

December 28, 2017

JSC “ALFA-BANK”

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Credit rating components	
Business profile	
First stage	a
Second stage	a
Key risk factors	
Capital adequacy	Adequate (+1)
Risk profile	Satisfactory (0)
Funding and liquidity	Adequate (0)
SCA	a+
Adjustments	
Systemic	0
Individual	0
Support	
Systemic importance	+2
Group support	0
State support	0
Credit rating	AA(RU)
Outlook	Stable

Key rating assessment factors

Strong business profile assessment. [Alfa-Bank](#) (the **Bank**) benefits on its strong franchise in lending and transactional services provided to businesses and individuals and moderate diversification of operating income. High quality corporate governance and adequate development strategy are also positive for the rating assessment.

Adequate loss absorption cushion. The regulatory capital adequacy ratio (as of October 01, 2017, N1.2 equaled 8.7%) is combined with a strong capital generation capacity (100–150 bps) by both the Bank and the entire Group, which allows the Bank to withstand the cost of risk increase of 300-400 bps while maintain the common capital adequacy ratio at not less than 6%.

Satisfactory risk profile assessment. In the last 12 months, the quality of loan portfolio has improved: the share of NPL90+ declined from 6.3% (as of July 01, 2016) to 2.8%, and the share of potentially problem loans (in terms of ACRA methodology) equaled to 6.0-6.5% (on the basis of the analysis of top 50 groups of borrowers). ACRA notes the high growth rate of the loan portfolio (+18% in 12 months preceding July 01, 2017), mostly in the retail segment, as well as a stably high share of non-collateralized loans (which is counter-balanced by the dominating role of the largest corporates with high credit quality play among other borrowers). The assessment also includes a high susceptibility of the financial performance (under the Russian reporting standards) to foreign currency revaluation of assets.

Adequate liquidity position. Under the ACRA base case scenario, the Bank can withstand an outflow of customer funds with a moderate margin, due to a high share of current accounts in the portfolio of liabilities (46.7% of customer funds). Under the stress scenario, liquidity deficit is at the average market level. A substantial undrawn limit of funds from the Bank of Russia is available to the Bank under Regulation 312-P (in late September, the limit was equal to USD 2.6 bln). The long-term liquidity position is assessed as strong, as LTLSI exceeded 70% in early September 2017).

The funding structure is well-balanced due to an adequate diversification by funding source (the share of individuals' funds was 37.7% as of July 1, 2017) and lender (the share of the largest lender was 3.8% and the share of top 10 lender was 14.3% of liabilities).

Moderate systemic importance. In our opinion, in case the Bank defaults, this may lead to a systemic crisis in certain segments of the Russian banking market and, consequently, may have a significant negative impact on the Russian financial sector and entire economy. The Bank is on the Bank of Russia's list of systemically important credit institutions.

Key assumptions

- Maintaining strong competitive positions in key business segments;
- Loan portfolio growth rate within 15-20%;
- Cost of credit risk within 0.7-1.2%;
- Net interest margin in the range of 4.3-4.5%;
- Tier-1 capital adequacy (N1.2) is above 8% within the 12 to 18-month horizon;
- Maintaining the current funding structure.

Potential outlook or rating change factors

The **Stable outlook** assumes that the rating will most likely stay unchanged within the 12 to 18-month horizon.

A positive rating action may be prompted by:

- A material decline in the share of problem loans in the loan portfolio.
- A substantial growth in the share of collateralized loans.

A negative rating action may be prompted by:

- A significant deterioration of the Alfa-Bank's regulatory capital adequacy as a result of aggressive dividend policy or increase in cost of risk;
- Deterioration of the liquidity position related to a thinning highly liquid asset cushion on the Alfa-Bank's balance;
- Deterioration of competitive positions in key business segments as a result of further consolidation of the banking sector.

Brief information about the bank

The Bank is a universal nation-wide bank focusing on lending to large- and medium-sized businesses and individuals and transactional services to businesses and individuals. As of October 01, 2017, the Bank was the largest private bank in terms of assets, capital and portfolio of deposits.

The Bank is a part of ABH Financial Limited Group (the Group), whose main beneficiaries are Mikhail Fridman and German Khan.

The Bank is on the list of systemically important credit institutions maintained by the Bank of Russia.

