

CREDIT RATING

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- A hand is pointing at a digital screen. The screen displays the text 'CREDIT RATING' at the top. Below the text is a row of five white stars. The hand is pointing at the first star. The background is a blurred image of a person's hand pointing at a screen.
- Credit Rating Concept and Utility
 - Credit Rating Agencies in India & Their Performance
 - Financial Dimensions of Credit Rating Methodology
 - Types of Ratings & Symbols

UNIT V

CREDIT RATING

What is credit rating?

- A **credit rating** is an evaluation of the credit worthiness of a debtor, especially a business(company) or a government, but not individual consumers.
- The evaluation is made by a credit rating agency. It is basically the debtor's ability to pay back the debt and the likelihood of default.
- Credit rating is built up on the basis of the (1)credit history, (2) present financial position, and the (3) likely future income.
- These rating agencies are paid by the entity that is seeking a credit rating for itself or for one of its debt issues.



MEANING

- A **credit rating** evaluates the credit worthiness of a debtor, especially a business (company) or a government. It is an evaluation made by a credit rating agency of the debtor's ability to pay back the debt and the likelihood of default.
- Credit ratings are determined by credit ratings agencies. The credit rating represents the credit rating agency's evaluation of qualitative and quantitative information for a company or government; including non-public information obtained by the credit rating agencies analysts.



MEANING

- Credit ratings are not based on mathematical formulas. Instead, credit rating agencies use their judgment and experience in determining what public and private information should be considered in giving a rating to a particular company or government.
- The credit rating is used by individuals and entities that purchase the bonds issued by companies and governments to determine the likelihood that the government will pay its bond obligations.
- A poor credit rating indicates a credit rating agency's opinion that the company or government has a high risk of defaulting, based on the agency's analysis of the entity's history and analysis of long term economic prospects.



NEED FOR CREDIT RATING

- It is necessary in view of the growing number of cases of defaults in payment of interest and repayment of principal sum borrowed by way of fixed deposits, issue of debentures or preference shares or commercial papers.
- Maintenance of investor's confidence, since defaults shatter the confidence of investors in corporate instruments.
- Protect the interest of investors who can not into merits of the debt instruments of a company.
- Motivate savers to invest in industry and trade.



OBJECTIVES OF CREDIT RATING

The main objective is to provide superior and low cost info to investors for taking a decision regarding risk return trade off, but it also helps to market participants in the following ways:

- improves a healthy discipline on borrowers,
- Lends greater credence to financial and other representations,
- Facilitates formulation of public guidelines on institutional investments,
- Helps merchant bankers, brokers, regulatory authorities, etc., in discharging their functions related to debt issues,
- Encourages greater information disclosure, better accounting standards and improved financial information (helps in investors protection),
- May reduce interest costs for highly rated companies,
- Acts as a marketing tool



CREDIT RATING METHODOLOGY

Consist of 4 areas:

