Ratings

CRISIL's criteria for rating short-term debt

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Executive summary

CRISIL assigns ratings to instruments with an original contracted maturity of up to one year, such as commercial papers (CPs), on a short-term scale. Such short-term instruments are generally rolled over or refinanced on maturity. The ability to refinance the short-term debt (STD) depends on the long-term credit risk profile of the issuer. Hence, the short-term rating is derived from the long-term rating of the issuer. CRISIL uses a mapping framework for capturing the linkage between long-term and short-term ratings. Liquidity backup, wherever applicable, may be required to address the refinancing risk associated with confidence-sensitive instruments such CPs and short-term non-convertible debentures (NCDs).

Scope

This article[1] covers CRISIL's criteria for arriving at short-term ratings of issuers. It covers the mapping framework for deriving short-term ratings from long-term ratings and analysis of the liquidity of issuers undertaken in conjunction with the mapping framework. It also details the liquidity backup requirements for confidence-sensitive short-term instruments.

Methodology

STD, including CP, is different from long-term debt; while the latter is expected to be repaid out of the internal cash accrual of the business, STD is usually rolled over.

The steps followed for arriving at the short-term rating are:

Step 1: Assess the underlying credit quality of the issuer, as reflected in its long-term rating

Step 2: Assess liquidity and analyse the monthly bank limit utilisation of the issuer

Step 3: Arrive at a short-term rating using a mapping framework

Step 4: Arrive at the quantum of CP/STD consistent with the rating[2]

Step 5: Evaluate the liquidity backup[3]

Step 6: Evaluate credit enhancement options, if applicable

Step 1: Assess the underlying credit quality of the issuer

CRISIL's rating on a CP or STD is primarily dependent on its opinion of the issuer's fundamental credit quality. The analytical approach adopted for assigning such a rating is very similar to that for a long-term rating as there is a strong linkage between the two. While the tenure of a CP is 7-365 days, the short-term rating's time horizon extends well beyond this period because even such ratings are expected to endure over time rather than change frequently. Moreover, if the maturity of a CP or STD issue cannot be met through subsequent CP or STD issues (roll-

[1] This article has been updated to clarify the applicability of maximum permissible STD. For the previous version of the article, which was published in January 2018, please refer to https://www.crisil.com/content/dam/crisil/criteria_methodology/criteria-research/archive/Criteria-for-rating-short-term-debt.pdf

[2] Step 4: In the case of non-financial sector entities, computation of maximum permissible STD is recommendatory in nature. This is because proceeds from CPs are typically used for short-term working capital needs.

[3] Step 5: Wherever applicable

over) for any reason, the issuer has to rely on fresh borrowings. In such a case, ability to refinance will largely depend on the fundamental credit quality, as reflected in its long-term rating.

Step 2: Assess liquidity

Once the long-term rating is assessed, CRISIL's rating methodology takes into account the issuer's current liquidity. For non-financial sector entities (non-FSEs), this entails a detailed analysis of the adequacy of internal sources of funds for covering short-term uses, including working capital requirement. This includes an assessment of the average monthly bank limit utilisation for the past 12 months, as well as of the variations in the working capital cycle of the issuer. Where applicable, assessment of the variations in the drawing power during the past 12 months as a proportion of the sanctioned bank limits serves as additional input for the analysis.

For FSEs, liquidity assessment focuses on the cumulative asset-liability mismatches over various maturity buckets, and the adequacy of liquid assets to cover maturing liabilities. Among FSEs, banks and primary dealers (PDs) enjoy more liquidity than non-banking financial companies (NBFCs) and housing finance companies (HFCs) due to their access to the liquidity adjustment facility (LAF) of the Reserve Bank of India (RBI) and call money markets.

Step 3: Mapping framework

While the short-term ratings are linked to the long-term ratings, the assessment made in Step 2 provides some flexibility in determining the exact mapping of a given long-term rating into the short-term scale. The long-term rating scale has more levels and hence there may not be a one-to–one mapping between the two scales (see Table 1). The mapping adopted for financial sector companies may be different from that for manufacturing companies, primarily on account of better liquidity and easier access to funds by the former.

