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MIDROOG

Rating Defaulted Debt Instruments and Issuers and Impaired Debt Instruments

Methodology Report | September 2017

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Preface

The purpose of this report is to explain Midroog's approach to rating debt instruments or issuers in default and impaired debt instruments, according to Midroog's definitions of default. The report is designed to reflect the main qualitative and quantitative characteristics influencing the rating of companies and debt instruments in default and impaired debt instruments, and can serve as a tool for companies, investors and other interested parties in the market to understand how quantitative and qualitative elements can influence the rating of debt instruments and companies.

The report does not include a thorough discussion of all the elements embodied in the rating, but is designed to enable the reader to understand the qualitative considerations, the information and the financial ratios that are usually significant and of the utmost importance when setting ratings for companies and debt instruments in default and impaired debt instruments. In the course of the rating process, individual business and financial parameters of each and every issuer are examined, based on their activity, taking a forward-looking view. Therefore, the rating of a specific issuer or debt instrument may be influenced by other parameters and assessment methods that cannot be anticipated in advance.

When a liability becomes impaired or enters a state of default, or when it is expected to become impaired at a high level of confidence, the rating will reflect our assessment of the expected recovery rate of interest and principal payments and the level of uncertainty in this assessment based on the definition of ranges of recovery rates at the various rating levels, as elaborated below.

This methodology to rate debt instruments in default and impaired debt instruments does not apply to debt instruments or issuers that are not in default/are not impaired debt instruments or that are not expected to become impaired or to enter default, at a high level of confidence, even if we characterize these debt instruments or issuers as having weak/very weak creditworthiness relative to other issuers (and accordingly, the rating determined for them is relatively low, including in the B.il group and down).

We stress that all Midroog credit ratings reflect the creditworthiness of an issuer or issue. The creditworthiness of an issuer or issue relates to Expected Loss (EL), which can be represented as the multiple of the probability of default and Loss Given Default (LGD). In its ratings, Midroog aspires to reflect the expected credit losses using a (relative) ordinal ranking, meaning that the EL at lower ratings will be higher than the EL at higher ratings. Creditworthiness as defined above is tested throughout the entire Midroog rating scale[1].

However, in the case of corporate finance and financial institutions issuer or issues, Midroog does not quantitatively measure the probabilities of default for the purpose of estimating EL, rather, it assesses the issuer's ability to meet its liabilities relative to other rated issuers, using qualitative credit risk

[1] The ratings of certain financial assets, such as various types of subordinate debt, which are determined relative to the relevant Issuer Rating, may factor in the issuer's degree of credit risk, as reflected in its Issuer Rating, in order to determine the rating gap from the Issuer Rating. Usually, the lower the rating level, the greater the rating gap because of the decrease in uncertainty regarding the structure of the debt and LGD. Elaboration of the considerations taken into account when rating various types of financial assets, including the height of the Issuer Rating, appears in the relevant methodology reports.

analysis through accepted parameters set forth in the rating methodologies, which in Midroog's opinion, reflect the issuer's ability to meet its liabilities.

Also, in rating corporate finance and financial institutions issuers or issues, Midroog takes into account in the framework of rating various financial instruments, the specific characteristics that may affect the height of LGD[2], even if it does not quantitatively measure the LGD unless a default event has occurred. In order to reflect the EL differential (in cases where we think that due to the characteristics of the financial instrument, EL will diverge from what it would be absent these characteristics), the rating of the financial instrument may diverge from the Issuer Rating as defined above.

According to the meaning of EL underlying Midroog's credit ratings, ratings of debt instruments or issuers in default and impaired debt instruments (based on the definitions of default and impaired debt instruments below) reflect the recovery rate as a central element, since the probability of default is certain or material.

According to Midroog's rating definitions in the long-term rating scale, liabilities in default or approaching default suit levels of Ca.il and C.il, as the default in question has happened or there is a high certainty of actual default, not a mere theoretical possibility. That said, the creditworthiness of issuers or debt instruments in default or impaired debt instruments may differ, and in some cases, debt instruments are expected to have relatively high recovery rates. Given an assessment of a relatively high recovery rate at high levels of confidence, a liability's rating may reach the B.il or Caa.il group, as relevant, and according to the considerations elaborated herein below.

