment, whichever is the lowest.

Moderate

Set the ICR one notch above the ESA OR one notch below the relevant group assessment, whichever is the lowest.

Low

Incorporate no uplift for support; the ICR will be the same as the ESA.

Given the often-subjective nature of extraordinary support assessments, which reflects the fact that parent support is often implicit rather than based on, for example, unconditional guarantees, we are cognisant of the risk of overestimating the reduction in default risk attributable to external assistance in the event of need. Consequently, we may apply a one or (more rarely) two notch adjustment to determine the ICR in cases where the initial outcome of our standard notching is a large multi-notch uplift (generally, in excess of three notches) but we believe the entity's overall credit risk profile would be better captured by a smaller (but typically still multi-notch) uplift.

ICRs where a Subsidiary's ESA is at the same level as the GRA

If a subsidiary's ESA is the same as the parent/group assessment, there is no rating headroom for a support uplift. Consequently, the entity's ICR will generally be equal to its ESA regardless of the likelihood of support.

(b) ICRs where a Subsidiary's ESA is higher than the GRA

(i) Subsidiary ICRs constrained by the Parent despite higher ESA

A subsidiary's baseline ESA could potentially be higher than the parent/group assessment.

Where this is the case, the entity's ICR will often be capped at the GRA level, especially if the linkages between the parent and subsidiary are significant. This rating practice reflects the following factors:

- There are often no binding restrictions on the ability of a parent to access the cash and other assets of stronger subsidiaries, and a parent may seek to upstream or transfer those assets should it or another group company come under financial pressure.

- The insolvency of a parent will typically have a significant adverse impact on its subsidiaries by, for example, prompting their own insolvency (depending on the jurisdiction and local laws), necessitating their sale, or by causing disruption to their business operations and market access, as well as harm to their reputations and franchise strength.

(ii) Subsidiary ICRs higher than the Parent (autonomous and protected entities)

It may also be possible for a subsidiary with a comparatively strong ESA to overcome or be shielded from the constraining factors referred to above and achieve a credit rating that is higher than the GRA.

A subsidiary is more likely to achieve a higher rating than its parent when it has a relatively strong standalone business franchise and operates with substantial autonomy, or is subject to robust and effective ring-fencing measures, regulatory restrictions, or other forms of protection that either insulate it from the parent or would prevent it from having to provide a level of support that would undermine its own financial strength.

In such cases the subsidiary would usually be rated on a largely standalone basis, however the rating differential between the subsidiary and parent would not normally exceed **three rating notches** (i.e. one rating category) – particularly if the parent would ultimately be able to use its direct or indirect control of a subsidiary's financial policies in its own economic self-interest.

Rating differentials when a subsidiary's ESA is higher than the GRA

One Notch Differential

To assign an ICR to a subsidiary that is one notch higher than the GRA we would generally expect the subsidiary's baseline ESA (or the baseline ESA plus extraordinary sovereign support, if applicable) to be at least one notch above the GRA.

In addition, we would expect all of the following to apply:

(a) The subsidiary has substantial operational autonomy, including over business operations, funding decisions and liquidity management (including no commingling of cashflows and assets).

(b) The subsidiary's access to funding is not dependent on the parent (e.g. it can borrow in its own name and has little or no reliance on recourse financing and debt guarantees) and is not particularly sensitive to credit concerns at the parent level.

(c) Under the relevant legal framework/insolvency regime, the insolvency of the parent would not necessarily cause or likely result in the insolvency (or similar) of the subsidiary.

(d) The parent has not taken actions in the past that have directly undermined or impaired the creditworthiness of the subsidiary and there are good reasons for believing it will not take any such actions in the foreseeable future. Supporting factors in this regard may include the presence of indenture covenants in bonds issued by the subsidiary in public debt markets that aim to restrict its

ability to make distributions (cash, assets etc) to shareholders, or the parent's limited reliance on dividends and other transfers from the subsidiary in order to meet its debt service requirements.

Two Notch Differential

We would consider a rating differential of two notches if the subsidiary's baseline ESA (or the baseline ESA plus extraordinary sovereign support) is at least two notches above the GRA and it meets the conditions in (a) to (d), above.

Differential of Three (or more) Notches

We would consider a larger rating differential of three notches if the subsidiary's baseline ESA (or the baseline ESA plus extraordinary sovereign support) is at least three notches above the GRA, and it meets the conditions in (a) to (d), above; and, in addition, at least one of the following applies:

(i) The entity's autonomy is protected by the presence of strong minority shareholders with sufficient board representation and/or active independent directors with the ability to prevent the parent upstreaming financial resources to the detriment of the subsidiary. This may be supported by legal or regulatory requirements for board or shareholder approval for potentially abusive related party transactions.