Rating assessment factors

Business profile (a)

Alfa-Bank's strong business profile is based on the high assessment of franchise, moderately diversified operating income, adequate development strategy, high corporate governance level, and transparent structure of ultimate beneficiaries.

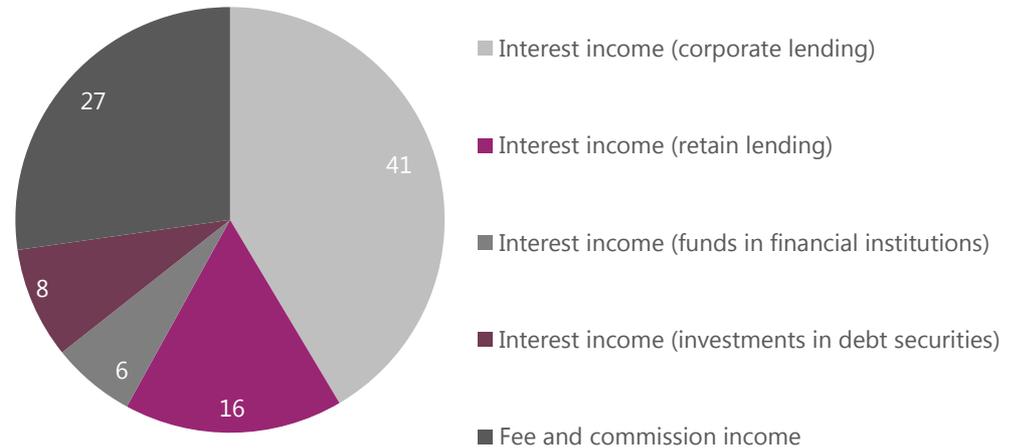
The Bank's business scale is nation-wide and its franchise is strong in the key business lines, including lending and transaction services. As of October 01, 2017, the Bank was the largest private bank in Russia ranked sixth by capital and fifth by assets.

The share of the Bank in the corporate and retail lending and fundraising segments is assessed as high. Operating in all Russia's federal districts, with over 700 business units running, the Bank served about 382 thousand corporate and 14.2 million individual clients as of mid-2017. The structure of client funds is dominated by on-demand

accounts, which provides for low funding costs allowing the Bank to compete with state and large foreign banks in lending to corporates. Extensive market coverage and a recognizable brand provide Alfa-Bank with an ability to influence pricing terms for raised and placed funds.

The Bank's operating income is moderately diversified by income source, combined with the good geographic diversification and long-term stability.

Figure 1. Alfa-Bank's operating income structure (% , 6M2017)



Source: JSC "ALFA-BANK"

ACRA assesses strategy and corporate governance quality at Alfa-Bank as sufficiently high in the context of the Russian banking market. Among other things, the Agency attributes this to a stable top management team and an effective operating management system. The Bank applies a moderately conservative approach to building up lending, while in terms of operating income it focuses mainly on increasing the proportion of net fee income, which is less sensitive to changes in the market environment.

Alfa-Bank's ownership structure is assessed as transparent: the Bank is controlled through a number of entities by several beneficiaries, with largest stakes held by Mikhail Fridman, German Khan, and Pyotr Aven.

Key risk factors

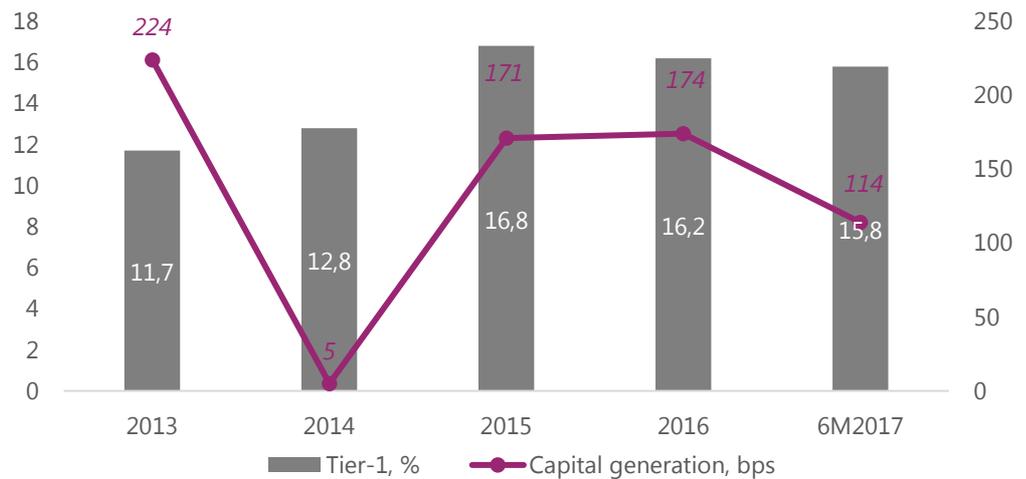
Capital adequacy: adequate (+1)

