Parent and Subsidiary Linkage Rating Criteria

Cross-Sector

Table of Contents

This report updates and replaces *Parent and Subsidiary Linkage Rating Criteria*, dated 1 December 2021.

Related Criteria

Corporate Rating Criteria (October 2022)
Infrastructure & Project Finance Rating Criteria (May 2023)
Government-Related Entities Rating Criteria (September 2020)
Investment Holding Companies Rating Criteria (May 2023)
National Scale Rating Criteria (December 2020)
Public Sector, Revenue-Supported Entities Rating Criteria (April 2023)

Analysts

Maude Tremblay
+1 312 368 3203
maude.tremblay@fitchratings.com

Rachel Chin
+44 20 3530 1629
rachel.chin@fitchratings.com

Danilo Quattromani
+39 02 879 087 275
danilo.quattromani@fitchratings.com

Scope

This report outlines the methodology Fitch Ratings uses for assigning or monitoring Issuer Default Ratings (IDRs) or National Long-Term Ratings for non-financial companies linked by a parent and subsidiary relationship. It also applies for IDRs and issue ratings assigned under the Infrastructure and Project Finance Rating Criteria.

These criteria supplement and apply in conjunction with the Corporate Rating Criteria for the corporates sector, the Public Sector, Revenue-Supported Entities Rating Criteria for the public finance sector, and *Infrastructure and Project Finance Rating Criteria* for the infrastructure and project finance sector.

The notching we apply to issuers rated on the national scale may vary from these criteria in order to preserve the ranking of risk within the country in question after considering national relativities. Please see the National Scale Rating Criteria for further details.

These criteria do not apply to credit ratings assigned to primary entities covered by the Government-Related Entities Rating Criteria (i.e. entities directly owned by government sponsors). However, corporate subsidiaries of government-related entities (GREs) will generally be rated using the present criteria, subject to the specific limitations detailed on page 13.

Where the Investment Holding Companies Rating Criteria apply, the parent rating is assigned as an investment holding company. In general, investees of companies rated under our *Investment Holding Companies Rating Criteria* will be rated on a standalone basis and will not be subject to the provision of these criteria. However, the principles of linkage in these criteria may be used to rate the investee closer to the investor where a weaker investee should benefit from implied support from the investor or where a weaker investor has sufficient access and control over a stronger investee.

Key Rating Drivers

Linkage strength determines if the consolidated credit profile or Standalone Credit Profile (SCP) is more or less important when assigning IDRs. The parent and subsidiary will be rated at the consolidated level, irrespective of their SCP, if their linkage is very strong. On the other hand, both entities can be rated with greater separation if their linkage is very weak, particularly for ring-fenced structures.

Parent-Subsidiary Linkage Relationship: Fitch determines if there is sufficient control by the parent such that linkage should be considered.

Relative Credit Quality: We compare the SCP of the parent and its subsidiary to determine which path and factors to use in determining linkage.

Linkage Characteristics: Where the parent is stronger, we will assess the legal, strategic and operational incentives for the parent to support the subsidiary. Where the subsidiary is stronger, we will assess the parent's level of access to and control over the subsidiary's resources, and legal or regulatory ringfencing provisions, which may stop the weaker parent accessing value from the subsidiary.

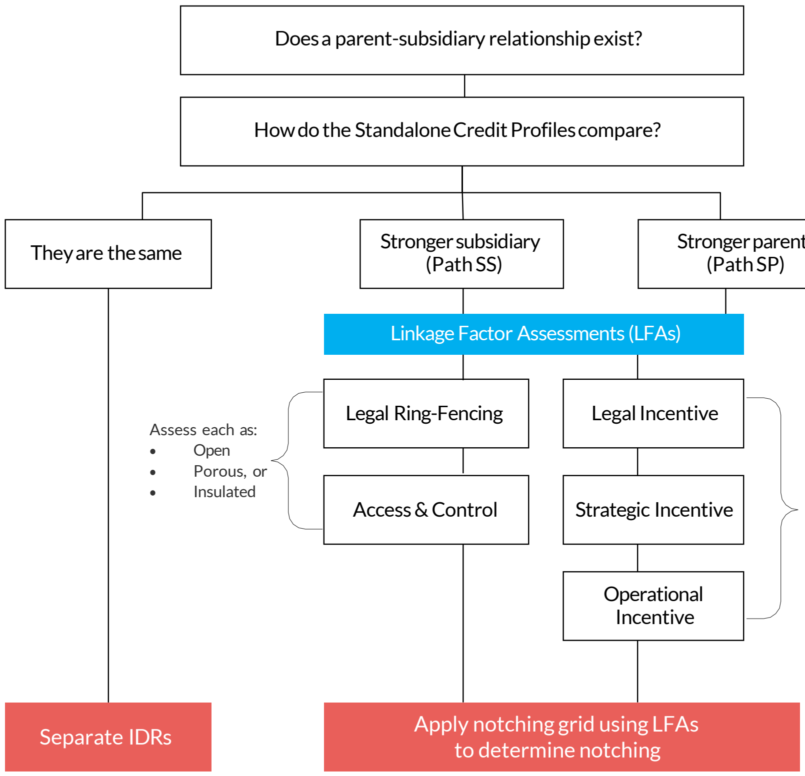
Certain strong legal factor considerations, such as guarantees, can outweigh other factors.