At the same time, as stated above, debt instruments and issuers may be rated according to the methodology for rating debt instruments in default and impaired debt instruments, even if the default has not yet occurred, if Midroog believes there is a high level of confidence regarding default / that the debt will become impaired. Usually, debt is defined as being in default is not expected to be rated higher than B1.il. However, there may be exceptional cases in which a debt in temporary and immaterial technical failure is rated higher than the B.il group. For elaboration on the considerations for grading at a rating level higher than B1.il even though the loss is material, see below.

It bears stressing that when Midroog rates debt instruments or issuers using the methodology for rating debt instruments in default and impaired debt instruments, Midroog customarily describes the circumstances of default in accordance with Midroog's definition, or alternatively, the circumstances and the assumptions based on which Midroog assesses with high confidence that the issuer or debt instrument will enter in a state of default/impairment.

[2] Characteristics such as the seniority of a financial instrument and support/collateral and various terms of the security may affect the rating, according to the considerations set forth in the relevant rating methodologies.

Definition and characteristics of default and impaired debt

Definition of default

Midroog's definition for default relates only to debt or debt-like securities (such as CDS). Three events constitute default:

1) A missed or delayed disbursement of a contractually-obligated interest or principal payment (excluding missed payments cured within a contractually allowed grace period);

2) A court filing in respect to default by the issuer, such as: bankruptcy filing, temporary bankruptcy, receivership or Chapter 11. Those events are likely to cause a miss or delay in expected future debt service payments.

3) A debt arrangement or restructuring proposal, whereby a) an obligor offers bondholders new bonds or securities with new terms, whose terms have been redefined, or a package of securities, cash or assets that amount to a diminished financial obligation relative to the original obligation (such as: shares, new bonds with a lower coupon or par value, or inferior bonds) and b) the arrangement has the effect of allowing the obligor to avoid a default.

The definition of default does not include infringement of financial covenants such as leverage ratios and debt coverage ratios unless the obligor cannot manage to cure the violation and fails to accelerate the debt repayment that could be required in such a situation. Violations of structured finance transactions such as: failure to comply with the assets/liabilities ratio or certain violations defined in legal documents, unpaid interest payments, while these payments may be postponed (with the appropriate added interest) until the final repayment date under the transaction documents, do not constitute events of default.

Also, for the purpose of defining default, unpaid payments on long-term liabilities due to technical and administrative errors that: 1) are not related to ability and willingness to make the payments and 2) have been cured within a very short time (usually within 1-2 business days after discovery of the error) are excluded. In addition, under certain circumstances, payments not made on time under financial contracts may be excluded if the nonpayment was consequent to a legal dispute regarding the validity of these contracts.

Definition of impaired debt

A security is impaired when investors receive (or expect to receive, with near certainty) less value than would be expected if the obligor were not experiencing financial distress or was otherwise prevented from making payments by a third party, even if the financing documents or trust deed do not allow the investors to act against the obligor in such events, such as resorting to legal proceedings, such as bankruptcy filing, and so on.

Midroog's definitions for impairment are based on Moody's definitions, relating to debt instruments, preferred stock and other hybrid securities. A security is deemed to be impaired if:

1) The events that meet the definition of default did occur;

2) Contractually-allowable payment omissions of scheduled dividends, interest or principal payments on debt, preferred stock or other hybrid instruments.

3) Downgrades to Ca.il or C.il, signaling the near-certain expectation of significant losses;

4) Write-downs or arrangement (or restructuring of impaired debt) on debt instruments, preferred stock or other hybrid instruments due to financial distress whereby (a) the principal promised to an investor is reduced according to the terms of the security or (b) the obligor offers investors new securities or securities whose terms have been redefined or a new package of securities, cash or assets, which amount to a diminished financial obligation relative to the original obligation, in order to avoid a contractually-allowable payment omission as described in 2) above.