The Bank's comfortable regulatory capital adequacy loss absorption buffer is complemented by its strong ability to generate capital.

As of late June 2017, the Bank's common capital adequacy ratio (on the ABHF level by Basel standards) stood at 15.8%, while the regulatory capital adequacy ratio N1.2 was much lower (due to higher loss provisioning requirements, a more conservative approach to calculation of risk-weighted assets, and a narrow consolidation perimeter of the Group members' income included in capital) – 9.1% (8.7% as of October 01, 2017). As of all reporting dates of 2017, the N1.2 ratio exceeded 8%, which is assessed by ACRA as a comfortable loss absorption buffer: the Bank is able to withstand a stress devaluation of its loan portfolio equal to 300–400 bps of the annual cost of risk and to maintain the N1.2 ratio not lower than 6%.

The Bank's capacity to generate capital out of retained earnings is about 100-150 bps on the 12 to 18-month horizon, which is assessed as strong.

Figure 2. Capital adequacy and generation



Source: JSC "ALFA-BANK"

ACRA's base case scenario for 2017 assumes net income at USD 600–700 mln (IFRS) or RUB 10–12 bln (RAS) (provided a stable annual average RUB/USD exchange rate). We also expect the net interest margin to remain at 4.3–4.5% in 2017. ACRA's base case scenario also envisages that the cost-to-income ratio will stay at around 50% due to the expected growth of capital expenses. Our forecast is based on the assumption that the loan portfolio will grow by 15–20% in the next 12 months.

Risk profile: satisfactory (0)

ACRA notes the high quality of the risk management system and the adequacy of risk policies implemented by the Bank.

The share of non-performing loans in the loan portfolio is assessed as moderate. In the last 12 months, the loan portfolio quality has improved: the share of NPL90+ has declined from 6.3% (as of July 01, 2017) to 2.8%, while the share of potentially NPLs (according to ACRA terminology) amounted to 6.0–6.5% (as of July 01, 2017) (as calculated for top 50 borrowers). The potentially NPLs include loans issued to building and real estate companies. ACRA believes it important to emphasize that the most part of those loans are highly secured.

The NPLs are partially counterbalanced by the adequately diversified loan portfolio, as top 10 borrowers (borrower groups) comprised 29.5% of the total loan portfolio by mid-2017.

ACRA notes that the growth rate of the loan portfolio, mainly in the retail segment, is high (+18% in the 12 months preceding July 01, 2017). However, the share of unsecured loans is also high, but such loans are issued to borrowers with high credit quality.

The Bank boasts a very low concentration of lending on companies representing high-risk industries (ACRA puts at top their list such sectors as construction, rental and real estate): according to the Group's consolidated statements, as of July 01, 2017, the portfolio of such loans amounted to 50.7% of Tier-1 capital, which is below the threshold requiring adjustments to the loan portfolio quality assessment.

According to the Group's IFRS financial statements, the amount of loans provided by the Bank to its affiliates is insignificant, amounting to less than 2.1% of Tier-1 capital as of mid-2017. However, ACRA considers it important to note that the loan portfolio of the Bank contains a number of large loans (in aggregate, about 20% of the Bank's Tier-1 capital) issued to companies whose shareholders hold shares in the Bank. Those

companies are not affiliated with the Bank under IFRS requirements (which is confirmed by the auditor's report), and ACRA notes the high credit quality of such companies.