Table 1: Mapping between short-term and long-term ratings (ratings within brackets only in exceptional cases)

LT rating	Corporates	Other Fin sector entities (other than banks and PDs)	PDs	Banks
AAA	A1+	A1+	A1+	A1+
AA+	A1+	A1+	A1+	A1+
AA	A1+	A1+	A1+	A1+
AA-	A1+	A1+	A1+	A1+
A+	(A1+) A1	A1+ (A1)	A1+	A1+
A	A1 (A2+)	(A1+) A1 (A2+)	A1+ (A1)	A1+
A-	(A1) A2+	A1 (A2+)	A1	A1+ (A1)
BBB+	(A2+) A2	A2+, A2	(A1) A2+	A1 (A2+, A2)
BBB	(A2) A3+ (A3)	(A2) A3+ (A3)	(A2+) A2	(A1) A2+, A2
BBB-	(A2, A3+) A3	(A2, A3+) A3	(A2) A3+, A3	A3+, A3
BB+	A4+	A4+	A4+	A4+
BB	A4+	A4+	A4+	A4+

LT rating	Corporates	Other Fin sector entities (other than banks and PDs)	PDs	Banks
BB-	A4+ (A4)	A4+ (A4)	A4+(A4)	A4 + (A4)
B, C categories	A4	A4	A4	A4

CRISIL may deviate from its mapping framework when it has a particular reason to ascribe a stronger (or weaker) short-term credit quality, and may assign a higher (or lower) short-term rating. The ratings within brackets in Table 1 indicate the typical deviations that may be taken. The deviations will be based on the analysis of liquidity, wherein CRISIL evaluates the extent of short-term sources of funds vis-à-vis short-term funding requirement.

Step 4: Arrive at the quantum of CP/STD consistent with the rating

While assigning the short-term ratings, CRISIL assesses the quantum of rated short-term debt that a company can issue based on its business plan. This assessment is based on an analysis of the maturity profile of the assets and liabilities, and assessment of liquidity and refinancing ability. In some instances, CRISIL may put a ceiling on the allowable quantum of short-term debt based on cash flow and liquidity.

Please refer to Annexure 1 for CRISIL's approach for computing short-term debt limits for issuers.

Step 5: Evaluate the liquidity backup

Liquidity backup is typically provided to confidence-sensitive instruments, on which the issuer may default in times of temporary financial stress. These are instruments that are susceptible to default due to loss of confidence among investors, which may jeopardise the financing options of the issuer as well as other issuers of the same instrument class and lead to a series of defaults. For instance, if depositors lose confidence in a bank, they may queue up for premature withdrawal, leading to a run on the bank's deposits.

Similarly, in the STD market, default by one issuer may cause nervousness among investors about other issuers and may prompt them to not roll over the STD facilities. Therefore, it is essential for the issuers to maintain liquidity backup on STD to prevent such financial contagion. The importance of liquidity backup is reflected in the fact that a majority of CPs are being primarily carved out of working capital limits, despite RBI allowing the issuance of CP as a distinct product. The maintenance of liquidity backup allows issuers to weather wide-spread disruptions in the CP market or lack of investor interest in the CP issued.

Liquidity backup for non-FSEs

CRISIL may not insist on liquidity backup for non-FSE issuers rated 'CRISIL AA-' or above on the long-term scale. That's because such highly rated issuers typically have substantial liquidity and high refinancing ability based on their market reputation. However, CRISIL may obtain liquidity backup on a case-to-case basis if it believes that this is warranted depending on the analysis of the liquidity of the issuer, its capital structure, cash flow stability, and the characteristics of the industry in which it operates. While analysing liquidity, CRISIL considers the ability of the issuer to meet short-term uses of funds such as working capital, repayment of maturing debt, and a portion of capital expenditure, without having to resort to additional borrowing. In all cases, however, the liquidity plan articulated by the issuer is evaluated.