Circumstances under which Midroog will assess default or debt impairment with high confidence, though it has not happened yet

Midroog may assess that there is high certainty of default or debt impairment in respect to one or more debt instruments, even if it has not happened yet, under circumstances in which Midroog identifies fear of default or debt impairment as defined above, for instance when Midroog assesses that the company is highly likely not to meet its debt payment in full and in time, or that it means to reach a debt arrangement, or when there is material concern of violation of contractual obligations that could lead one or more of the company's liabilities to be immediately recalled, which could lead to default. Our assessment of a default or impairment event with high confidence will factor in qualitative and quantitative considerations depending on the circumstances and the professional judgment of Midroog, on a case by case basis.

Rating issuers or debt instruments with high risk characteristics but that are not in default[3]

Debt instruments or issuers may have relatively low ratings (including the B.il group and down) even though we do not define them as being in default, and do not believe they are particularly likely to reach default. This may happen, for instance, when the risk characteristics of the issuer or debt instruments indicate very weak creditworthiness[4], based on the parameters in the methodology relevant to the rating, however, there are risk-mitigating elements based on which Midroog believes that the issuer is not in default, and is not highly likely to reach default. The credit risk characteristics of an issuer of this type may stem from a very high level of business risk in the industry, a very high leverage level, especially weak profitability cushion levels, or a combination of all the above, as well as other risk characteristics. Risk-mitigating elements may stem from a liquidity level that may be sufficient for the foreseeable future, considering the quality of liquid sources, or from external support by the parent company. Another example of a case in which a debt instrument would bear a rating reflecting weak creditworthiness, yet not be in default, is a debt instrument whose terms "absorb" relatively heavy

[3] Or issuers that are highly likely to reach default.

[4] As defined above and in the document Midroog Rating Scales and Definitions .

losses, though the probability that the debt will become impaired is relatively low. For instance: subordinate debt instruments from the perspective of their priority along the "payments waterfall".

Characteristics of debt instruments in default or impaired debt instruments

When a company cannot pay its debts when the time arrives, it may enter a process of receivership, or alternatively, turn to restructuring, during which a compromise or arrangement may be reached with the purpose of curing the company, or lead to maximizing value from selling its assets. Default may also stem from creditors taking legal steps against the company, for example if it violates contractual obligations in the financing agreement or trust deed, constituting cause to call in the debt immediately, e.g., failure to meet financial covenants. It bears stressing in this context that failure to meet financial covenants, such as breach of leverage ratios or coverage ratios, is not considered in and of itself to be default under Midroog's definitions unless the obligor cannot manage to cure the violation and fails to accelerate the debt repayment, in which case default would be declared anyway. However, when the company is in breach of its financial covenants, Midroog may assess, depending on the circumstances, that default is highly likely.

In some cases, an attempt is made to reach a debt arrangement outside the courts. Creditors appoint a representation on their behalf that negotiates with the company's management. Note in this context that companies may offer investors buybacks, some of which could be considered to be arrangement proposals. If the terms of the proposal meet the definitions of Section 3 in the definition of default or 4 in the definition of impaired debt, these debt instruments will be defined as debts in default or impairment, respectively.

Parameters used to rate debt instruments or issuers in default and impaired debt instruments

When a debt instrument is in default according to Midroog's definitions of default, or is defined as impaired, or is highly likely to become such in Midroog's opinion, the manner in which the rating is determined is based on our assessment of the recovery rate of the debt instrument in keeping with the central scenario that we factor in regarding the company's path of action, considering the company's circumstances at the time the debt instrument defaulted.

Midroog defines the recovery rate of a debt instrument as the ratio between the sum of the recovery estimated by Midroog and the adjusted balance of the debt, including accrued interest and linkage.

Recovery rate table

When determining a rating for a debt instrument in default or impairment, Midroog bases itself on Moody's approximate recovery rate table for securities in default or impairment, without adjusting it in any way to the local market. The recovery rate table only applies to debt instruments that, according to Midroog's definitions, are in default or impairment, or are highly likely to become so. This table defines the appropriate rating level for the estimated range of recovery rates, and in consideration of the degree of confidence regarding the recovery rate. Midroog's use of the recovery rates table when setting ratings is designed to lead, consistently and reliably, insofar as possible according to Midroog's estimations, to an ordinal rating (on a relative order scale) or creditworthiness – where debt in default with low EL is rated higher than debt in default with high EL. It is important to note that the recovery table is not based on a statistical connection between the recovery rate and a given rating level, but represents a scale of rating levels according to the defined ranges of recovery rates, and also the ceiling of rating accepted at Midroog for debt in default.