Linkage Considerations Framework

The following section outlines the steps Fitch takes when determining whether or not to link the IDRs of a parent and its subsidiary. The steps collectively form a linkage considerations framework (LCF). The three steps are:

1. determine if a parent-subsidiary relationship exists;
2. compare SCPs of the parent and its subsidiary, as well as the consolidated credit profile;
3. determine the parent and subsidiary relationship by assessing the linkage factors depending on the path taken.

Linkage Considerations Framework



Source: Fitch Ratings

Step 1: Determine if a Parent-Subsidiary Relationship Exists

Fitch examines the relationship between a parent and its subsidiary to identify whether the parent has sufficient control for such a relationship to exist before determining if the IDRs of a parent and its subsidiary should be linked.

The parent is defined as the highest entity in the group with considerable control over management and strategy for the group. For that reason, intermediate holding companies, with no material operations or debt, used by the parent or its material subsidiaries to hold their stake will not be regarded as parents, meaning we will "look through" such entities when applying these criteria.

Sufficient control is typically indicated by the parent having majority (direct or indirect) economic or voting control over the subsidiary, which also would normally mean the subsidiary is consolidated in the parent's group financial statements. The criteria also treat minority ownership scenarios in the same manner when there is evidence of control.

An associate or joint-venture relationship may also qualify for linkage in the rare case that we determine that a stronger investor is likely to support a weaker investee in distress. This may occur because of a strategic investment in new technology, a minority owner with anticipation of progressively greater ownership, or other strategic or reputational reasons.

We follow steps two and three of the LCF to determine the degree of appropriate linkage where a qualifying parent-subsidiary relationship exists. We rate entities based on their SCPs if no relationship exists and the LCF terminates at this stage.

Funding Vehicles Exempted

Many companies operate funding vehicles: companies with no operations that are used solely to issue debt that is then made available to the operating parts of the group. This may include entities that exist solely to support the treasury functions of the group that do not have operations.

Funding vehicles are typically exempt from SCP analysis and are not assigned a separate IDR. When one is assigned, it is equalised with the IDR of the relevant entity within the group, even in the absence of a guarantee, where the funding vehicle is recognised by the market as acting as one of the principal issuing vehicles for the group. The funding vehicle could be notched down if it were to bear material risks (e.g. FX) not passed to operating entities.

Other Excluded Entities or Vehicles

We rate entities owned by private equity vehicles, or similar financial investors, based on SCPs and do not generally assume a parent-subsidiary relationship under these criteria, because:

- such owners may not be relied upon to be providers of financial support in the long term;
- the influence of weaker private equity owners with a strong desire for cash would normally be reflected in our assumptions of dividends and the recognition that lenders generally require covenant protection with restricted payment conditions when an issuer is controlled by private equity owners; and
- such investors may be aggressive on one deal but supportive on another, weakening the value of any systematic support or constraint judgements.

Similar rationales apply for our decision to not give credit for family ownership. Fitch rates legal structures, or combinations of legal structures, and does not rate private individuals or their family groupings.

On this basis, the debt at excluded sponsors would likely be excluded from ratings analysis under the present criteria. However, ownership by excluded parents or groups, including related-party considerations, may have an impact for a rated entity under the financial policy and governance elements of the respective Navigator for corporates. A similar approach will be taken for infrastructure entities as per the *Infrastructure and Project Finance Rating Criteria*. Similarly, our financial forecasts may include assumptions on dividend expectations or other cash flows, driven by our understanding of the demands placed upon the rated entity by its ownership structure. Specifically, as it pertains to holdco payment-in-kind and shareholder loans in corporates, Fitch will apply Adjustment 7 in the *Corporate Rating Criteria*.

Ownership Levels

Fitch does not set minimum ownership thresholds, or change the level of deemed support in direct correlation to ownership percentage. The degree to which ownership affects the incentive to support, or access to support, are fully addressed within the LCF factors. We do not believe the influence of percentage ownership would consistently scale in a fully linear manner. For example, a 30% stake in a company that is critical for a parent company's growth may be more likely to attract support than a 60% stake in a sunset industry from which the issuer is strategically disengaged.

Step 2: Determine Standalone Credit Strengths

If Fitch determines that linkage (as defined in Step 1 of the criteria) exists, the next step is to form a preliminary view of the parent's and subsidiary's relative SCP using the relevant elements of Fitch's *Corporate Rating Criteria* or *Infrastructure and Project Finance Rating Criteria*.

