Global
Cross-Sector Criteria

Parent and Subsidiary Rating Linkage

Fitch's Approach to Rating Entities within a Corporate Group Structure

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Related Research

- *Notching for Sovereign Ownership and Sovereign Support – Guidelines for Local- and Foreign Currency Notching (May 2010)*
- *Utility Sector Utilities Sector Notching and Recovery Ratings (March 2010)*
- *Sovereign Ownership Impact on Corporate Ratings – Asia (March 2010)*
- *Update: Sovereign-Owned Corporate Ratings in EMEA (December 2009)*
- *Corporate Rating Methodology (November 2009)*
- *Recovery Ratings and Notching Criteria for Non-financial Corporate Issuers (November 2009)*
- *Sovereign Ownership Impact on Corporate Ratings (June 2009)*
- *Coercive Debt Exchange Criteria (March 2009)*
- *Rating Industrial Investment Holding Companies (May 2008)*
- *Country-Specific Treatment of Recovery Ratings - Revised (August 2006)*

Non-Corporate Related Research

- *Ratings of Non-US Public Sector Entities (September 2009)*

This Criteria Report updates and replaces the *"Parent and Subsidiary Rating Linkage"* report dated 19 June 2007. This update further clarifies that these criteria encompass examples of rating linkages with a sovereign entity.

Introduction

Understanding the multi-faceted relationship between a parent company and its subsidiaries is crucial for determining each company's respective probabilities of default. Many factors make this process challenging: legal jurisdiction, corporate structures, company bylaws, loan documentation, the degree of integration between the entities, and the strategic importance of each subsidiary.

This report outlines the methodology Fitch Ratings uses when assigning Issuer Default Ratings (IDRs) to non-financial companies that are tied together by a parent and subsidiary relationship. Included within this report are the considerations that Fitch uses when assessing the legal, operational and strategic ties that can link the IDRs of two or more issuers. These considerations are outlined in five steps, and assist the agency in determining when it is appropriate to:

- assign a rating to a parent company and its subsidiary according to their respective standalone credit profiles;
- equalise the ratings of a parent company and its subsidiary due to a very high degree of financial, legal and/or business integration;
- notch the IDR of a subsidiary higher than its standalone credit profile would indicate, due to its relationship with a parent company that has a stronger credit profile; or
- notch the IDR of a subsidiary lower than its standalone credit profile would indicate, due to its close relationship with a parent company that has a weaker credit profile.

Scope

This Criteria Report outlines the methodology used by Fitch in respect of public and private companies that operate in non-banking and non-financial sectors. This methodology does not cover diversified investment holding companies whose main purpose is holding and monetising equity stakes in different companies which are not necessarily integrated operationally (see "*Rating Industrial Investment Holding Companies*", dated 22 May 2008). However, whenever appropriate, it will be applied to parent/subsidiary relationships within LBO transaction structures. Recovery prospects for specific debt instruments in the event of default are also not covered by this paper, but are outlined in the *"Recovery Ratings and Notching Criteria for Non-financial Corporate Issuers"*, dated 24 November 2009.

References to "notching" within this paper refer only to the relationships between IDRs, and not to specific debt issuances. It is also important to point out that any notching guidance described in this report applies both to investment-grade and speculative-grade IDRs.

Application of this Criteria

Recent examples of application of the parent and subsidiary methodology include the following rated entities Cox Enterprises, Fidelity National Information Systems, Liberty Media, OJSC Aeroflot, and the Walt Disney Company, among others.

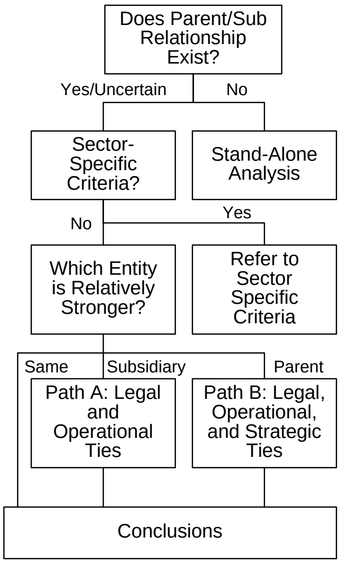
The following Special Reports include illustrate examples of rating linkages with the state:

- *"Update: Sovereign-Owned Corporate Ratings in EMEA: Dubai Restructuring not a Precedent"*, dated 4 December 2009; and
- *"Sovereign Ownership Impact on Corporate Ratings – Asia"*, dated 8 March 2010.
- *"China's listed State-Owned Entities – Governance, Support and Bankruptcy"*, dated 29 October 2008.