The recovery rates of different debt instruments a company issues, including different series of bonds, may differ, according to existing collateral for the various debt instruments, the nature and value of the collateral and according to the subordination characteristics of the debt instruments relative to other debt instruments. Therefore, under these circumstances, Midroog may set different ratings for the different debt instruments.

Determining a rating level according to the recovery rates table will factor in the degree of confidence regarding the recovery rate. For the purpose of setting a B.il rating, for instance, for a debt instrument in default or impairment, uncertainty regarding the recovery rate should be low. For example: if the probability that the recovery rate is lower than 90% is not negligible (for instance above 10%), the rating will generally be below the B.il group.

In most cases, debt defined as being in default is not expected to be rated above B.il, although there are *rare* circumstances in which a debt, technically in default but not substantial, will get a higher rating. For example, in structured finance transactions, when a small, nonrecurring writedown of principal is significantly less than 1% and is not expected to be cured (additional administration costs of the transaction constitute a loss to holders). We stress that in the extraordinary cases above, Midroog customarily notes and explains the extraordinary circumstances in the rating report. For elaboration on the subject of considerations for ratings deviating from the recovery rate ranges in the recovery rates table, see the section on additional considerations below.

Once the terms of a debt instrument have changed and it no longer has its original terms, it will stop being considered as being in default from the time the new terms were signed. The new debt instrument will be rated with careful, conservative examination of the arrangement being effected, according to the circumstances and on a case by case basis.

Using parameters relevant to the company's activity for the purpose of examining the recovery rate as set forth in the industry rating methodology

In many cases, the parameters used to set a rating when the company was considered a going concern and had a long-term operating horizon may be less relevant when examining the recovery rate if one or more of the company's debt instruments is in default. However, to the extent that the company is assumed to be able to continue to operate, in the format of restructuring, the examination of the recovery rate may also be based on parameters relevant to the company's activity in the medium to long term, as set forth in the relevant rating methodology.

The central recovery scenario and the degree of confidence in it

Usually, at various stages of the debt arrangement, there is uncertainty about the ultimate path of the process. Debt arrangements involve a lot of parties and various interested parties, including the company, its controlling shareholders, the various types of creditors, existing and future investors, and court-appointed officers. In many cases debt arrangements involve protracted negotiations and the central scenario that Midroog factors into examination of the recovery rate is liquidating assets and recovering liabilities based on the ranking of the liabilities and considering the operating and administrative costs of activity in the short to medium run, according to the circumstances. In cases where Midroog believes there is a good probability that a concrete debt arrangement and/or restructuring plan suggested by the company will materialize, Midroog will base itself on the debt arrangement and/or restructuring plan in assessing the recovery rate. Absent a concrete debt arrangement or restructuring plan for the debt, and when Midroog believes with high confidence that the value of the company is greater than that of its assets in liquidation, Midroog may examine scenarios in which the company continues to operate under refinancing of the debt.

When the default event is defined as an offer to buy back bonds at a price reflecting a "haircut" relative to the par value of the debt, and under circumstances where the offer is driven by financial distress and is designed to avert legal default, Midroog may estimate the recovery rate based on the EL embodied in the offer.

Estimating the expected recovery rate

As stated, Midroog defines the recovery rate of a security as the ratio between the recovery Midroog estimates and the balance of the adjusted debt, including accrued interest and linkage. Assessment of the expected recovery rate for the rated security will be based on the balance of the company's assets and liabilities around the default date and assessment of cash flows or deficit the issuer may expect, in the range of the cash flow forecast factored into the rating or consummation of the debt arrangement, whichever is earlier. The company's liabilities in the balance sheet and off-balance sheet will be mapped by priority rank. As a rule, under circumstances of default, Midroog classifies liabilities according to the following types: liabilities backed by collateral, liabilities with priority, debts under floating lien, and finally, financial obligations and operating liabilities, and other (such as supplier debt, outstanding claims, debts to authorities that are not prioritized, and so forth) and that are not secured by any pledges. Estimation of the debt amounts to be recovered by creditors from the company's assets will be based on estimating the value of the company's assets, expected cash flows from these assets and the costs involved in the company's continued operation. If there is a good degree of confidence in a restructuring plan that embodies additional sources for recovery of liabilities, such as cash infusions by the owners, capital issues, etc., this will be taken into account.