CRISIL insists on liquidity backup for corporates rated 'CRISIL A+' or below. This is assessed for STD under two options:

- **Liquidity backup to the extent of 100% of outstanding STD:** CRISIL insists on 100% liquidity backup for the value of outstanding STD until its maturity.
- **Liquidity backup for STD maturing over the next few days on a rolling basis:** Stipulation of 100% liquidity backup for the entire outstanding STD of highly rated entities may not be necessary in all cases. That's because many such entities have strong liquidity as they consistently maintain sufficient liquid assets to meet short-term requirements. Hence, CRISIL may stipulate a rolling liquidity backup for total STD (rated and unrated) maturing, say in the next "N" days. The stipulation of the number of days is based on evaluation of the specific liquidity plan and other factors such as gearing, current ratio, debt repayment in the near to medium term, availability of alternative options to meet STD redemptions, and propensity of the issuer to rely on STD.

The various forms in which a corporate can provide liquidity backup are:

- Drawing power available against unutilised bank lines
- Investments in liquid MFs
- Cash/unpledged fixed deposits in a bank, of a similar or higher short-term rating in comparison with the issuer

CRISIL also assesses the quality of the liquidity backup facility while assigning the short-term rating. For issues that are carved out of the existing working capital bank limit, the limit would function as a liquidity backup. For other forms of liquidity backup facilities, CRISIL looks at the nature and commitment of the facility, its tenure, the strength of the relationship between the issuer and facility provider, and the covenants/restrictions affecting the issuer's ability to access the facility. CRISIL does not insist on a liquidity backup for companies that have availed of only bank facilities.

Liquidity backup for FSEs

FSEs typically have better liquidity than those engaged in manufacturing, trading, and infrastructure. Hence, CRISIL may not insist on pre-arranged liquidity backup facilities for all classes of FSEs. CRISIL's analysis of the liquidity of an FSE involves understanding the extent of mismatches in its asset-liability maturity (ALM) profile. Also considered is the liquidity plan presented by the issuer with specific emphasis on its policies regarding maintaining liquid assets, staggering of the debt maturities so as to avoid bunching up of repayments, and ease of access to systemic liquidity.

- **Banks and PDs:** Access to systemic liquidity under the LAF of RBI and access to unsecured borrowing in the call money markets enable banks and PDs to comfortably manage liquidity. Hence, CRISIL may stipulate liquidity backup requirements for such companies only in exceptional circumstances. Lack of access to refinance from the regulator and a low long-term rating would typically necessitate a financial sector issuer to provide liquidity backup for availing a CRISIL rating for its confidence-sensitive STD instruments.
- **Other FSEs (NBFCs, HFCs, FIs):** For such entities, CRISIL may not insist on liquidity backup if the issuer is rated 'CRISIL AA-' or above on the long-term scale. That's because such highly rated issuers typically have a prudent ALM profile, and have high refinancing ability. However, CRISIL may obtain liquidity backup on a case-to-case basis if it believes that liquidity backup is warranted based on the analysis of the asset quality of the issuer, its ALM profile, and the presence of liquid assets to cover asset-liability mismatches. In all cases, however, the liquidity plan articulated by the issuer is evaluated.

CRISIL insists on liquidity backup for NBFCs, HFCs, and FIs rated 'CRISIL A+' or below. The liquidity backup may be a combination of the following:

- Sanctioned and unutilised bank lines

- Sanctioned and unutilised refinance limits from financial institutions such as RBI, National Bank for Agricultural and Rural Development (NABARD), National Housing Bank (NHB), Small Industries Development Bank of India (SIDBI), and Export-Import Bank of India (EXIM Bank).
- Investments in liquid MFs or money market instruments
- Investments in listed equity shares subject to suitable hair cuts
- Finance limits provided by parent/group company (rated in at least the 'AA' category)
- Unpledged fixed deposits
- Loan against shares facility from a 'AAA' rated NBFC, provided it is accompanied by a board resolution and other relevant authorisations required