Linkage Considerations Framework

The following sections outline the steps taken by Fitch when determining whether or not to link the IDRs of a parent and its subsidiary issuer (collectively the steps form a Linkage Considerations Framework, (LCF)). The five steps followed are:

LCF Summary Flow Chart



LCF – Linkage considerations framework
Source: Fitch

1. determine if a parent/subsidiary relationship exists;
2. determine whether or not the parent and/or subsidiary operates under special restrictions that would dictate the use of other existing Fitch criteria methodology;
3. determine the relative standalone credit strength of the parent and its subsidiary;
4. determine the strength of any parent and subsidiary relationship by assessing any legal, operational and strategic ties; and
5. formulate a conclusion.

An abridged flow chart (at left) summarising these steps (please see *Appendix I* for a more detailed chart).

Step 1: Determine if Parent/Subsidiary Relationship Exists

Before determining whether the IDRs of a parent and subsidiary should be linked, Fitch examines the relationship between the two companies to see if it is more than a joint venture or associate. In doing so, the agency determines if ownership by the parent constitutes sufficient control and/or recourse that linkage should be considered. While there are varying levels of strength and weakness to this relationship, the first step is a binary decision — either no significant relationship is present, or some form of relationship is present.

- **Associate or Joint Venture Relationship**: an example of this type of a relationship is when a "parent" company (or investor) holds a passive equity stake in another company (vehicle or investee) perhaps not consolidating the investee in its financials, nor does it have control over strategic decisions made by the investee. In addition, the investee's existence would not be considered to be particularly important to the parent. As such, any related dividends, capital calls or debt (usually with no recourse to the parent) would be treated as non-operational.

  Under this assessment, there is no potential linkage of the ratings between the entities, and their ratings should be based on their individual standalone credit profiles. Consequently, there would be no need to proceed any further under the guidance in this report.

- **Parent and Subsidiary Relationship**: conversely, a parent that has majority ownership and/or an influential control of the entity should be considered a parent/subsidiary relationship for the purpose of this analysis. As a result, steps 2–5 of the LCF would be followed to determine the degree of linkage that is appropriate, even up to potentially identical IDRs. This would also include entities whose existence is of strategic importance to the parent, even though the company's financials may not be formally consolidated. For example, this could include a subsidiary that may not be financially material to its parent but whose solvency is important (i.e. default by the subsidiary poses "reputational risk" to the parent) or represents an entry point into an important foreign territory for the parent.

Step 2: Determine if Sector-Specific Criteria Exists

The next step is for the agency to determine whether any legal or regulatory hurdles exist that would require the use of other specific Fitch criteria. Companies that operate within the Insurance, Financial Institutions or Public Utility sectors abide by specific industry regulations that would affect Fitch's assessment of credit linkage, as would ratings related to public sector entities (see *Related Research*). While Fitch strives to assign IDRs to all issuing entities, latitude is provided to not assign an IDR when appropriate.

Step 3: Determine the Standalone Credit Strengths

Should Fitch determine that a relationship stronger than that of an associate or joint venture exists in a non-regulated industry, the next step of the analysis would be to determine the standalone credit profiles of the parent and subsidiary consistent with Fitch's "*Corporate Rating Methodology"*, dated 24 November 2009.

It will occasionally be determined that the standalone credit profiles of the parent and its subsidiary are the same. This occurs when the companies' respective business risk, financial risk (including contingent liabilities), and event risk profiles lead Fitch to assess that the probabilities of defaulting on their debt obligations are similar. In this situation, the two companies' IDRs will be the same, although technically not "linked" — in other words, the parent does not rely upon its subsidiary to service its obligations. This is most likely because the parent has sufficient cash flow from other activities, thus analysis has taken into account any diversification benefits accruing to the consolidated entity when assigning the IDRs to both entities. For non-linked identically assigned IDRs in a group, there will be no need to proceed to Path A or Path B of the LCF.