Mapping the issuer's assets and liabilities upon default

The farther off the horizon to default, the greater the uncertainty about the structure of assets and liability that constitute the basis for estimating the recovery rate upon default. Asset sales, taking new loans and attaching assets, capital issues or bringing in investors are examples of moves that could affect the equity and assets structure during the time the company is in financial distress but is not yet defined as being in default. Moreover, at operational companies, activity continues and the structure of working capital is dynamic, varying with the extent of activity. Even near the time of default and during it, new outstanding liabilities may arise, inter alia because of the unique state of the company's business. The company's financial statements around the time of default constitute the *point of origin* for assessing the recovery rate. Midroog will factor in changes that it anticipates in the equity structure and assets balance, and also the uncertainty inherent in that structure.

Mapping the balance of financial liabilities by priority rank

This stage of analysis combines structural considerations and contractual considerations in the examination of the company's liabilities. On the structural side, Midroog analyzes the organizational structure of the group companies: holding and administration companies, operational companies, designated companies, partnerships, and so forth, in order to map the location of the company's assets and liabilities in a manner that produces the ranking of liabilities, including intercompany liabilities and mutual guarantees. This examination may also map potential structural and legal complexity stemming from operations in different countries, partnerships and partners, minority holdings, and so forth. Midroog's assumptions are usually based on the rule of proximity to the source of the cash flow. Operational companies that own a cash-generating asset or that are nearer to that asset will be prioritized higher than administration/holding companies, which even if they own the shares in the operational company, they do not hold it directly.

The existence of intercompany guarantees may affect priority ranks. For instance, when an operational subsidiary guarantees a debt of the parent company, then the guaranteed debt can be considered equivalent to the ordinary debt of the operational company. On the front of contractual considerations, Midroog examines the terms of the company's various debt instruments, according to the structure of collateral and priority. Midroog also examines the degree of coverage of debts secured by pledges, if any, and assesses the surplus/shortfall in existing pledges against these debts.

Usually, secured debts with fixed charges and assignment debt secured by pledge are at the top of the priority ranking, after default process costs, followed by prioritized debts, followed by debts secured by floating charges, and finally debts that are not prioritized and are not secured by pledges. Regarding liabilities defined as subordinate (that do not constitute shareholders equity, capital notes or owner's loans), Midroog will examine the terms of subordination in order to determine their position in the debt ranking relative to other unsecured debts.

Debts arising from co-controlled entities, partnerships and designated companies (project companies or SPCs) will be examined by the characteristics of the debt and the willingness and ability of the company to support that debt. It bears stressing that there is uncertainty over the court's ruling regarding assets and liabilities that are excluded in practice and about the actual distribution among the various creditors. In this context, note the absence of a securitization law and the uncertainty about the nature of cash flow insulation of project companies or SPCs, and on the other hand, the quality of insulation of liabilities from debt of project companies or SPCs. As a rule, nonrecourse debt and project debts will be excluded from the priority ranking. Owners' loans made to the issuer will be examined based on their terms, and insofar as defined as shareholders equity, will be excluded from the priority ranking, and will be handled as shareholder equity relying on the residual value of the company's assets.

Operating and other liabilities

The nature and extent of operating and other liabilities varies with the type of the issuer's activity: if the issuer is an operating company, for instance in trade, building or business services, or is a financial company or holds shares of operating companies or real estate. In the category of operating and other liabilities, consideration is made of outstanding debt to suppliers, various contractual obligations that are not prioritized, actuarial liabilities and more. Some of these liabilities originate in off-balance-sheet liabilities or claims that may be filed during legal proceedings in the event of default. Attention is paid to obligations towards suppliers secured by pledges, letters of credit, performance guarantees and other guarantees. These liabilities will be estimated and classified according to the circumstances of the case, on a case by case basis. In the absence of a concrete senior status for various liabilities, by virtue of pledges or by virtue of the law, they will be considered unsecured liabilities of the same rank as non-senior financial liabilities.