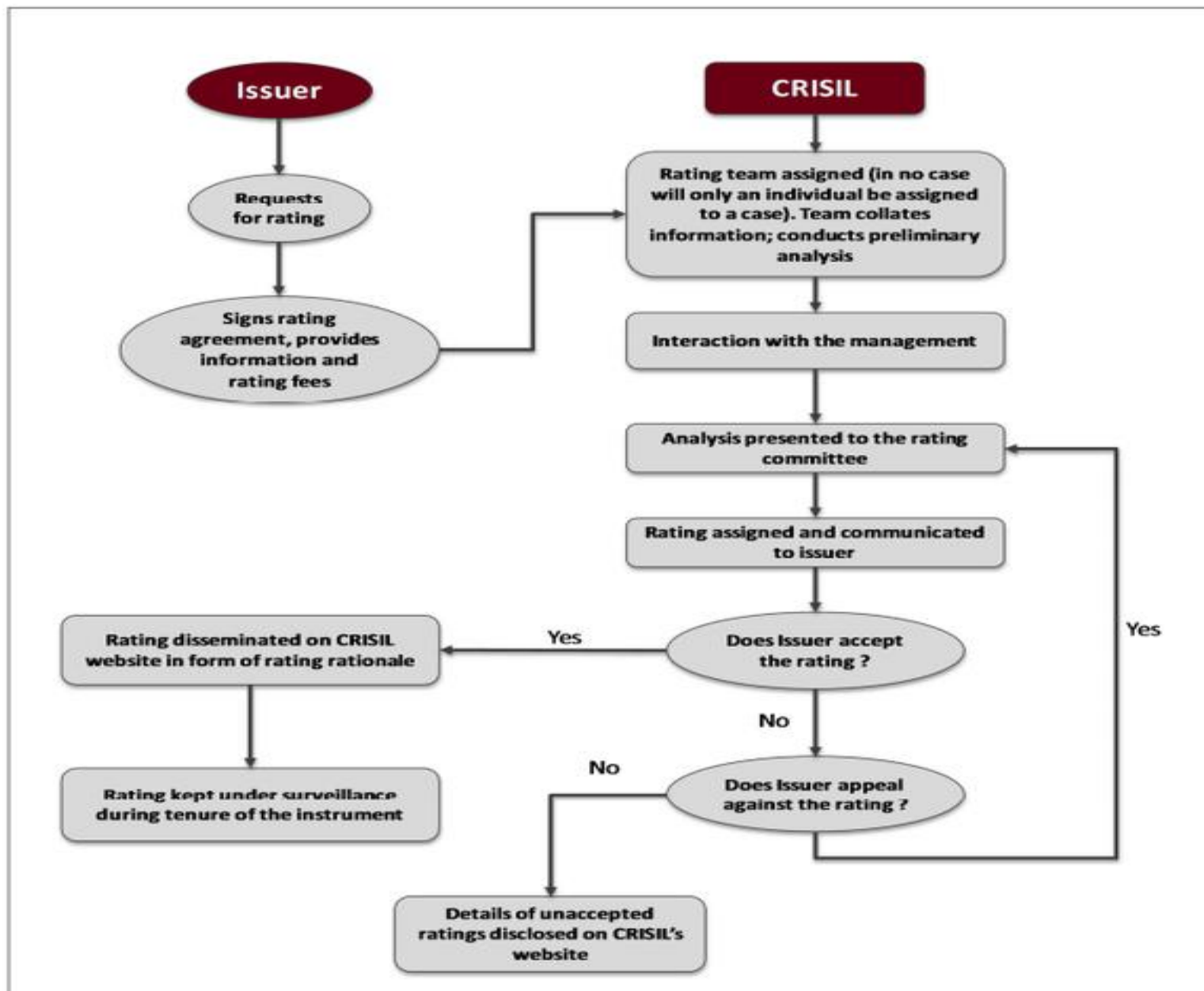
- **Business analysis-** covers an analysis of industry risk, market position in the country, operating efficiency of the company and legal position.
- **Financial Analysis-** analysis of accounting quality, earnings protection, cash flow adequacy and financial flexibility.
- **Management Evaluation-** study of track record of the management's capacity to overcome adverse situations, goals, philosophy and strategies.
- **Fundamental analysis-** analysis of liquidity management, asset quality, profitability and interest and tax sensitivity.



CREDIT RATING METHODOLOGY

Steps:-

- information is collected and then analysed by a team of professionals in an agency.
- If necessary, meetings with top management suppliers and dealers and a visit to the plant of proposed sites are arranged to collect additional data. This team of professionals submit their recommendations to the rating committee.
- Committee discusses this report and then assigns rating.
- Rating assigned is then notified to the issuer and only on his acceptance, rating is published.
- Assures confidentiality of information.
- Once the issuer decides to use and publish the rating, agency has to continuously monitor it over the entire life of instrument, called surveillance.





Rating Process

- The process begins with issue of rating request letter by the issuer of the instrument and signing of the rating agreement.
- CRA assigns an analytical team consisting of two or more analysts one of whom would be the lead analyst and serve as the primary contact.
- Meeting with Management- The analytical team obtains and analyses information relating to its financial statements, cash flow projections and other relevant information.
- Discussion with management on management philosophy, competitive position, financial policies and future plans.

Rating Process cont-

- Discussions on financial projections based on objectives and growth plan , risks and opportunities.
- Rating committee- after meeting with the management the analysts present their report to a rating committee which then decides on the rating.
- After the committee has assigned the rating, the rating decision is communicated to the issuer, with reasons or rationale supporting the rating.
- Dissemination to the Public: Once the issuer accepts the rating, the CRAs disseminate it, along with the rationale, to the print media.