When the parent's standalone profile is weaker than that of its subsidiary, Path A of the LCF is used to determine the legal and operational relationship that exists. In contrast, when the parent is financially stronger than the subsidiary, Path B of the LCF is used.

Determination of the relative credit strengths of two entities should be based on the aforementioned business, financial and event risk profiles of each entity. Such profiles would include the relative size, competitive position, credit metrics, fiscal polices, and industry trends of each entity, among other analytical factors.

In instances where a lack of financial information of the subsidiary exists, Fitch will make a judgement call as to whether or not sufficient data is present to determine the relative credit profile of a subsidiary. Data from consolidating financial statements, segment disclosures and/or unaudited private information can sometimes be adequate to broadly determine the credit strength relative to its parent.

Step 4: Analyse Legal, Operational and Strategic Ties

- Legal ties would generally be the most important form of tangible support, and result in an equalisation of ratings

In order to assess the degree of linkage between the parent company and its subsidiary, and therefore the extent to which the IDRs are correlated, Fitch undertakes an analysis of various aspects of the relationships. These are broadly described under the captions (i) Legal Ties, (ii) Operational Ties and (iii) Strategic Ties.

Legal Ties

Of these three major sub-components of the LCF, legal ties would generally be the most important since they may constitute specific, tangible linkage between the parent and subsidiary. As a result, the presence of a legal tie could outweigh the 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

If a stronger entity guarantees all the debt obligations of its weaker related entity, this illustrates a close correlation between the two entities' IDRs. If a subsidiary guarantees payment of a substantial portion of its parent's unsecured debt obligations on an irrevocable, unconditional, unsecured basis, the senior unsecured rating of the parent's guaranteed debt is usually the same as that of the subsidiary. If the weaker parent defaults, the rating of the bond would not be affected provided that the subsidiary meets its obligations under its guarantee. If the stronger guarantor defaults, the rating of the parent's guaranteed debt would drop to a level consistent with the parent's IDR. The guarantor's IDR, meanwhile, would have reflected the burden of the guarantee obligation as well as its own debt liabilities.

Fitch notes that upstream guarantees are not enforceable in certain legal jurisdictions, or hurdles of "corporate benefit" or "adequate consideration" being given have to be evidenced. In such circumstances, the agency would rely on legal opinion as to any guarantee's validity and enforceability. Equally, some jurisdictions or company law limit recourse to the guarantor.

Where only certain subsidiaries guarantee the parent's debt, Fitch assesses the independent credit profiles of the subsidiaries (particularly if they have different risk profiles and/or activities) and their contributions to the relevant rating. This analysis would also consider whether guarantees are granted on a joint and several basis. Fitch considers that a level of significant joint obligation must exist. As an example, the agency would strongly consider equalising the parent IDR to the group's consolidated risk profile where group subsidiaries representing at least 80% of group EBITDA or assets guarantee the parent debt. In such group structures, however, investors should assume that subsidiaries which are not guarantors would not contribute to this support.

In the context of the IDR, a weaker entity that has only some portion of its debt guaranteed by a stronger entity may have a lower IDR than that of the stronger (or consolidated) entity — despite specific guaranteed debt instruments having identical ratings as the IDR of the stronger guarantor.

Public or private letters of support, comfort letters and "keep well" agreements do not constitute legal guarantees. Fitch notes that some capital call agreements do create an obligation of funding, and would therefore be taken into consideration when applicable.

Dividend and/or Inter-Company Loan Restrictions

Where there are forms of restricted access of cash flows (one component of ringfencing) between a holding company and its subsidiaries, Fitch will generally undertake separate analyses of the respective probabilities of default, and will usually expect to assign different IDRs if the two entities have different standalone credit profiles. Such ringfencing mechanisms can take the form of restricted dividend covenants, or minimum financial ratios, before paying subordinated inter-company loan obligations. The bylaws of an operating company could also include a clause that makes it necessary for a "super-majority" of board members to approve a dividend or related-party loan.

The presence of one or more of these factors could result in an operating company being rated higher than its parent company. This covenanted insulation could benefit the IDR of the operating company by hampering the flow of cash from the stronger to the weaker party at a time of stress. From the perspective of a holding company, its IDR is derived in part from the same underlying risk profile as that of its principal subsidiaries. However, it is receiving an income stream in the form of a dividend or loan, which is inherently discretionary in nature and potentially variable in quantum. Additional explicit restrictions such as those noted above would serve to increase this conditionality (and unpredictability) further, and widen the notching of the IDR between the parent and its operating company.

