Criteria

The Link between Sovereign Ratings and Government Related Entities

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Overview

The scope of this criteria is to explain how DBRS determines whether the rating of a sovereign can be applied to a government-related entity (GRE). Applying the sovereign rating effectively implies that the GREs creditworthiness is directly tied to the sovereign’s creditworthiness.

GREs include institutions, administrative bodies, agencies and public corporations formed or nationalized by a government to carry out specific public policy roles and functions. Examples include social security administrations, privatization agencies, export credit financing vehicles, or guarantee issuance facilities. Some of these GREs engage in financing activities on behalf of the government, in pursuit of their specific mandate. The specific accountability arrangements between a government and a GRE may vary, but the conditions below are more likely to be met when the government exercises effective control of the entity. Companies that are partially owned by the government may be considered GREs.

Applying sovereign ratings to GREs

DBRS may apply the sovereign rating to a GRE if the sovereign has issued explicit guarantees which conform to the characteristics described in DBRS Criteria: Guarantees and Other Forms of Explicit Support. Alternatively, DBRS may apply the sovereign rating to a GRE if the following conditions are met:

1. The status of the GRE is clearly specified by legislation or regulation. (Note that in cases where the underlying legislation or regulation is unclear about the status of the entity being rated, an outside legal opinion may be sought by DBRS.)

2. There is a clear commitment from the sovereign to honor GRE obligations, potentially taking the form of one or more of the following:
   i. Special legal status that effectively requires the sovereign to honor GRE obligations or otherwise protects the entity from normal bankruptcy provisions applicable to non-government-related entities;
   ii. A specific pledge of financial resources through capital replenishment, compensation for operating losses, or assumption of debt obligations in the event of dissolution or insolvency.

3. The GRE has been authorized by the government to borrow and conduct the activities covered by the credit rating being assigned.

These conditions typically only apply to GREs that perform an important role for the country, serving a core public policy function. These conditions indicate that the government has sufficient willingness and ability to support the GRE, such that even in the absence of a formal guarantee, any difference in the likelihood of default is not sufficient to result in a differentiation between the sovereign ratings and the ratings of the GRE.

Even if the above conditions are met, DBRS may in some cases apply a rating to the GRE that is below the sovereign rating. This would typically reflect DBRS’ view that sovereign commitments fall short of effectively guaranteeing equal ranking between direct sovereign obligations and GRE obligations. It could also reflect a lack of broad-based political support for the GRE, suggesting that political developments could have an impact

on commitments to support the GRE. A default by a sovereign is typically a traumatic event, and given the lack of any applicable insolvency framework, the precise ranking of sovereign obligations is often unclear. In a stress scenario, DBRS analysis focuses on whether or not the sovereign could be expected to attach the same importance to honoring GRE obligations as it does to honoring its own direct obligations.

In cases where sovereign guarantees are not comprehensive and where the other conditions described above are not met, DBRS typically does not apply the sovereign rating to the GRE. Instead, DBRS conducts a full credit assessment of the entity, which is based on an evaluation of the GRE’s intrinsic credit fundamentals and factors in any prospects for support from the sovereign. In addition, DBRS usually conducts a full credit assessment of GREs that benefit from material independent sources of revenue.