Estimating sources of debt repayment

When analyzing the sources to return debt, Midroog may base itself on one of two main scenarios: the scenario of liquidation assumes that the company's assets are sold in the medium to short run, and that the compensation for them, net after tax and transaction costs, is used to repay liabilities according to the priority ranking. This scenario is like a liquidation scenario, which does not assume that the company will remain a going concern in the long run and usually constitutes the lowest height of the company's asset value.

The scenario of refinancing debt is based on a concrete debt arrangement plan, including one or more of the following elements: rescheduling the debt, with or without the creditors forgoing some of it, capital infusion by previous or new shareholders, asset sales, and possibly also a restructuring plan to get the company's operations back on track. In most cases, Midroog bases itself on a concrete plan to refinance the debt if presented to it, on condition that Midroog thinks with high probability that it will materialize. Note that this condition does not apply to most of the first stages of the default event. The nature of debt refinancing processes, which involve a great many interested parties, is to evolve over time until reaching a feasible, agreed-on arrangement. In the absence of high confidence in a concrete scenario of debt refinancing, the scenario of liquidation is the central scenario for estimating the sources for repaying debt.

The liquidation scenario factors in the asset values in the company's balance sheet and/or evaluations, if any, of nontraded assets (such as real estate assets, holdings in private companies) or market value, if any (such as holdings in traded securities), while applying sensitivity coefficients to the asset values, reflecting rapid sale or distressed sale. The sensitivity coefficient for the value of an asset is determined depending on the nature of the asset and its quality, its degree of tradability, the legal ownership structure of the asset, the existence of unique commercial or legal affiliations with the asset (such as a permit required to control the asset, a special licensing duty to operate the asset, dependence on maintaining a franchise agreement, lease agreement, and more), the economic and business state of the market or territory relevant to the asset, and the circumstances. Midroog also factors in the costs the company can anticipate in the short and medium run, including costs of a trustee or other officer, costs involved in selling assets, and current costs. Estimation of these costs will be based on the company's estimates and on Midroog's assessment methods relative to a benchmark.

When there is a central scenario of the company continuing to operate under debt refinancing, that Midroog has high confidence will materialize, analysis of the sources for debt recovery will factor in the avenue of the plan and its elements. In each of the central scenarios underlying the estimation of sources to repay debt and the recovery rate, Midroog will consider the existing degree of uncertainty about the underlying assumptions.

Debt restructuring by way or buying securities on the open market

Buying back bonds on the open market under terms that represent, in Midroog's opinion, an informal debt arrangement arising from the issuer's financial distress, may be considered under Midroog's criteria to be a forced debt arrangement that is equivalent to default. Midroog's criteria for examining a buyback offer as an informal debt arrangement are as follows (in whole or in part): (1) the offer is priced significantly below the par value of the bonds, reflecting a haircut for debt holders (2) the offer is consequent to the issuer's financial distress and to avoid "formal" (legal) default, such as inability to repay debt on time (3) the extent of the offer is substantial relative to the nominal value of the security in circulation (4) acceptance of the offer will considerably diminish the issuer's liquidity and will imperil its ability to meet the rest of its liabilities (5) the offer could be considered as preferential treatment of creditors, leading the company's creditors to take legal steps. In the case of a buyback offer equivalent to Midroog's assessment of default, the estimate of the recovery rate will be based on the terms of the offer and Midroog's assessment as to the extent to which the offer will be accepted, the company's financial state, and the implications of the offer on the company's other liabilities and on its continuing activity in general.

Rating Structured Finance instruments defined as impaired debts

Rating financial instruments from Structured Finance that are defined as impaired debts also involves assumptions about the recovery rate of expected cash flow to the impaired instrument. Financial instruments in the field of Structured Finance vary in their terms and in the types of assets backing them. In general, when cash flow backing the rated debt becomes impaired (hereinafter: "asset/s in violation") in a manner that causes a loss to investors, the rating will be based on EL resulting from the impairment of the cash flow. Note that usually, rating Structured Finance-type instruments is based on EL even when the loss is theoretical. In the event of debt impairment that constitutes an actual loss to bondholders, the EL will be calculated weighting in the recovery rate scenarios for the asset/s in violation and the EL for assets not in violation. The result of this assessment will serve in determining the rating based on the range of recovery rates listed in the recovery rates table.