The Bank's susceptibility to market risk is assessed as moderate. Foreign currency assets of the Bank typically exceed relevant obligations. In case of a steady appreciation of Russian ruble, the Bank needs to carry out negative revaluation of currency denominated assets and liabilities, which is adverse for its financial performance and capital under the RAS. Given ACRA's expectations in respect of the ruble exchange rate in 2017 and 2018, we estimate the negative impact of such revaluation on the above indicators as moderate.

In ACRA's opinion, the operational risk level appears to be insignificant.

Funding and liquidity: adequate (0)

We view the Bank's liquidity management policy as adequate. The top management adheres to a conservative approach, which is based on its profound experience in dealing with local and broad systemic crises on the banking market and reflected in liquidity stress testing scenarios applied on a regular basis and in payment position operational planning principles.

As of September 01, 2017, in the base case scenario of ACRA, the Bank was able to withstand an outflow of customer funds with a moderate surplus (the short-term liquidity shortage indicator (STLSI) is positive), which is explained by the high share of current accounts (46.7% of client funds). Under the stress scenario, the liquidity shortage amounted to about 5–10% of total liabilities, which is an adequate level for a large Russian bank. The stress scenario of ACRA excludes prolongation of deposits maturing in three months, although the likelihood of such development is quite high.

The long-term liquidity is assessed as strong (as of September 01, 2017, the long-term liquidity shortage indicator (LTLSI) exceeded 70%).

In the next 12 months, the Bank is expected to make a range of large payments under corporate accounts, but the risk of default under such obligations is assessed as minimal.

In addition to its own liquidity cushion, the Bank has access to funding offered by the Bank of Russia and secured by non-market assets in accordance with the Bank of Russia's Regulation No. 312-P (as of October 01, 2017, the potential borrowing amount estimated by the management was USD 2.6 bln). The Bank also has a significant portfolio of unencumbered securities on balance that can be pledged under repo transactions with the Bank of Russia.

The funding structure is balanced due to the adequate diversification by funding source (the share of the largest source, retail funds, was 37.7% as of July 1, 2017) and lender (the share of the largest lender, excluding the Bank of Russia, was 3.8% of liabilities, and the share of top 10 lenders was 14.3% of liabilities). In ACRA's opinion, the funding structure of the Bank will not undergo significant changes in the next 12–18 months.

ACRA notes that Alfa-Bank has no restrictions on raising funding from foreign capital markets.

Additional adjustments

Systemic

We expect the key indicators of the Bank's operating environment to be stable within the 12 to 18-month horizon. Consequently, there are no grounds for applying a negative systemic adjustment to Russian banks, including Alfa-Bank.

Individual

There are no grounds for applying individual adjustments.

Systemic importance

The Bank's systemic importance is assessed as moderate. As of October 01, 2017, the Bank's balance sheet included RUB 1,071 bln or 4% of the total funds held by corporates in banks and RUB 773 bln or 3.1% of the total funds held by individuals in banks. The Bank's share in the current accounts segment was 9.2%. In our opinion, a default of the Bank may trigger a systemic crisis in certain Russian banking market segments, mass panic among account holders and higher distrust to the banking system, which, in turn, may have a significant negative impact on financial stability and the entire economy of Russia. The Bank is on the Bank of Russia's list of systemically important credit institutions.

Group support

The Bank is part of ABH Financial Limited group making up around 90% of its assets, with key ultimate beneficiaries being a number of individuals. ACRA does not account for potential extraordinary support from the beneficiaries and, therefore, applies no additional support notches pertaining to this factor. Apart from the banking business, the main beneficiaries of Alfa-Bank own assets in various other sectors, including trade and commerce, telecommunications, oil & gas, and asset management. ACRA notes that other assets of the Bank's beneficiaries are isolated from banking activities within the group structure, which allows ACRA not to consider a potential deterioration in their creditworthiness as a negative rating factor for Alfa-Bank.

The ACRA's opinion is expressed via the absence of additional support notches added to the SCA.

State support

The Bank is not a government-related organization; hence no additional support notches have been added to the SCA.

Support

Issue ratings

[Subordinated perpetual eurobond issued by JSC "ALFA-BANK" \(XS1513741311\)](#); issue volume: USD 700 mln — BBB-(RU).

[Certified exchange-traded interest-bearing unregistered bond issued by JSC "ALFA-BANK", BO-22 series \(RU000A0ZYGB6\)](#); maturity date: December 04, 2032, issue volume: RUB 5 bln — AA(RU).