(ii) The entity operates in a regulated sector with strong and effective restrictions on the ability of the parent company to access the cash and other assets of its subsidiaries.

If neither of the above two conditions apply, the rating differential will generally be limited to two notches even though the baseline ESA may be three notches higher than the GRA.

Wider notching may be warranted in rare cases where the baseline ESA is more than three notches above the GRA, and all other conditions are met to a significant degree. In such cases we would use analytical judgement to determine whether the final ICR should be four or more notches above the GRA based on our assessment of the strength of the additional protection or insulation afforded by the factors identified above, as well as the extent to which we believe that financial contagion from the parent to the subsidiary is limited and that financial stress or default at the parent level would not lead to a similarly severe deterioration in the relative creditworthiness of the subsidiary.

The above notwithstanding, the ICR assigned may be lower than the maximum potential level arrived at through the application of the above criteria due to sovereign risk considerations. For example, even if the entity meets the criteria for being rated three notches above the GRA, its ICR could be assigned at the same level as the GRA if the sovereign is rated at the same level as the group and the subsidiary does not meet our criteria for being rated higher than the sovereign.

The above guidance applies in particular when the risk of financial distress is remote, or at least not imminent. Clearly a subsidiary's ICR could potentially be multiple notches higher than the ICR of the parent in situations where the parent is in, or close to, default but the subsidiary is still able to meet its financial obligations in full and on time and is expected to continue to perform even in the event of the resolution or insolvency of the parent.

Additional considerations for Parents and Subsidiaries in different countries

The above considerations generally apply irrespective of whether the parent and subsidiary are located in the same country or in different countries. Nevertheless, being located in different countries may require some additional methodological considerations depending on the credit standing of the parent relative to the sovereign of the country in which it is based and the difference, if any, in the level of sovereign risk in the two countries.

In particular, if the parent's ICR is close to the sovereign's rating or constrained by sovereign risk factors and the subsidiary is based in a country with a higher sovereign rating, we need also to consider whether the foreign subsidiary can be rated above the sovereign of the country in which the parent is domiciled.

The rating notch differential achieved via the application of the criteria in 6(b)(ii) above would still apply, subject to any limitations imposed by sovereign risk factors in the country in which the subsidiary is located, provided all of the following conditions are met:

- The subsidiary retains a substantial proportion of its liquidity outside of the country of the parent and in countries with a higher credit rating than that of the parent's country.
- The business activity of the subsidiary, and in particular cash-flow generation, is not concentrated in the country of the parent or highly dependent on economic conditions in the country of the parent.
- The subsidiary has little direct exposure – in terms of assets, liabilities, and business contracts – to the sovereign of the country of the parent or to entities owned or controlled by the sovereign.
- The subsidiary would not be significantly affected by transfer and convertibility restrictions imposed by the sovereign government of the parent company's country of domicile, including restrictions on profit repatriation and other types of cross-border capital flows, moratoria on external debt service payments, currency controls, surrender requirements on export earnings, restrictions on the use of bank deposits, or the introduction of a law or decree on the repatriation of funds held abroad.
- The subsidiary's ability to obtain sufficient financing for its operations and debt servicing needs would not be impaired in the event of a default by the sovereign of the parent's country of domicile.

We would generally restrict the subsidiary's ICR to the level implied by our assessment of sovereign credit risk or sovereign interference risk (whichever we deem applicable) in the country of the parent company when we consider it likely that:

- The subsidiary would be adversely affected to a significant extent by the economic stress and financial market dislocation that would likely accompany a sovereign default in the parent's country of domicile; and/or
- The subsidiary's ability to service its financial obligations on an ongoing basis would be directly or indirectly impaired by the introduction of exchange and capital controls in the parent's country of domicile.

7. EXCEPTIONS AND OTHER CONSIDERATIONS

We expect our standard notching to apply in most, but not all, circumstances. Where a rating committee deems a deviation to be warranted, the reasoning will be explained in the relevant rating report rationale. Potential reasons for deviating may include the following:

Constraints on a Parent's ability to support a Subsidiary

Parent companies generally face few, if any, constraints on their ability (defined in terms of the absence of legal, regulatory, and structural restrictions or barriers) to support subsidiaries, particularly if operating in non-financial sectors and based in the same jurisdiction.

However, if constraints on the ability to support are material, we may apply a more conservative uplift for extraordinary support, or refrain from incorporating any uplift at all into an entity's ICR, even though the parent may be both willing and have the financial capacity to provide the requisite assistance.