Conversely, where dividends from a subsidiary to its shareholders — including a dependent parent, whether restricted or not — are regarded as "quasi-debt service", the IDR of the subsidiary will reflect that burden or additional fixed-charge obligation (e.g., the parent can only service its debt through dividends received from its subsidiary).

The positioning of covenants is also considered. Any such restricted access covenants in public bond documentation typically support long-lasting adherence to such mechanisms. Fitch would not place much reliance on these types of covenants in private bank financings, as they can be easily refinanced — or breached covenants waived. Fitch recognises, however, that issuers can take steps to remove constraints imposed on them by such ringfencing covenants even in public debt obligations, by refinancing the specific bonds that contain such provisions. Fitch would take into account the likelihood of such a refinancing (including total size of debt needed to be refinanced), as well as the track record and announced intentions of the relationship of a parent and its subsidiary — as they relate to cash flow movement between the entities.

Cross-Defaults

Cross-default clauses generally provide that a meaningful default within an entity's capital structure or a related party's debt instrument triggers an event of default in its other debt instruments. At this point, debtholders can decide if they are prepared to wait for the grace period to expire, consider whether the relevant quorum should waive the event of default, or enforce it by accelerating the loan. The cross-default enables all debtholders to simultaneously prepare to take action, whereas progressing to enforcement enables each one (or under cross-acceleration clauses, all relevant debt holders) to take more definitive action.

Listed events of default may range from those as serious and unambiguous in their implications as non-payment of debt obligations or filing for insolvency, to the less serious administrative mishap. Some of these events of default (often, but misleadingly, referred to as "technical defaults"), such as missed filing dates for financial statements, may not be triggers for a rating action. Conversely, Fitch may treat other events — such as a coercive debt exchange offer (see "*Coercive Debt Exchange Criteria*", dated 3 March 2009) — as a default even if bond provisions do not define such occurrences as Events of Default. Cross-default mechanisms usually capture guarantors that have defaulted on a payment or failed to honour a call under another guarantee.

When viewed as a form of legal linkage and as a statement of intent by both debtor parties, cross-defaults may lead to equalising or near-equalising of ratings on an ex-ante basis. Materiality would have to be taken into account including any basket of carve-outs for cross-defaults and/or the relative size of the debt instrument with the cross-default. At the very least, at a point of stress, they may provide the opportunity for creditor classes (who may have stakes in both entities) to link the fates of two entities as, say, lenders at the parent level could exert pressure on 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.

In line with Fitch's observations on companies specifically prepaying bonds which have restrictive covenants, the agency recognises that, when possible, the parent company may take action ahead of the above scenario of subsidiary distress that could trigger a group-wide cross-default, by de-designating the subsidiary (or removing it out of a "Restricted" or "Principal" Subsidiary definition) to prevent it from triggering the cross-default clause. Fitch's assessment of linkage determined by the presence of cross-default clauses will therefore remain dynamic.

Different Jurisdictions

Even if workable contractual guarantees or cross-defaults exist, multi-domiciled subsidiaries — despite their financial strength — may not be a benefit to a consolidated group profile or as a guarantor, because of the quality of the different legal jurisdictions in which they are domiciled and impediments (legal or otherwise) to enforceability of contractual terms.

In a similar fashion to the considerations employed in Fitch's Criteria Report *"Country-Specific Treatment of Recovery Ratings"* dated 21 August 2006, Fitch may choose to limit the benefit derived from a financial guarantee if the subsidiary is domiciled in a country where concern about the stability, timeliness and/or enforceability of law exists. This consideration would also extend to Fitch's assessment of support in situations other than those where there is a full financial guarantee or cross-default clause and where the potential for support could be affected negatively by any restriction on the cross-border transfer of funds. The latter would also encompass Fitch's *"Country Ceilings"* methodology dated 12 September 2008, particularly if the guarantor is overseas.