Our assessment of a parent's SCP starts from the consolidated profile of the group (generally including the subsidiary under consideration), adjusted for deconsolidation and other adjustments pursuant to Adjustment 6 in the *Corporate Rating Criteria*. Such adjustments may include deconsolidation of fully ring-fenced or financial services subsidiaries. A similar approach is taken for infrastructure entities under the Issuer Structures section of the *Infrastructure and Project Finance Rating Criteria*.

If the SCPs are the same, the parent's and subsidiary's IDRs will be the same. There is no need to proceed to the stronger subsidiary path (Path SS) or the stronger parent path (Path SP) of the LCF for identical IDRs in a group, although this analysis may be performed to determine rating triggers in the event that either entity's SCP changes.

Path SS of the LCF is used to determine the linkage that exists if the parent's SCP appears weaker than that of its subsidiary. Path SP of the LCF is used if the parent appears to have higher credit quality than its subsidiary.

When rating GRE subsidiaries, the parent's credit profile will depend on whether we believe government support will flow to the subsidiary. If government support is likely to extend to the subsidiary, the parent's credit profile will be the parent IDR including support. If support does not extend to the subsidiary, the assessment will be based on the parent's consolidated profile without support. This resulting credit profile will be used to determine whether to embark on Path SS or Path SP. Please see the *Government-Related Entities* section on page 11 for additional detail.

At this initial stage, the rigour with which the SCPs of the parent and subsidiary and consolidated profile are analysed is a matter of practicality, and can be the first step in an iterative process. We will undertake sufficient analysis to allow us to proceed to Step 3, understanding that if we determine certain relationship we may need to deepen our analysis to be sufficiently informed to assign a final rating.

The results of Step 3 may also determine that we do not need to form a firm credit view on all profiles. For example, where we determine that the subsidiary will always be rated on a standalone basis regardless of whether a parent is stronger or weaker than the subsidiary, there would be no logical need to determine the SCP of the parent or a consolidated view of the group. Likewise, where the parent is evidently considerably stronger than the subsidiary and the linkage is deemed strong enough to rate the subsidiary on an equalised or top-down basis, the SCP of the subsidiary would not be required. A rating committee will determine whether the depth of analysis done to determine SCPs and a consolidated profile is sufficient to support the rating being assigned.

Where adequate information on the parent is not available, and the parent does not belong to one of the exempt classes noted above, analysts will take a view on whether more conservative Navigator scores on financial policy and governance, as well as conservative assumptions on shareholder returns, will be sufficient to reflect the parent's influence. Similarly, for infrastructure entities, analysts will take a view as per the *Framework* section of the *Infrastructure and Project Finance Rating Criteria*. Fitch may decline to assign a rating if information is insufficient.

Step 3: Analyse Linkage Factors

Linkage Factor Assessments

Path SS: weaker parent, stronger subsidiary	Path SP: stronger parent, weaker subsidiary
Assessed as open, porous or insulated:	Assessed as low, medium or high:
Legal ring-fencing	Legal incentive
Access & control	Strategic incentive
	Operational incentive

Source: Fitch Ratings

Different Relationships, Different Factors

The two paths, Path SS and Path SP, consider different linkage factors, and each linkage factor will be assessed as displaying one of three gradations. Details of each path, with sample considerations, are considered below. Where the analyst believes the substance of a linkage may differ from the formal state – for example, when we believe nominally strong insulation will have questionable enforcement or will be subject to circumvention in other ways – analysts will select the factor that best reflects the substance of the relationship. When this is the case, we will disclose this in our rating action commentary.

For entities rated under the *Corporate Rating Criteria*, analysts will also be guided by the governance structure factor in the parent's and/or subsidiary's Navigator profile. A governance structure sub-factor evaluation of 'bb', or more particularly 'b' or below, increases the likelihood of an 'open' evaluation in Path SS, or 'low' in Path SP.

The assessment of each linkage factor for infrastructure entities will also be guided as per the *Issuer Structure* and *Ownership and Sponsors* sections of the *Infrastructure and Project Finance Rating Criteria*.

Path SS: Stronger Subsidiary, Weaker Parent

Subsidiary Rating Under Path SS

Legal Ring-Fencing

Legal or covenanted restrictions have the most impact amongst the linkage factor assessment (LFA) sub-components since they may constitute specific and tangible separation between the parent and subsidiary.

In the context of Path SS, we are assessing whether mechanisms exist that would prevent or dilute the capacity of a parent company to extract value from a subsidiary of a higher credit quality. These may be included in financing documents, noting prohibitions on upstream guarantees, placing limits on intercompany loans and other transactions such as asset sales or dividend amounts.