<div>  Investment Grade </div>	'AAA'	Extremely strong capacity to meet financial commitments. Highest rating
	'AA'	Very strong capacity to meet financial commitments
	'A'	Strong capacity to meet financial commitments, but somewhat susceptible to adverse economic conditions and changes in circumstances
	'BBB'	Adequate capacity to meet financial commitments, but more subject to adverse economic conditions
	'BBB-'	<i>Considered lowest investment grade by market participants</i>
<div> Speculative Grade  </div>	'BB+'	<i>Considered highest speculative grade by market participants</i>
	'BB'	Less vulnerable in the near-term but faces major ongoing uncertainties to adverse business, financial and economic conditions
	'B'	More vulnerable to adverse business, financial and economic conditions but currently has the capacity to meet financial commitments
	'CCC'	Currently vulnerable and dependent on favorable business, financial and economic conditions to meet financial commitments
	'CC'	Currently highly vulnerable
	'C'	A bankruptcy petition has been filed or similar action taken, but payments of financial commitments are continued
	'D'	Payment default on financial commitments
Ratings from 'AA' to 'CCC' may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories.		

Benefits of credit rating

•	<u>To investors</u>	•	<u>To company</u>
1.	Helps in Investment Decision	1.	Improves Corporate Image
2.	Benefits of Rating Reviews	2.	Lowers Cost of Borrowing
3.	Assurance of Safety	3.	Wider Audience for Borrowing
4.	Easy Understand ability of Investment Proposal	4.	Good for Non-Popular Companies
5.	Choice of Instruments	5.	Act as a Marketing Tool
6.	Saves Investor's Time and Effort	6.	Helps in Growth and Expansion

Credit Rating Agency

A **credit rating agency (CRA)** is a company that assigns credit ratings, which rate a debtor's ability to pay back debt by making timely interest payments and the likelihood of default.

An agency may rate the **creditworthiness** of issuers of debt obligations, of debt instruments, and in some cases, of the servicers of the underlying debt, but not of individual consumers.

The debt instruments rated by CRAs include government bonds, corporate bonds, CDs, municipal bonds, preferred stock, and collateralized securities, such as mortgage-backed securities and collateralized debt obligations.

Credit rating is a highly concentrated industry, with the two largest CRAs—**Moody's** Investors Service and **Standard & Poor's (S&P)**—controlling 80% of the global market share, and the "Big Three" credit rating agencies—Moody's, S&P, and Fitch Ratings—controlling approximately 95% of the ratings business.

As of December 2012, **S&P** is the largest of the three, with **1.2 million** outstanding ratings and **1,416 analysts** and supervisors; **Moody's** has **1 million** outstanding ratings and **1,252 analysts** and supervisors; and **Fitch** is the smallest, with approximately **350,000** outstanding ratings, and is sometimes used as an alternative to S&P and Moody's.

- Credit rating agencies generate revenue from a variety of activities related to the production and distribution of credit ratings.
- The sources of the revenue are generally the issuer of the securities or the investor. Most agencies operate under one or a combination of business models: the **subscription model** and the **issuer-pays model**. However, agencies may offer additional services using a combination of business models.
- Under the **subscription model**, the credit rating agency does not make its ratings freely available to the market, so investors pay a subscription fee for access to ratings.
- This revenue provides the main source of agency income, although agencies may also provide other types of services.
- Under the **issuer-pays model**, agencies charge issuers a fee for providing credit rating assessments.
- This revenue stream allows issuer-pays credit rating agencies to make their ratings freely available to the broader market, especially via the Internet.



CRISIL

- The first rating agency 'Credit Rating Information Services of India Ltd. , CRISIL, was promoted jointly in 1987 jointly by the ICICI and the UTI. Other shareholders included ADB, LIC, HDFC Ltd, General Insurance Corporation of India and several other foreign and Indian Banks.
- It pioneered the concept of credit rating in the country and since then has introduced new concepts in credit rating services and has diversified into related areas of information and advisory activities.
- It became public in 1993.
- In 1996, it formed a strategic alliance with S&P rating group.

Services offered by CRISIL

- Credit Rating Services
- Advisory Services
- Credibility first rating and evaluation Services
- Training Services

Credit Rating Services(CRS)

- The principle function of CRISIL is to rate mandated debt obligations of Indian Companies chit fund, real estate developers, LPG Kerosene dealers, NBFC, Indian states and so on.
- Rating of debt obligations:
 - Debt obligation includes rupee denominated credit instruments like debentures, preference shares, deposits, CD's commercial papers and a structured obligations of manufacturing ,finance companies, banks, financial institutions etc.
 - It ensures stable and healthy growth of capital market by offering credit rating which is widely acceptable. It provides increased disclosures, better accounting standards and improved financial information to the users.
 - It reduces cost of issue by direct mobilization of resources.
 - It protects the interest of investors by constantly monitoring the results of rated companies.