Operational Ties

- Operational Ties encompass management control, centralised treasury, and being operationally integral to the group

The criteria for linkage determined by operational ties differ depending on whether the parent is stronger or weaker than its subsidiary. For example, common management and decision-making is important in establishing linkage when the parent is weaker because it would likely draw on the stronger subsidiary's resources, assuming that no ringfencing exists. This is a less important consideration when the parent is stronger. Similarly, operational integration is not relevant when the subsidiary is stronger, as the weaker parent would likely be less interested in synergies with the subsidiary than it would be in obtaining its cash flows — again, assuming no ringfencing is in operation, as previously detailed in the *Legal Ties* section above.

Management Control and Commonality

The level of control and commonality that exists between the management of a parent company and its subsidiary is an important factor in determining linkage when the parent is weaker than the subsidiary. Degrees of control in this context indicate varying levels of linkage. An example of strong linkage would be effective control of the board of directors (BoD) of the subsidiary by the parent company. Weak linkage would typically entail a low level of senior management overlap, with the parent company and the subsidiary having separate CEOs, CFOs, board of directors, and/or marketing functions.

Centralised Treasury

The level of financial integration between parent and subsidiary is another indication of the degree of linkage between the two entities and, consequently, between their IDRs. Under a weaker parent/stronger subsidiary scenario, Fitch examines the level of integration between the financing operations of the two entities to determine the degree of linkage between them. Specifically, Fitch would deem that strong linkage exists when all external funding is channelled through the parent company; with that entity acting as the subsidiary's central treasury, and on-lending funds to its subsidiaries which do not raise funds on their own account. In this scenario, all cash for both entities would be held in an account in the name of the parent company.

Conversely, Fitch would deem linkage to be weak when the funding is entirely decentralised, with all significant group companies operating their own treasury functions and raising funds (including liquidity facilities) on their own accounts with no involvement of the parent company.

Operational Overlap and/or Integration

While the first two operational ties outlined above address the weaker parent/stronger subsidiary analysis under Path A of the LCF, operational overlap and integration is generally only relevant under the stronger parent Path B scenario. Strong linkage under these criteria would reflect subsidiary operations that are operationally integral to the core business of the parent company. For example, an oil and gas company which owns subsidiaries operating in the downstream petrochemicals sector: long-term off-take agreements between the two parties, and an absence of alternative off-takers/suppliers, would provide evidence of strong interdependence. More moderate levels of integration, with considerable avoidance costs arising for one year after the parent's decision to replace its subsidiary, would represent weak-to-moderate linkage.

Strategic Ties

- Strategic Ties are only considered when the parent is stronger. All things equal, a weaker parent will use cash flow from its stronger subsidiary regardless of strategic relationships.

Strategic ties are a key consideration when determining the correlation of the probability of default between a financially strong parent company and a weaker subsidiary, due to the ability of the parent to financially support its subsidiary if it makes strategic sense. This section of the analysis is broken into two distinct areas: Strategic Importance and Tangible Support.

Strategic Importance

A financially weak subsidiary is deemed to be highly important to its financially stronger parent if the latter's own performance is contingent upon the success of the subsidiary. Where the strategic importance is so high that it potentially affects the survival of the financially stronger entity, ratings may be equalised.

At the other end of the spectrum is a subsidiary whose operations and/or business strategy are distinctly different from the core operations of its financially stronger parent company, and of little financial or commercial value to the future direction of the parent. Under this latter situation, the two entities' ratings would be based upon their own credit fundamentals, reflecting Fitch's view that the parent would not hesitate to sell the subsidiary or allow it to fail if doing so made economic sense. In between the two edges of the spectrum are situations in which a subsidiary has some strategic importance to its parent company, but not to the degree that it is a foregone conclusion that the parent would step in to help the subsidiary meet its debt obligations on a timely basis.

Tangible Support

The higher the degree of demonstrated tangible support between a financially stronger parent company and its subsidiary, the more likely the ratings will be closely linked. Examples of tangible support include frequent cash-based equity injections and occasional (preferably subordinated) intercompany loans, and regular provision of low (or zero) cost land from the sovereign to a state-supported free-zone developer. Weak strategic ties tend to be reflected in an absence of tangible support or the presence of only soft support letters to banks. In the situation of a newly formed subsidiary where an historical record of support is not available, Fitch would take into account the event risk related to the subsidiary, the degree of isolation of such entity from the rest of the organisational structure, and management's intention toward such a structure.

Fitch notes that it is common for operations with riskier business profiles to be placed in a subsidiary isolated from the rest of the organisation, which could sometimes imply a lower intention of support from management if the entity is not successful.