Fitch will consider the tenor and permanence of the relevant debt instruments. Private bank financings may be more easily refinanced or the covenants waived if breached

Fitch recognises, however, that issuers can also remove covenant constraints even in public debt obligations by refinancing the relevant bonds. Fitch would take into account the likelihood of such refinancing, including the size of the debt needing to be refinanced, as well as the history and announced intentions of the relationship between a parent and subsidiary as they relate to cash flow movement between the entities. For issue ratings rated under the *Infrastructure and Project Finance Rating Criteria*, where modifications of covenant constraints require lenders' approval, Fitch would generally consider such constraints as permanent.

Consequently, limitations enshrined in long-dated public market debt, or project finance debt rated under the *Infrastructure and Project Finance Rating Criteria*, may support an 'insulated' grading. Milder versions of these restrictions may result in a 'porous' grading. The absence or effective absence of limitations would result in an 'open' grading.

Mechanisms may also involve externally-imposed ring-fencing, typically for regulated entities. These may result in varying degrees of insulation. At one extreme, insulation could be virtually impenetrable resulting in an 'insulated' assessment and, in turn, a 'standalone' rating outcome. At the other end, ring-fencing may be non-existent or mildly effective, resulting in an 'open' assessment.

Access & Control

In addition to formal external financing or regulatory limitations, we form a view on the relative level of access to and control of cash or other assets through an assessment of the effectiveness of the parent's control of the subsidiary and the level of insulation of the subsidiary in the group's funding and cash management policy.

Formal ownership where the parent dominates control of the subsidiary with limited or no influence from external stakeholders would lead to an assessment of effective control as 'open'.

Conversely, if minority shareholders or other external stakeholders have a high level of rights, effective control would be assessed as 'insulated'.

Subsidiaries where we expect all external funding to come from the parent, or where cash can be lent upstream to be pooled with other group cash, or where there is no formal policy related to separate funding, would be assessed to be 'open' for funding and cash management policy. Conversely, this factor would be assessed as 'insulated' when funding is entirely decentralised, with significant group companies raising funds (including liquidity facilities) and managing their cash on their own accounts, with no involvement from the parent, and when we expect such arrangements to continue.

The more open of the two sub-factors typically carries more weight in the analysis. However, there is allowance for analysts' discretion where appropriate. Past behaviour, while an important consideration, is less important than our forward-looking assessment of access and control.

Arriving at a Conclusion

To arrive at the gradings, analysts are guided by the sample considerations contained in Path SS (see the LFA table below) to generate two LFAs. Not all considerations will be relevant for every issuer. Each consideration can be assessed in isolation, but the overall LFA will focus on the importance relative to that individual issuer. Additionally, an 'insulated' grading of either legal ring-fencing consideration would result in an 'insulated' result for that factor assessment.

Path SS: Linkage Factor Assessment

		Open	Porous	Insulated
Legal ring-fencing	Self-imposed conditions	No limitations, or only informal indications of financial policy from management, or other contra-indicating provisions (e.g. legally enforceable upstream guarantees already in place)	Effective limitations on dividends and other intercompany flows are the subject of short-dated or limited efficacy documentation	Effective ring-fencing documentation in key long-dated financing documents, limiting dividends, upstream guarantees and intercompany lending, explicitly designed to support the subsidiary's profile. In the infrastructure and project finance sector, this may extend to key contracts and incorporation documentation
	Regulatory ring-fence (typically utilities)	No to mildly effective regulatory ring-fencing	Ring-fence limitations on dividends or debt raising, or imposition of other financial restrictions. However, the parent may still weaken the subsidiary in the longer term	Ring-fencing is more insulated. This may be due to, for example, additional provisions that exert control over governance or tightened financial controls at specific rating thresholds
Access & control	Effective control	Dominant shareholder control of all major transactions. No minority shareholders or JV partners, or minority shareholders of <20% in a low-regulation environment	Minority shareholders or JV partners present, separate public listing. Some separation of board composition/ functional control.	Minority shareholders or JV partners in a high-regulation environment, separate public listing, limitations on major transactions without minority shareholder consent
	Funding and cash management policy	No formal policy relating to separate funding. Subsidiary can lend cash upstream to be pooled with other group cash. Widespread co-borrower status or all/nearly all external funding via the parent.	A mixture of external vs intercompany funding, and/or limited visibility on the future independence of the subsidiary to manage its own external funding and cash	All of the subsidiary's non-equity funding is external and is managed by the subsidiary with a high degree of autonomy. Cash management and funding policy embodies a long-term intention for the subsidiary to separately manage its cash and funding needs

Source: Fitch Ratings

The two LFAs are then combined to recommend a notching relationship as shown in the table below. Notching will be capped at the subsidiary's SCP. For example, for a subsidiary one notch stronger than its parent on a standalone basis, a score of 'consolidated+2' would see the subsidiary notched up only by one notch.