[Certified exchange-traded interest-bearing unregistered bond issued by JSC "ALFA-BANK", BO-21 series \(RU000A0ZYBM4\)](#); maturity date: October 13, 2032, issue volume: RUB 5 bln — AA(RU).

[Certified exchange-traded interest-bearing unregistered bond issued by JSC "ALFA-BANK", BO-20 series \(RU000A0JXR7\)](#); maturity date: May 11, 2032, issue volume: RUB 5 bln — AA(RU).

[Certified exchange-traded interest-bearing unregistered bond issued by JSC "ALFA-BANK", BO-18 series \(RU000A0JX5W4\)](#); maturity date: January 05, 2032, issue volume: RUB 5 bln — AA(RU).

[JSC "ALFA-BANK" Eurobonds \(LPN\) \(XS1648266788\)](#); maturity date: July 20, 2021, issue volume: RUB 10 bln — AA(RU).

[JSC "ALFA-BANK" Eurobonds \(LPN\) \(XS1567117566\)](#); maturity date: February 16, 2022, issue volume: RUB 10 bln — AA(RU).

Rating history

November 13, 2017 — AA(RU), outlook Stable.

November 15, 2016 — AA(RU), outlook Stable.

Regulatory disclosure

The credit ratings were assigned to JSC "ALFA-BANK" and to bonds (ISIN XS1513741311, RU000A0ZYGB6, RU000A0ZYBM4, RU000A0JXRV7, RU000A0JX5W4, XS1648266788, XS1567117566) issued by JSC "ALFA-BANK" under the national scale for the Russian Federation based on the [Methodology for Credit Ratings Assignment to Banks and Bank Groups Under the National Scale for the Russian Federation](#) and the [Key Concepts Used by the Analytical Credit Rating Agency Within the Scope of Its Rating Activities](#). The Methodology for Assigning Credit Ratings to Individual Issues of Financial Instruments Under the National Scale of the Russian Federation was also used in the process of credit rating assignment.

For the first time, the credit rating of JSC "ALFA-BANK" and credit ratings of bonds (ISIN XS1513741311, RU000A0ZYGB6, RU000A0ZYBM4, RU000A0JXRV7, RU000A0JX5W4, XS1648266788, XS1567117566) issued by JSC "ALFA-BANK" were published by ACRA on November 15, 2016, December 09, 2016, November 24, 2017, October 02, 2017, May 31, 2017, January 24, 2017, July 24, 2017, and February 17, 2017, respectively.

The credit rating and credit rating outlook of JSC "ALFA-BANK" and the credit ratings of the above bonds (ISIN XS1513741311, RU000A0ZYGB6, RU000A0ZYBM4, RU000A0JXRV7, RU000A0JX5W4, XS1648266788, XS1567117566) are expected to be revised within one year following the relevant rating action dates (November 09, 2017, December 07, 2017, November 23, 2017, September 28, 2017, May 30, 2017, January 23, 2017, July 21, 2017, and February 17, 2017, respectively).

The credit ratings were assigned and affirmed based on the data provided by JSC "ALFA-BANK", information from publicly available sources, as well as ACRA's own databases. The rating analysis was performed on the basis of the IFRS consolidated financial statements of ABH Financial Limited group. ACRA also used IFRS consolidated financial statements of JSC "ALFA-BANK" and financial statements of JSC "ALFA-BANK" composed in compliance with the Bank of Russia Ordinance No. 4212-U dated November 24, 2016. The credit ratings are solicited and JSC "ALFA-BANK" participated in the rating process.

No material discrepancies between the provided data and the data officially disclosed by JSC "ALFA-BANK" in its financial statements have been discovered.

ACRA provided additional services to JSC "ALFA-BANK". No conflicts of interest were discovered in the course of credit rating assignment.