Rating Linkages with the State

The above criteria is applied when considering the rating of a state-owned entity (SOE) or state-supported entity, but not in cases where the corporate entity is classified by Fitch as a public sector entity (PSE), defined as follows:

> "An entity directly or indirectly majority-owned or tightly controlled by the state/sub-national (the sponsor), or with equivalent special public status,

whose activities fulfil a public sector mandate in a non-competitive sector, where forms of state subsidy or grant from the sponsor comprise the majority of revenues for the entity, or it receives ongoing capital injections, and are material to the existing and prospective financial profile of the entity. Generally such entities do not have a profit maximisation function, with profitability often being determined by the aforementioned grants or subsidies."

For such PSEs, Fitch applies its criteria "*Ratings of Non-US Public-Sector Entities",* dated 1 September 2009.

The above three headings of Legal, Strategic and Operational are equally applicable to Fitch's assessment of the linkage between the sovereign and privately or publicly-owned entities linked with it. As with the above approach for publicly- or privately-owned corporates not linked by explicit guarantees, full or majority ownership of a subsidiary does not lead to an equalisation of two entities' IDRs. Obstacles to equalisation include the weak enforceability of an explicit sovereign guarantee and the likelihood of non-payment under such a guarantee triggering a meaningful, immediate, cross-default on its direct sovereign debt. Considerations of size in relation to the sovereign parent may also be relevant. Thus, as shown in Fitch's periodic research (see the sovereign-owned special reports listed on page 2), over 70%-80% of relevant entities in EMEA and Asia-Pacific do not have the same IDR as that of the state or state-related parents purely because of ownership links.

Turning to strategic considerations, some industries such as railways and post offices can be fundamentally strategic to the country, and state ownership can support the case for enhanced credit ratings. This, in itself, is not enough to build a case for an equalisation of the ratings — forms of government involvement typical for such entities can both enhance or be detrimental to support linkage. Conversely, industries which have strategic value to a country but whose companies have been privatised or operate in a competitive environment — such as telecoms and utilities with truly independently assessed tariff-setting regimes — are unlikely to benefit from the same degree of rating linkage, on the grounds of their strategic significance.

Operationally, some companies embody state development objectives such as developing national infrastructure. Of particular note are oil rich countries with the objective of shifting away from dependence on oil-related activities, whose SOEs often receive regular tangible support. Equally, some non-state-owned oil & gas companies can verge on being arms of the state in terms of revenue generation, and this mutually beneficial form of connectivity can be conducive to a company's IDR.

Assessing the degree of support is always potentially dynamic. There are differences between the parent and subsidiary linkage between corporate-to-corporate entities compared with corporate-with-state and the notching for support, as it is more likely in the corporate-with-state grouping that notching for support could widen when the parent, the state, is moving down the rating scale. In Fitch's experience of where high investment grade countries have expressed willingness to support towards the weaker entity being assessed, such support (probably on-going at the time) is less in doubt given the greater financial capacity of the highly-rated sovereign. But the recent turmoil has shown that when sovereigns are lower-rated, some unexpectedly facing weaker access to the capital markets, its willingness to support the same type of entity may be re-prioritised. Under the latter scenario, Fitch may widen the notching accordingly.

Regarding a separate mechanism, Fitch's criteria "*Notching for Sovereign Ownership and Sovereign Support – Guidelines for Local- and Foreign-Currency Notching",* dated 14 May 2010, clarifies that when notching down a corporate from the sovereign rating, the same amount of notching-down is normally applied to both the foreign-currency and local-currency rating.

Step 5: Conclusion and Notching

The ultimate conclusion on whether to link IDRs and guidelines related to any notching depends on whether Path A or Path B of the LCF is followed. Identical IDRs are a *possibility* under four of the five decision trees. Any such case of equal IDRs would be based on the consolidated credit profile of the two entities. Conversely, different IDRs would be based on the standalone credit profiles of each entity. Because the ultimate linkage and ratings are determined only after the full LCF process has been completed, Fitch would be mindful of both the consolidated and standalone profiles of the entities.

Notching Impact

The next section details general guidance under both LCF paths and the potential notching impact of the linkage assessment.