Path SS Notching Matrix

Access & Control	Open	Porous	Insulated
With open ring-fencing	Consolidated	Consolidated + 1	Consolidated + 2
With porous ring-fencing	Consolidated +1	Consolidated + 2	Consolidated + 2
With insulated ring-fencing	[a]	Standalone	Standalone

[a] It is unlikely that considerations for 'insulated' legal ring-fencing would co-exist with the conditions outlined under 'open' for access and control. It is more likely that other factors relevant to legal ring-fencing or access & control, but not within this table, would move either one, or both, of the individual LFAs to a 'porous' level that would lead to a consolidated+1, consolidated+2 or standalone outcome.
Source: Fitch Ratings

Parent Rating Under Path SS

Typically, the parent IDR is rated at the level of the consolidated group profile. This reflects the parent's broader credit strengths deriving from subsidiary ownership, including greater bankability relative to peers, the residual equity value of ownership, and benefits of scale in the marketplace. Scale in particular is a frequent key factor within our Navigator framework, across the majority of industry templates that we apply. Dividend and other intercompany flows (from consolidated tax planning, for example) can also support greater emphasis being placed on the consolidated profile, recognising that the SCP of the subsidiary would in turn be partly determined by our forecast assumptions of those cash flows.

Where the parent's access to significant cash flows of the group is limited, we may rate the parent below the consolidated profile or deconsolidate the subsidiary. These adjustments are set out in the *Adjusting Consolidated Profiles for Group Structures* section of the *Corporate Rating Criteria*.

For project finance holding companies' issuer or issue ratings, please refer to the *Project Finance Holding Company* section under the *Infrastructure and Project Finance Rating Criteria.*

Path SP: Stronger Parent, Weaker Subsidiary

Subsidiary Rating Under Path SP

Legal Incentives

Like Path SS, legal considerations can effectively trump other factors since they may constitute specific and tangible linkage between the parent and subsidiary. Strong legal ties typically result in an equalisation of ratings. The presence of legal ties could outweigh a lack of operational and strategic ties and result in a close linking of ratings. Conversely, the absence of formal agreements would not necessarily supersede the presence of strong operational and strategic ties. Below is an analysis of the main legal ties examined by Fitch.

Guarantees

A close relationship between IDRs is indicated if a stronger entity guarantees over half the debt obligations of its weaker related entity. Where subsidiaries only have 20%-50% of their debt guaranteed, we would likely grade the linkage as 'medium'. Individual guaranteed instruments in such cases would nonetheless be rated at the level of the guarantor. Trajectory will also be considered; if the parent is progressively guaranteeing more or less debt, this will affect the incentive grading.

Public or private letters of support, comfort letters and "keep well" agreements do not constitute legal guarantees. However, some capital call agreements do create a funding obligation and would therefore be taken into consideration, and may qualify for a 'medium incentive' level of support. Supportive factors include full versus partial support, and indefinite versus time-limited obligation.

Cross Defaults

Cross defaults may indicate a high incentive to support both as a legal linkage and as a conscious and persisting statement of intent by both debtor parties. Conversely, it may be legacy documentation of minimal relevance to the credit judgement. The eventual assessment here will consider, among other factors, whether the instrument featuring the cross-default language is broad and long-dated, and if we believe incentives align to support creditors calling them, versus instruments that represent a small portion of the debt quantum, and/or are short-dated, and where the committee believes incentives are more limited for the cross-default to be called. We take into account any carve-outs for cross defaults known to us and the size of the debt instrument relative to the cross-default threshold.

Cross defaults may, at the very least, provide the opportunity for creditor classes, who may have stakes in both entities, to link the fates of the entities at a point of stress. For example, lenders to the parent could exert pressure on the management to either support or not support the subsidiary with parent cash flows, depending on whether those lenders are also lending at the subsidiary level. This may see our judgement on support likelihood change over time as the credit position and creditor base of entities change.

Strategic Incentive

We look at the strategic incentive through the triple lens of financial contribution, competitive advantage and growth potential.

A subsidiary can provide tangible value either through the scale of cash flows generated, or the value of specific assets, even where these are not immediately cash flow generating. As business models vary – with some companies operating large, homogenous operations, and others a combination of separate, but each materially notable, businesses – the threshold of contribution will vary by issuer.

Indicators for relative strategic importance will also include any competitive advantage – beyond immediate cash generation – that a subsidiary may offer, perhaps as a trading operation for a commodity producer.

Separately, a subsidiary may be more likely to be graded 'low incentive' if it is in secular decline, with negative growth prospects, and 'high incentive' if it has both good growth prospects and makes a material contribution to the consolidated business.

Forms of Support Undertaking

Various forms of support undertakings exist in different markets. These range from soft letters of comfort, which simply acknowledge a subsidiary's parentage, to full and unconditional guarantees. These have varying degrees of legal enforceability and/or support offered to the subsidiary.