Determining a rating based on the recovery rate range

After estimating the recovery rate, the rating will be determined according to the recovery rates table below. We stress that the recovery table helps *map the rating level* according to the recovery rate estimated by Midroog, by parameters set forth in this methodology and according to the level of confidence in it, but not vice-versa: in other words, the recovery table does not serve to map the recovery rate for a given rating level (meaning, the table is read from left to right).

For instance, for an expected recovery rate of 40% to 50%, the appropriate rating is Ca.il, but that does not mean that estimating a recovery rate of 40% to 50% characterizes only ratings of Ca.il[5].

As said above, when setting a rating for debt instruments in default or impaired debt, Midroog bases itself on the approximate recovery rate table for securities in default or impairment, without adjusting it in any way to the local market. The recovery rate table only applies to debt instruments that, according to Midroog's definitions, are in default or impairment, or are highly likely to become so. This table defines the appropriate rating level for the estimated range of recovery rates, and in consideration of the degree of confidence regarding the recovery rate. Midroog's use of the recovery rates table when setting ratings is designed to lead, consistently and reliably, insofar as possible according to Midroog's estimations, to an ordinal rating (on a relative order scale) or creditworthiness – where debt in default with low EL is rated higher than debt in default with high EL. It is important to note that the recovery table is not based on a statistical connection between the recovery rate and a given rating level, but represents a scale of rating levels according to the defined ranges of recovery rates, and also the ceiling of rating accepted at Midroog for debt in default.

Usually the level of uncertainty regarding the expected recovery rate is high and the table constitutes a guideline, not rigid rules:

Expected recovery rate (Midroog definitions, according to Moody's definitions[6])	**Structured Finance rating**	**Rating**
99% to 100%	B1.il(sf)*	B1.il*
97% to 99%	B2.il(sf)*	B2.il*
95% to 97%	B3.il(sf)*	B3.il*
90% to 95%	Caa1.il(sf)	Caa1.il
80% to 90%	Caa2.il(sf)	Caa2.il
65% to 80%	Caa3.il(sf)	Caa3.il
35% to 65%	Ca.il(sf)	Ca.il
Less than 35%	C.il(sf)	C.il

*In B.il group ratings, uncertainty about the recovery rate should be low. For example, if the probability that the recovery rate will be below 90% is not negligible (for example, above 10%), the rating will generally be lower than the B.il group.

Additional considerations when rating debt instruments or issuers in default and impaired debt instruments

When examining the recovery rate, Midroog may grant weight to additional qualitative considerations that are not directly embodied in the quantitative measurement of the recovery rate, but may affect it,

[5] Moreover, and as said in the preface to this methodology report, in ratings of corporate finance and financial institutions, Midroog does not use a quantitative estimate of the recovery rate when the debt instrument is not in default or impaired or is not expected to default or become impaired, with high confidence.
[6] Change in Moody's definitions may lead to change in Midroog's definitions.

for better or for worse. These considerations may include the history of defaults by the issuer or companies affiliated with it, management quality at the company, and its track record in dealing with crises, the business and financial policy of its shareholders as proven in the past or as stated by the present shareholders, and the value of mutual relations between the company and its shareholders, such as the existence of cross-holdings, intercompany loans, and so forth.

As said above, the recovery rates table above does not necessarily suit the full range of special circumstances. For instance, securities in default that are likely to be repaid in full in the short term, but remain risky in the long-term, could be rated significantly differently from what the table would imply. Another example could be ratings at very low risk that are experiencing a temporary credit event and could be rated higher than B1.il[7].

Related Reports

Midroog Rating Scales and Definitions

The reports are published on the Midroog website www.midroog.co.il

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[7] Payments not made for technical or operational reasons may not be classified as default events. Also, in Structured Finance transactions, payment of interest and/or principal may be postponed beyond the date of record due to delay in receipt of a recovered payment or for operational reasons. In these cases, an increase in EL as high as the interest on the delayed payment will be taken into account and the security will be rated higher than B1.il.

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