Appendix

Table 1. Consolidated balance sheet items, USD mln

	2014	2015	2016	6M2017
Assets	43,566	31,470	38,247	41,804
Cash and equivalents	1,693	1,012	1,109	4,458
Receivables from Bank of Russia and Russian Finance Ministry	764	1,233	1,956	n/a
Receivables from banks and financial institutions	6,338	2,247	4,279	4,301
Debt securities	3,833	4,516	5,776	5,459
Shareholdings	56	34	27	39
Loans to and receivable from corporates, sole entrepreneurs and authorities	22,171	17,692	19,907	21,922
Loans to and receivable from individuals	4,294	2,547	2,855	3,257
PPE	0	0	524	520
Other financial assets	3,180	1,330	1,219	1,202
Other non-financial assets	413	267	299	328
Liabilities	39,270	27,126	32,513	35,805
Funds of banks and financial institutions	2,149	1,723	3,147	1,652
Funds of Bank of Russia	6,038	371	281	619
Funds of individuals and individual entrepreneurs	12,056	10,465	12,252	13,494
Funds of entities	7,352	6,690	8,563	12,022
Funds of Russian Federation subjects, non-budgetary funds and municipalities	651	593	906	892
Securities issued	5,257	4,029	3,580	4,097
Subordinated debt	1,813	1,533	1,534	1,349
Funds of Deposit Insurance Agency	276	242	323	354
Deferred tax liabilities	208	317	31	88
Financial liabilities assessed at fair value through profit or loss	3,224	907	-	-
Other liabilities	246	256	1,896	1,238
Equity	4,296	4,344	5,734	5,999
Share capital	1,265	1,265	1,265	1,265
Fair value reserve for investments available for sale	-	-	6	8
Retained earnings	3,868	4,407	4,948	5,125
Revaluation reserve for premises	73	71	69	68
Revaluation fund for financial assets available for sale and/or hedging	(55)	27	-	-
Cumulative translation reserve	-868	(1,438)	(1,275)	(1,210)
Perpetual subordinated bonds	-	-	700	701
Other sources of capital	13	12	21	42

Source: IFRS statements of ABHF

Table 2. Consolidated profit and loss statement items, USD mln

	2014	2015	2016	6M2017
Interest income	4,142	3,189	2,705	1,508
Interest expenses	(1,964)	(1,910)	(1,380)	(755)
Net interest income	2,178	1,279	1,325	753
Impairment provision change	(1,228)	(777)	(296)	56
Net interest income after impairment provision	950	502	1,029	809
Fee and commission income	1,087	805	905	565
Fee and commission expenses	(262)	(220)	(271)	(169)
Net fee income	825	585	634	396
Other income net of expenses	(577)	451	57	(47)
Net income (expenses)	1,198	1,538	1,720	1,158
Administrative and other operating expenses	(1,186)	(971)	(957)	(572)
Income (loss) before taxes	12	567	763	586
Income tax expenses	21	(87)	(236)	(150)
Income (loss) after taxes	33	480	527	436

Source: IFRS statements of ABHF

Table 3. Key ratios (adjusted by ACRA)

	2014	2015	2016	6M2017
Capital adequacy				
Tier-1 CAR	12.8%	16.8%	16.2%	15.8%
N1.2	n/a	7.5%	8.83%	8.86%
Capital generation, bps	5	171	174	114*
ACGR, bps	н. п.	168	157	n/a
Leverage	9.1%	12.7%	11.5%	11.1%
NIM	5.1%	3.7%	4.2%	4.4%
CTI	45.8%	43.0%	48.4%	51.5%
Risk profile				
NPL90+	2.7%	6.9%	4.2%	2.8%
Problem debt share (adjusted by ACRA), including NPL90+	n/a	n/a	n/a	6.5%
Provision coverage of problem debt	n/a	n/a	n/a	< 20%
10 largest borrowers (borrower groups) share	n/a	n/a	n/a	29.5%
Concentration on high-risk sectors	n/a	n/a	n/a	50.7%
Concentration on affiliated parties	n/a	n/a	n/a	2.1%
Funding and liquidity				
Share of the largest funding source in total liabilities	30.7%	38.6%	37.7%	37.7%
Share of regulative funding in total liabilities	15.4%	1.4%	0.9%	1.7%
Share of the largest client's (group of clients) funds, excluding funds borrowed from the Bank of Russia	n/a	n/a	1.7%	3.8%
Share of 10 largest clients' (client groups') funds, excluding funds borrowed from the Bank of Russia	n/a	n/a	8.7%	14.3%

* y-o-y

Source: ACRA

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