Generally, we would only consider debt guarantees as supportive of a 'high' legal incentive. Other arrangements, or debt guarantees of lower coverage/permanence, are more indicative of 'medium' to 'low' legal incentives. However, these weaker arrangements may form part of a fact set that supports 'strategic' or 'operational' incentives. Examples of these 'weaker' legal undertakings may include:

- Letters of comfort or support
- Profit- and loss-absorption agreements
- "Keep well" agreements
- Non-debt-related agreements such as guarantees for pension obligations and trade guarantees
- Partial credit guarantees or similar partial support arrangements such as insurance.

This list is not exhaustive and analysts have discretion to consider the substance of the undertaking in question to determine the extent of legally obligated support.

Strategy is a broad topic, affecting many areas of a company's operations. Other factors relevant to the industry or issuer may also be considered, including reputational implications of a default at the subsidiary. Prior tangible support, through injections of cash, subordinated intercompany loans, operational support or other means, increases Fitch's incentive grading only to the extent that, when coupled with other considerations, it increases the prospects of future support.

Operational Synergies

'High incentive' linkage under these criteria would reflect subsidiary operations that are integral to the parent's core business. For example, in the case of a manufacturing group that owns a raw material producer or distribution chain, an absence of alternative distribution chains or raw material suppliers would provide evidence of strong interdependence.

Lower levels of integration – for example, avoidance costs arising for just one year after the parent's decision to replace its subsidiary, would be more likely graded 'medium incentive'.

Similarly, fully integrated branding/bundling of a subsidiary's products with the parent group can represent a 'high incentive' operational linkage, depending in turn on the level of importance that brand holds for the group, and the value of the franchise in the geography that the subsidiary serves.

Common management structures may also provide incentives to support. Where both the parent and subsidiary operate with common executives in key positions, this can see the linkage graded as 'medium incentive' or 'high incentive', depending on the past and anticipated breadth and tenure of their engagement. The risks of consolidation of a parent on bankruptcy, or "piercing the corporate veil", are relatively low in most jurisdictions but may be sufficient to provide a 'medium incentive' grading.

Arriving at a Conclusion

To arrive at the gradings, analysts are guided by the sample considerations contained in Path SP in the LFA table to generate three LFAs. Importance relative to that individual issuer will vary. For example, a subsidiary that offers 'high' incentive related to growth potential may outweigh a 'low' incentive financial contribution if the subsidiary represents a new entrance into a key market or service. Additionally, a 'high' incentive grading of either legal incentive consideration would result in a 'high' incentive result for that factor assessment.

The three LFAs are then combined to recommend a notching relationship per the notching matrix on page 10.

The status of 'equalised' would see the subsidiary IDR equalised with the IDR of the parent, which in turn would most likely represent the consolidated financial profile (excluding any de-consolidations applied under our master criteria, such as financial services subsidiaries, discontinued operations, and dividend-only affiliates).

Path SP: Linkage Factor Assessment

Path SP		Low incentive	Medium incentive	High incentive
Legal incentive	Guarantees	Absence of measures listed under 'medium' and 'high', or only soft support factors (e.g. "letter of comfort")	Guarantees are in place but coverage and permanence is less certain than for "high" (e.g. guarantee for 20%-50% of debt)	Parent guarantees a major portion of subsidiary's long-dated debt (>50%) with confidence in stability of financial policy
	Other legal ties		Cross-defaults with moderate permanence or with limitations on scope; and/or other support language - profit- and loss-sharing agreements/undertakings regarding subsidiary liquidity, etc	Cross-default/acceleration language in parent's long-dated public debt documents with reasonable certainty about the permanence of the cross-default/cross-acceleration provisions
Strategic incentive	Financial contribution	Low financial or asset value contribution to future group profile	Reasonably material financial or asset value contribution to future group profile	Substantial financial or asset value contribution to future group profile
	Competitive advantage	Subsidiary provides no material competitive advantage to the parent	Subsidiary provides a material competitive advantage	Subsidiary provides critical competitive advantage to parent
	Growth potential	Secular decline, sunset phase, negative growth prospects	Moderate growth potential, in area of reasonable materiality to group profile	Rapid growth anticipated, very favourable long-term prospects that are material to group profile
Operational incentive	Operational synergies	Avoidance cost of the subsidiary's operational benefits to the parent are not material	Avoidance cost for the parent is reasonable	Avoidance cost of the subsidiary operational benefits to the parent would be substantial
	Management & brand overlap	No common management and/or sharing of product/service branding, or bundling of products/services	Some material common management/sharing of brands, or bundling of major products/services	Fully integrated management decisions and product/service branding, and/or fully integrated bundling of critical products/services

Source: Fitch Ratings

For a parent-subsidiary relationship that is assessed at either 'equalised' or top-down from the parent's credit profile, a rating on the parent is required. For relationships assessed as bottom-up rating uplift for the subsidiary, if the information available on the parent is not sufficient to arrive at a rating for the parent, but is still adequate to derive a sufficiently robust assessment of its credit quality, a rating uplift on the subsidiary's SCP may still be applied; however, a committee may choose to apply a more conservative rating uplift than indicated by the matrix below, especially if the differential between the subsidiary's SCP and the assessed credit quality of the parent is narrow.