- Rating of structured obligations:
 - It reflects CRISIL opinion regarding the capacity and willingness of the company to make timely payments of financial obligations on rated instruments.
- Rating of real estates developers:
 - CRISIL has developed framework for rating of real estate projects. Such rating helps investors to identify their investment options
 - The rating is expected to help developers mobilize funds for their projects.
 - The methodology assesses a project in terms of project risk factors and developer's risk factors.

- Bond Fund ratings:
 - The rating is an opinion of the quality of bond funds underlying portfolio holdings. They mainly focus on fixed income securities.
 - The rating methodology takes into account the following factors i.e., credit associated with the securities, the systems and procedures followed by the funds and management quality and expertise.
- Bank loan rating:
 - The creditworthiness of bank's borrower is assessed offering comments on the likelihood of repayment of loans.
 - The methodology considers the borrowers underlying assets liquidity and risk management initiative and for NBFC quality of assets , loans and investment.

- **Collective investment schemes:**

This covers rating of collective investment schemes offering opinion on the degree of certainty of the scheme to deliver the assured returns in terms of cash as mentioned in the offer document

- **Grating of health care institutions:**

The grading for healthcare institutions is an opinion on the relative quality of health care delivered by the institutions to the patients. Grading is done taking into account facilities, quality , consistency in delivering the service etc. Flowing are the grades given Grade A(Very good quality), Grade B (Good Quality) , Grade C (Average Quality) and Grade D(Poor Quality)

CRICIL Advisory Services (CAS)

- The CAS offers consulting services that aim at identifying and mitigating risk. The main focus of these services is transaction and policy level assignments in the area of energy, transport, banking and finance disinvestment, privatization and valuation.
 - Energy group services: it offers advisory services to companies engaged in energy sector like power, coal, oil and gas. The policy level assignments include aspects like sector reforms and structuring, regulatory framework privatization, corporate plan fuel related services.
 - Transaction level assignment include project scoping and structuring, bid process management, financial viability analysis of projects, risk identification and analysis and structuring of project contracts, security package, structuring and analysis.

- Transport and urban infrastructure group services: It provides financial advisory services to transport and infrastructure service provider.
 - Policy level assignments include advice on transport sector privatization policy of state ports, development of risk identification allocation, long term sector plans and state role.
 - Transaction level assignments include financial viability analysis, project structuring, bid process management, negotiation of terms with successful bidders
 - Privatization and disinvestment group: this group renders advisory services to central state governments, public sector enterprises and private sector entities interested in participating in privatization program, these services cover 3 aspects policy level, enterprise level and reforms and restructuring.

- Banking and finance group:

CRISIL offers a wide range of services covering restructuring and business reengineering, credit management, investment management and portfolio insurance, equity valuation, resource mobilization studies and financial feasibility studies

- Capital Market Group:

This group provides customized research and advisory assistance to meet specific transactional and strategic requirements of clients. It offers services like diagnostic evaluation for valuation of Indian partner of a foreign asset management company, technical assistance to AMFI, portfolio evaluation and portfolio analysis for leading mutual funds, composite performance ranking of domestic mutual funds, assistance to government for the development of India's financial sector.

CRISIL DEBENTURE RATING SYMBOLS

SYMBOL	SAFETY LEVEL
AAA	HIGHEST SAFETY
AA	HIGH SAFETY
A	ADEQUATE SAFETY
BBB	MODERATE SAFETY
BB	INADEQUATE SAFETY
B	HIGH RISK
C	SUBSTANTIAL RISK
D	DEFAULT

CRISIL FIXED DEPOSIT RATING SYMBOLS

SYMBOL	SAFETY LEVEL
F AAA	HIGHEST SAFETY
F AA	HIGH SAFETY
F A	ADEQUATE SAFETY
F B	INADEQUATE SAFETY
F C	HIGH RISK
F D	DEFAULT



ICRA Ltd

- Information and Credit Rating Services (ICRA) has been promoted by IFCI Ltd as the main promoter and started operations in 1991.
- Other shareholders are UTI, Banks, LIC, GIC, Exim Bank, HDFC and ILFS.
- It provides Rating, Information and Advisory services ranging from strategic consulting to risk management and regulatory practice.
- The main objectives of ICRA are to assist investors both individual and institutional in making well informed decisions
- To assist issuers in raising funds from a wider investor base.
- To enable banks, investment bankers, Brokers in placing debt with investors.
- To provide regulators with market driven systems to encourage the healthy growth of capital markets.
- It provides rating services, information services and advisory services.