Explicit debt guarantees

If all, or almost all, of the debt obligations of an entity are fully guaranteed by a stronger parent, the entity's ICR may be assigned at the same level as, or one notch below, that of the guarantor

(regardless of whether it is classified as a 'core' subsidiary) provided that:

(a) The guarantees are unconditional, irrevocable and provide for full and timely payment of principal and interest;

(b) There are no constraints on the ability of the parent to honour its obligations as stated in the guarantee;

(c) The portion of debt covered by legally binding payment guarantees is expected to remain at very high levels over at least the medium term; and

(d) We have no concerns about the parent's financial capacity and commitment to ensuring full and timely servicing of the guaranteed obligations and believe it has a strong incentive to ensure timely repayment of all the subsidiary's senior unsecured debt.

Cross-default provisions

We may increase the uplift for extraordinary support beyond that indicated by our standard notching guidelines – generally by one or two notches, up to a maximum of one notch below the parent's ICR for non-core subsidiaries – where, in our opinion, the default risk of a parent is highly correlated with the default risk of a (weaker) rated subsidiary due to cross-default or cross acceleration provisions in bond indentures or loan agreements that would affect a substantial proportion of the parent's debt outstanding.

We would only consider applying additional notches where:

(a) We believe the parent would very likely extend timely support to the entity to avoid the triggering of cross-default clauses, regardless of the entity's strategic importance; and

(b) The strong linkage created by cross-default provisions is not expected to weaken significantly or be broken, at least in the medium term, for example through the repayment of all, or a significant part of, the relevant debt obligations, or the removal of the entity from the scope of the provisions or definition of principal/ material subsidiary.

We would generally refrain from any additional notching in this regard if any of the following apply: the amount of debt likely affected by the triggering of cross-default/acceleration clauses is not significant relative to the repayment capacity of the parent; the volume of parent debt with cross-default/ acceleration clauses is expected to decline significantly over the medium term; or we believe creditors would likely waive such defaults.

Sovereign considerations

The ICRs of corporates and financial institutions are often set no higher than the ICR of the relevant sovereign. Consequently, in cases where the application of the criteria and notching guidance contained in this report result in a baseline ICR for an entity that is above that of the sovereign, the final rating assigned may be set at a lower level – equal to our assessment of sovereign credit risk – unless the entity meets our criteria for being rated above the sovereign.

Ratings above the sovereign are less likely for banks, but may be achievable for some corporate issuers and NBFIs. In such cases, ICRs are usually capped by the country limit implied by our assessment of sovereign interference risk.

It may also be possible for the ICR of a corporate or NBFI subsidiary to be directly uplifted for extraordinary sovereign support outside of the group framework. This could be because the entity is strongly linked to the government, for example as a critical supplier of key goods, services or infrastructure, or is systemically important. In such cases the credit risk of the subsidiary could be decoupled from the parent, potentially resulting in the entity being rated above the GRA (although this is more likely to apply to bank subsidiaries).

8. APPLICABILITY TO HOLDING COMPANIES

The ICR of holding companies of corporate and NBFI groups will generally be the same as the GRA provided the holding company is able to meet its cash needs (particularly for debt servicing) from its own business activities and/or operating companies, and there are no significant constraints on the ability of operating subsidiaries to support the holding company.

The ICR of a holding company will usually be lower than the GRA if any of the following apply:

(a) The debt-servicing capacity of the holding company is reliant on the performance of its operating subsidiaries, and it would likely face regulatory, legal or other barriers (such as strong minority interests or protective covenant restrictions) to upstreaming sufficient cash and assets, particularly in a stress scenario.

(b) The GRA is uplifted for extraordinary support, which is not expected to be available to the holding company.

If (a) is applicable – and the associated risk exceeds the level reflected in our assessment of the GRA (which will generally be the case for non-operating holding companies, even though the GRA may already have been adjusted, at least partially, for autonomous or protected subsidiaries) – the holding company's ICR will be a minimum of one notch lower than the GRA.

If (b) is applicable, the ICR will be equal to the GSA unless (a) also applies, in which case the ICR would be notched down from the GSA by at least one notch.

A larger rating differential between the holding company and group may be warranted depending, inter alia, on the following:

- the holding company's overall debt maturity profile/exposure to refinancing risk;
- the extent of holding company double leverage (allowing for any mitigants to potential cashflow mismatches, such as the level of the holding company's liquid assets); and
- risks to the adequacy of up-streamed distributions arising from the weak or declining profitability/internal capital generation capacity of the principal operating companies (particularly where subject to dividend and other restrictions).

The negative notching differential could be more than two if repayment risk is very high relative to the main subsidiaries.

Similar notching considerations apply to intermediate holding companies, although we may rate an intermediate holding company at the same level as the GRA if we believe it to be highly likely that the broader group would support the company and its operating entities in the event of need.

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