Path SP Notching Matrix

Strategic & operational incentives	Both low	One medium, one low	Both medium or one high, one low	One high, one medium	Both high
With low legal incentive	Standalone	BU + 1[a]	BU+2[a]	TD-1[b]	Equalised
With medium legal incentive	BU+1[a]	BU+2[a]	TD-1[b]	Equalised	Equalised
With high legal incentive	Equalised	Equalised	Equalised	Equalised	Equalised

BU – Bottom-up, notched from the lower SCP; TD – Top-down, notched from the consolidated profile.
[a] BU rating outcomes are capped at TD-1. where the subsidiary's SCP is more than one notch away from the consolidated profile. Where the subsidiary's SCP is one-notch below the consolidated profile, the subsidiary's rating will be equalised.
[b] TD-1 rating outcomes will be equalised where the subsidiary's' SCP is one-notch below the consolidated profile.
Source: Fitch Ratings

Parent Rating Under Path SP

Like the approach to determine the parent rating under Path SS, the parent is typically rated at the level of the consolidated group profile, determined in the same manner described under *Step 2: Determine Standalone Credit Strengths* on page 3.

Other Considerations Applicable for Both Paths

A. Different Jurisdictions

In some jurisdictions, subsidiaries – despite their financial strength – may not benefit a consolidated group's profile, even if contractual guarantees or cross defaults exist, because of impediments (legal or otherwise) that prevent enforcement of contractual terms.

We may limit the benefit derived from a financial guarantee if the subsidiary is domiciled in a country where we have concerns about the stability, timeliness or enforceability of law, in a similar fashion to the considerations employed in our Country-Specific Treatment of Recovery Ratings Criteria. This extends to Fitch's assessment of support when there is no full financial guarantee or cross-default clause and potential support could be negatively affected by restrictions on the cross-border transfer of funds. The latter would also encompass Fitch's Country Ceilings Criteria, particularly if the guarantor is overseas (although this may impede a restricted parent from extending support, rather than a restricted subsidiary from receiving it).

B. Analytical Overlay

If the analysts should determine that the rating approach resulting from the application of the LCF would overstate, on a forward-looking basis, the benefit to the weaker entity of the linkage with the stronger entity, the committee may opt to reduce, or not include, any benefit from the linkage in the rating of the weaker entity.

This could apply, for example, where either record or statements from the management indicate a contrary, less-supportive path to that indicated in our LCF analysis; where either parent or subsidiary are in a high-volatility or distressed situation that may also bear upon support likelihood, or where market conventions around financing separation indicate greater separation of entities.

Conversely, a stronger subsidiary may benefit from a wider notching up from the consolidated profile in extreme situations, such as when a parent is in bankruptcy and the subsidiary continues to operate without risk of consolidated bankruptcy filing.

Where these scenarios arise, they would be disclosed in the rating action commentary.

C. Government-Related Entities

Defining the Parent-GRE

Typically, GREs are formally owned by entities such as government ministries, treasury vehicles, wealth funds, trusts or other public ownership structures. We define the parent GRE as the highest entity in the group responsible for operational management and setting strategic goals for the whole group.

As such, when we review these entities' consolidated financials, we typically exclude any superior level above the GRE that would not be addressable under the *Corporate Rating Criteria*, the *Public Sector, Revenue-Supported Entities Rating Criteria* or *Infrastructure and Project Finance Rating Criteria*, as applicable. The consolidation perimeter would be the highest level at which financial statements are available, adjusted if appropriate for any incremental external debt burden which the committee determines may require servicing, either legally or practically, by the rated entities.

The following types of entities will therefore not be regarded as parent GREs, meaning Fitch may "look through" these entities, i.e. apply GRE criteria using the sovereign as the parent, rather than these criteria with an entity as the parent:

- sovereign wealth funds or similar institutions
- intermediate holding companies, with no material operations or debt, used by the government to hold its investments.

Rating GRE Subsidiaries

Subsidiaries of GREs are rated using the parent-subsidiary linkage criteria. The parent credit profile used in the parent-subsidiary linkage assessment will generally be the parent GRE's IDR, including government support. The consolidated profile for the purposes of the GRE will be that of the parent GRE and relevant consolidated subsidiaries.

If we believe government support will flow to the subsidiary, we will decide whether to embark on Path SP or Path SS in Step 2 based on the parent's IDR, including support. If support does not flow to the subsidiary, the assessment will be based on the parent's consolidated profile without support.