Path A (Weaker Parent)

Based on the presence of linkage from the legal and operational considerations outlined above, and any appropriate weighting that may be necessary, the following general criteria in respect of the IDR levels of the two entities is applied at Fitch.

If the balance of considerations indicates:

- **Strong Linkage** — the stronger the degree of linkage between the two entities, the more likely the IDRs will be assigned at the same level. Under this scenario, Fitch would analyse the parent and subsidiary as a consolidated entity — and set the rating accordingly. For example, if the parent's standalone financial condition suggests a 'BB' rating, and the subsidiary's standalone profile suggests 'BBB', the parent and subsidiary IDRs will be based on the consolidated credit profile — which would likely come out somewhere between the two standalone ratings, depending on the relative size of the subsidiary.
- **Weak Linkage** — in certain situations, where Fitch deems linkage to be weak, the IDR of the subsidiary could be rated higher than that of its parent company (similarly, the parent can be notched down from the subsidiary). In general, the rating guideline is a maximum of two notches higher for the subsidiary if weak linkage is established (contractual ringfencing, no guarantees, zero or little common management), but wider notching may be warranted in some cases based on specific circumstances (eg if a parent is in bankruptcy while the subsidiary continues to operate with no risk of consolidated bankruptcy filing).

The relative importance of the factors that determine any potential notching will be assessed by Fitch on a case-by-case basis, as in certain situations individual factors will tend to carry more weight in the analysis. Generally, however, the presence of documentary or legal protection for the cash flows of the subsidiary company will be the most important factor in assessing the ability to notch the subsidiary IDR above that of the parent.

Path B (Stronger Parent)

Again, based on the presence of linkage from the legal, operational and strategic considerations, the following general criteria in respect of the IDR levels of the two entities will apply. If the balance of answers indicates:

- **Strong Linkage** — the stronger the degree of linkage between the two entities, the more likely the IDRs will be closely *correlated* with each other; however, that is not to say that they will be identical. While there is potential for the IDRs of the parent and subsidiary entities in this situation to be the same (assuming that strong linkage can be established), there is also capacity for the IDR of the subsidiary to be lower than the IDR of the parent, typically within a range of five notches. In order to rate the subsidiary's IDR at the same level as its parent in this scenario, Fitch would expect a large majority of the following sub-set of criteria to be met:

- comprehensive cross-default provisions affecting parent and subsidiary across all major lending groups and public debt obligations;
- subsidiary is operationally integral to the core business of the parent;
- subsidiary is strategically important to the future direction of the group's operations, potentially providing long-term fiscal benefits or access to markets that the parent could not otherwise access;
- tangible financial support is provided by the parent to the subsidiary in the form of ongoing cash subsidy or guarantee;
- level of parent's investment in the subsidiary is deemed significant relative to the scale of the group and its financial resources; and
- publicly declared or agency-notified group strategy regarding the parent's treatment of its subsidiary and access to its cash flows.

To the extent that only some of the above criteria are met in this scenario, Fitch's analytical judgment will determine the level of downward notching that should be applied to the subsidiary's IDR.

- **Weak Linkage** — in situations where Fitch deems there to be a weak linkage relationship under Path B of the LCF outline, the IDRs of the parent and the subsidiary should not be linked — and should therefore be based on the respective standalone credit profiles of the two entities. Fitch realises there are instances when a parent (such as a conglomerate or a country) holds a minority equity stake in an operating company ("subsidiary") where it would be a larger burden for the parent to allow the subsidiary to declare bankruptcy than it would be to maintain capital calls. This is typically the case when the parent's reputation would be harmed by allowing the subsidiary to go bankrupt (often called "reputational risk"). Since these investments usually comprise minority stakes, their ratings may or may not be determined by the LCF (step #1: Determine if Parent/Subsidiary Relationship Exists). If Fitch believes support by the parent will be available in time of crisis, then the agency will consider notching up the standalone rating of the subsidiary.