Rating services

- ICRA rates debt instruments issued by manufacturing companies, commercial banks, NBFCs, financial institutions, PSUs and municipalities.
- The instruments rated by it include bonds/ debentures, fixed deposits commercial papers and certificate of deposit. It also rates structured obligations in accordance with the terms of the structure based on risk assessment of the instrument . It rates sector specific debt obligations issued by power, telecom and infrastructure companies.
- It also provides corporate governance rating , rating of claims paying ability of insurance companies, credit assessment of large medium and small scale companies to obtain assistance from banks, FIs. It also provides services of general assessment of companies.

Information services

- The information services division of ICRA focuses on providing authentic data and value added products used by intermediaries, financial institutions, banks, asset managers, institutions and investors.
- Value added services include equity grading providing a critical input on a company's earning prospects and inherent risks in decision making process of equity investors and equity assessment.
- Other services include corporate reports, equity assessment, mandate based studies (customized research) and sector/industry specific publication.

Advisory services

- The advisory services division of ICRA offers wide ranging management advisory services. Under advisory services ICRA provides its understanding on the business processes and relevant organizational issues to different players of financial markets such as investors, issuers, regulators, intermediaries and media.
- The advisory services include 1.strategic consulting/ strategic practice 2. risk management (credit risk, market risk and operations risk) 3. regulatory practice 4 transaction practice 5. information(content services).
- It focuses on sectors like banking and financial services, infrastructure sector, manufacturing and service sector, government and regulatory authorities.

ICRA LONG-TERM DEBT INSTRUMENT **RATING SYMBOLS**

SYMBOL	SAFETY LEVEL
L AAA	HIGHEST SAFETY
L AA	HIGH SAFETY
L A	ADEQUATE SAFETY
L BBB	MODERATE SAFETY
L BB	INADEQUATE SAFETY
L B	RISK PRONE
L C	SUBSTANTIAL RISK
L D	DEFAULT

ICRA MEDIUM-TERM INSTRUMENTS(INCLUDING FIXED DEPOSITS & CERTIFICATES OF DEPOSITS)

SYMBOL	SAFETY LEVEL
M AAA	HIGHEST SAFETY
M AA	HIGH SAFETY
M A	ADEQUATE SAFETY
M B	INADEQUATE SAFETY
M C	RISK PRONE
M D	DEFAULT

ICRA SHORT-TERM INSTRUMENTS(INCLUDING COMMERCIAL PAPER) RATING SYMBOLS

SYMBOLS	SAFETY LEVEL
A 1	HIGHEST SAFETY
A 2	HIGH SAFETY
A 3	MODERATE SAFETY
A 4	RISK PRONE
A 5	DEFAULT



CARE Ltd.

- Credit Analysis and Research Ltd or CARE is promoted by IDBI jointly with Financial Institutions, Public/Private Sector Banks and Private Finance Companies.
- It commenced its credit rating operations in October, 1993 and offers a wide range of products and Services in the field of Credit Information and Equity Research.
- It also provides advisory services in the areas of securitisation of transactions and structuring Financial Instruments.
- It offers services like 1. Credit rating of debt instruments
2. Advisory services like securitization transactions, structuring financial instruments, financing infrastructure projects and municipal finances 3. Information services like providing information to companies, industry and businesses.
4. Equity research

CARE LONG-TERM AND MEDIUM-TERM INSTRUMENTS RATINGS SYMBOLS

SYMBOLS	SAFETY LEVEL
CARE AAA	HIGHEST SAFETY
CARE AA	HIGH SAFETY
CARE A	ADEQUATE SAFETY
CARE BBB	MODERATE SAFETY
CARE BB	INADEQUATE SAFETY
CARE B	SUSCEPTIBLE TO DEFAULT
CARE C	HIGH INVESTMENT RISK
CARE D	DEFAULT OR LIKELY TO BE IN DEFAULT

CARE SHORT-TERM INSTRUMENTS RATING

SYMBOLS

SYMBOLS	SAFETY LEVEL
PR 1	HIGHEST SAFETY
PR 2	HIGH SAFETY
PR 3	ADEQUATE SAFETY
PR 4	INADEQUATE SAFETY
PR 5	DEFAULT OR LIKELY TO BE IN DEFAULT