To determine whether the subsidiary will receive the benefit of government support, we consider:

- the consequences of a subsidiary default on the GRE parent's operations;
- whether the subsidiary's operations are integral to the provision of the public service or economic activity that drives support of the government to the GRE. For example, a foreign subsidiary of the GRE, even if very large, is less likely to benefit from support from the government. The parent's socio-economic incentive score in the GRE criteria will be a useful indicator in this regard.

When the parent-subsidiary linkage approach cannot be used because the parent GRE is not rated, Fitch will assess government support by applying the GRE criteria directly to the subsidiary, provided that Fitch is confident that entities upstream in the ownership chain would not prevent the subsidiary from receiving timely government support. In such a case, the SCP taken into account in the application of the GRE criteria would be that of the subsidiary.

Rating GREs Above the Sovereign

In situations where a GRE's SCP is above the government's IDR, and the government has limited access to the cash or assets of its GRE per the *Government Related Entities Rating Criteria*, the GRE's IDR can be higher than the government's IDR. In such situations, the principles of the *Parent and Subsidiary Linkage Rating Criteria* – in particular, Path SS – can be applied to determine the notching above the government's IDR. In applying the notching matrix, 'consolidated' in the notching matrix on page 7 will be replaced with the IDR of the sovereign. For example, a 'consolidated+2' rating outcome will be 'sovereign IDR+2'.

For the same purpose, where the SCP is assessed under the Infrastructure and Project Finance sector, the *Infrastructure and Project Finance Rating Criteria* will be applied. For policy GREs, we will use the *Public Sector, Revenue-Supported Entities Rating Criteria*.

Criteria Disclosures

In Fitch's rating action commentaries and rating reports, Fitch expects to disclose, as applicable, how these criteria have been applied, including:

- the approach taken, i.e. strong parent/weak subsidiary, weak parent/strong subsidiary or equally strong parent and subsidiary;
- assessment of the quality of the overall linkage and individual incentive to support factors under Path SP, and access and control factors under Path SS. This includes situations where analysts select a factor that best reflects the substance of the relationship, instead of its formal state; key elements of the linkages that drive the overall linkage assessment; and
- the notching approach: top-down or bottom-up, the number of notches and the anchor rating for the notching (i.e. the rating from which we notch, be it parent SCP, subsidiary SCP or consolidated). This includes the circumstances and outcome of the *Analytical Overlay* section described on page 11, where it applies.

Variations from Criteria

Fitch's criteria are designed to be used in conjunction with experienced analytical judgment exercised through a committee process. The combination of transparent criteria, analytical judgment applied on a transaction-by-transaction or issuer-by-issuer basis, and full disclosure via rating commentary strengthens Fitch's rating process while assisting market participants in understanding the analysis behind Fitch's ratings.

A rating committee may adjust the application of these criteria to reflect the risks of a specific transaction or entity. Such adjustments are called variations. All variations will be disclosed in the respective rating action commentaries, including their impact on the rating where appropriate.

A variation can be approved by a ratings committee where the risk, feature or other factor relevant to the assignment of a rating and the methodology applied to it are both included within the scope of the criteria, but where the analysis described in the criteria requires modification to address factors specific to the particular transaction or entity.

Limitations

Ratings including Watches and Outlooks) assigned by Fitch are subject to the limitations specified in Fitch's *Ratings Definitions*, found at https://www.fitchratings.com/products/rating-definitions.

In addition, ratings within the scope of these criteria are subject to limitations in the master criteria Corporate Rating Criteria.

Rating Sensitivities

Ratings are sensitive to legal, operational and strategic links for Path SP, and legal, access and control links for Path SS, with higher importance accorded to legal links in both paths. We may also revise our assessment of any of the above links, usually driven by new evidence. For example, stronger ties might be indicated by a parent providing equity support or guaranteeing a subsidiary; selling off assets, leading to a rated-subsidiary becoming more significant to the group; or taking greater management control of a subsidiary.

Conversely, weaker ties might be indicated if a parent announces the sale of a rated subsidiary or deems it non-core in a revised strategy; if a stronger subsidiary is refinanced with non-recourse lending containing robust ring-fencing mechanisms; or if a subsidiary does not receive the parental support we expected.

Data Sources

Key rating assumptions for the criteria are informed by Fitch's analysis of various corporate finance ratings over many years; analytical discussions with issuers and obligors; information received from participants across fixed-income markets; and general market observations determined by experienced analytical rationale. When performing its assessment on the existence and linkage quality between a parent and a subsidiary, Fitch uses public information and information received from the issuer, as required under the relevant path (Path SS or Path SP).

Such information can include annual accounts (to determine the consolidation method), debt documents or summaries thereof (such as guarantee terms and restrictive covenants), and information regarding decision-making between the entities (management board composition) or treasury policies and practices or evidence of past support.