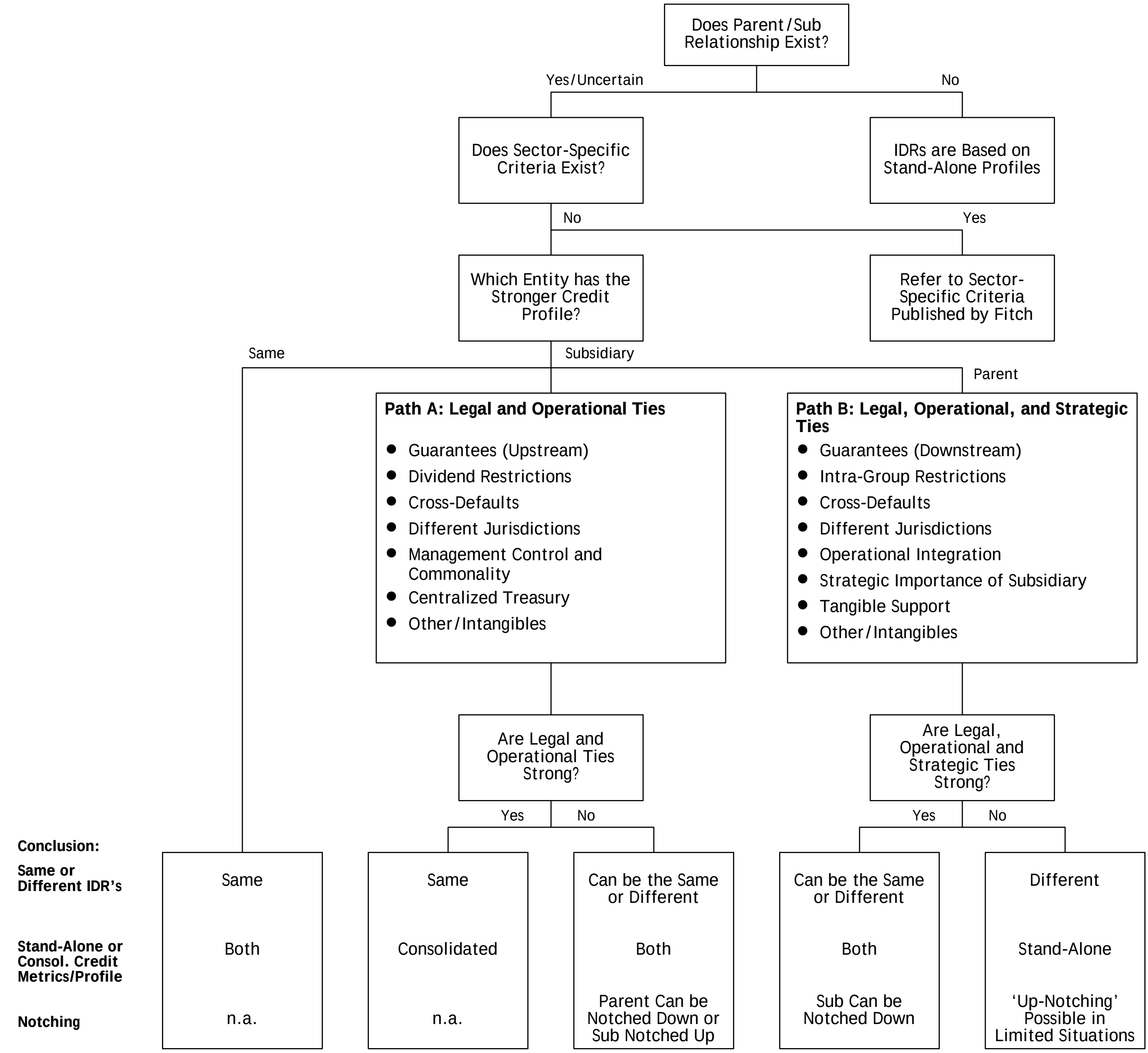
Limitations

These criteria do not apply to finance companies (FinCos), which are assigned IDRs on a case-by-case basis depending on issues such as whether or not the entity has business(es) outside of financing its parent's products — as is typically the case with US FinCos. Conversely, European FinCos are traditionally shell companies with no activity other than to issue group debt. These shell companies are traditionally not assigned an IDR since parent guarantees are granted on specific debt instruments.

The criteria may not be relevant or necessary in corporate structures that have a shell holding company issuing debt where the only other issuing entity is a direct subsidiary that houses all relevant operations. This structure has been common with leveraged buyouts in the U.S. over the last few years and has been used by companies such as Warner Music Group, AMC Entertainment, Inc., and First Data Corporation, among others.

Appendix 1

LCF Outline



IDR – Issuer default rating; n.a. – Not applicable
Source: Fitch