

PEFINDO's Government-Related Entities (GRE) Rating Methodology

PEFINDO adopts this methodology to assess the likelihood of the Government of Indonesia to support its subsidiaries in the event of financial and liquidity distress. PEFINDO's final rating will be a combination between the stand alone rating and degree of the likelihood of the support from the Government, the rating of which we assume as *id*AAA. PEFINDO considers the supports as short-term, entity-specific, and related to financial stress situation. We distinguish it from the Government ongoing support that is aimed to back entity's employment and/or its everyday operations. For the latter support, we will incorporate it to the GRE's standalone ratings.

PEFINDO approach to rating GREs begins by determining the GREs standalone rating. In order to determine the GREs standalone rating, PEFINDO will analyze all aspects of entity's business model, including industry, business, competition, management, and financial profiles. After we determine the GREs standalone rating, we then assess the importance of the GRE's role to the Government.

Entities that can become the target of this methodology include:

- All State-Owned Enterprises (Badan Usaha Milik Negara or BUMN),
- BUMN holding companies,
- and special financial institutions established by the Government.

The Government should be a controlling shareholder in these entities. Subsidiaries of BUMN can also be considered as GREs, if PEFINDO believes that the Government support will be given directly to the subsidiaries.

Assessing the importance of a GRE's role to the Government

When assessing the likelihood of the Government's support, PEFINDO is using a basic rule that the more important the GRE's role to the Government, the higher the likelihood of Government support and the closer the GRE's rating to the Government's rating. As opposed, the less important the GRE's role to the Government, the weaker the likelihood of Government support and the closer the GRE's rating to its standalone.

When analyzing degree of a GRE's role to the Government, PEFINDO will distinguish the GRE's role into three categories as critical, important, and limited importance.

1. Critical

PEFINDO believes that a GRE can be categorized to have a critical role to the Government if a default of a GRE would have a critical or major impact for the Government. For the GRE that we believe has critical role to the Government, PEFINDO may assign rating to the GRE the same as or close to the Government's rating. Although in some cases the implementation of the support may be delayed due to regulation, but we believe that support from the Government will be given eventually. The GRE that we view has a critical role to the Government should have one of the following factors:

- The GRE's main purpose is to provide a key public service and it could not be readily undertaken by a private entity. It operates essentially on behalf of the Government and would be likely conducted by the Government itself if the GRE did not exist.
- The GRE is backed by regulation that underlies Government support.
- The GRE is one of the most important GREs in the country and established by the Government specifically to meet the Government's interests in the implementation of key economic, social, and political objectives.
- The GRE has a special public status or is a Government agency and can be considered as an extension of the Government.

- The GRE is an independent not-for-profit entity and it plays a very important role in meeting key economic, social, or political objectives of the Government.
- The GRE's default or credit stress would lead to a disruption of its activities and have a significant systemic impact for the country.

2. Important

PEFINDO views that a GRE can be categorized to have an important role to the Government if a default of a GRE would have an important but manageable impact for the Government. We believe that the impact would be significant enough, but we view that the Government still has a way out from the GRE's default. In most cases, the final rating, for the GRE that we believe to have an important role to the Government, after notching should be closer to the standalone rating rather than to the Government's rating, except for the cases where the rating gap between the GRE and the Government is very close. Notching up given to a GRE that we view has an important to the Government should be one notch up to maximum of three notches. The GRE that we view has an important role to the Government should meet one of the following criteria:

- The GRE provides important infrastructure, goods, or services to the population.
- The GRE produces a critical product and/or service, but its legal status may constraint the Government willingness to support.
- The GRE's activities related to an important public policy role.
- The GRE monopolizes the production of goods and/or services that are important to the economy, but is not backed by regulation.
- The GRE produces products and/or services that are critical to the economy, but its contribution to total national production is not very significant.

3. Limited importance

PEFINDO believes that a GRE can be categorized to have a limited role to the Government if a default of a GRE would have limited impact for the Government. In most cases, PEFINDO rates these GRE on a purely stand-alone basis. Maximum notching up given to a GRE that we view has a limited role to the Government should be one notch, if PEFINDO believes that the GRE would receive Government support were it to experience financial difficulties. PEFINDO defines the GRE that has a limited role to the Government as those that:

- The GRE's activity could easily be undertaken by a private sector entity or another larger GRE if it ceased to exist. The GRE is one among many GREs that operates in the same industry.
- The Government's support is mainly focused on the GRE's operations and/or employment and not so much by the GRE's credit standing.
- The GRE produces a critical product and/or service, but its legal status may constraint the Government willingness to support.
- The GRE has proven capital injection from the Government.
- Privatization is ongoing or contemplated within the next two years and PEFINDO expects this to lead to a significant reduction in the Government's ownership.
- The Government has policy and/or track record of not interfering in the management of the GRE and it is not willing to provide support to its GRE's on a timely basis.
- The Government has a very limited administrative and/or legal capacity to provide support to its GREs on a timely basis.

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