Although liquidity backup facilities are a pre-requisite for rating a CP, CRISIL does not enhance CP ratings based on the backup. That's because most liquidity backup facilities are technically revocable by the facility provider if the credit quality of the issuer deteriorates during the time when the rated instrument is outstanding. In its purest sense, the liquidity facility's purpose is to cover temporary shortfalls in the issuer's cash flows. This means that even the strongest form of backup does not enhance the underlying credit and does not lead to a higher rating than indicated by the issuer's own creditworthiness. Thus, liquidity backup facilities provide support only in times of market disruption and not when the fundamental credit quality of the CP or STD issuer deteriorates. CRISIL enhances short-term ratings only based on unconditional and irrevocable credit-support facilities, which, if available, are evaluated in the next step of the rating process.

Step 6: Evaluate credit enhancement options

Commercial banks may provide back-stop facilities for credit enhancement, such as a standby credit facility. These are distinct from liquidity facilities and work like guarantees. Corporate entities may also provide guarantees for a CP issue. A standby credit facility or a guarantee is unconditional and irrevocable and is available under all circumstances to meet obligations on the issue if the primary obligor (the issuer) fails to do so. In such cases, the CP/STD rating is generally equated to that of the facility provider irrespective of the issuer's standalone rating.

For more details, please refer to "CRISIL's criteria for rating guaranteed instruments", available on www.crisil.com.

Box 1: Ratings for CP issues of IPO Financiers

CRISIL assigns ratings to commercial paper issues which are used for raising resources for financing investors in initial public offerings (IPO) and follow-on public offers. It is to be noted that the rated quantum of commercial paper for IPO financing could be higher than the steady-state business-as-usual requirement given the high level of oversubscription in many of the IPOs. However, appropriate structure is present for the entire IPO process which ensures that the overall process of fund flow is well defined; the bank account of client for application money and the demat account where shares are allotted, are controlled by the lender. Also, an accurate estimation of demand for the IPO makes the debt structure largely self-liquidating.

It is also of a significantly shorter tenor, being linked to the duration of the IPO process. The rating on these instruments will typically be at the same level as that of the regular commercial paper issuance of the issuer. In assigning these ratings, CRISIL factors in the significantly low degree of risks of this product due to the largely self-liquidating structure of IPO financing wherein the amount refunded post allocation of securities covers the quantum funded by the lender. This is ensured through the margin policy of the lender; the margin collected from the client is a function of the expected oversubscription level. Given the operational intensity of IPO financing, in assigning these ratings, CRISIL also factors in the risk management systems and processes of the lender, as well as the experience of the lender in IPO financing.

Conclusion

CRISIL assigns short-term ratings to instruments with original contracted maturity of less than one year, such as CPs and STD. These short-term ratings are derived from the long-term ratings of issuers as per a mapping framework that captures the linkages between long-term and short-term ratings. The mapping is different for FSEs and non-FSEs to account for inherent differences in their liquidity. CRISIL also analyses in detail the liquidity of the issuer to arrive at the exact mapping level as per the mapping framework. CRISIL typically insists on liquidity backup for CPs and STD, except for certain FSEs and highly rated issuers with strong liquidity.

Annexure 1: Computation of short-term debt limits for issuers of CP / STD

For non-financial sector entities

The total amount of rated STD may be the higher of the "Maximum Permissible Short Term Debt" or the total sanctioned bank limits. This ensures that there is adequate liquidity to back up the short term debt.

Maximum Permissible Short Term Debt (MPSTD) = 0.75*EGCA – CL – CPLTD + (90/360)*NCA

EGCA is Effective Gross Current Assets (Current Assets – Loans and Advances to group companies)

CL is Current Liabilities

CPLTD is Current Portion of Long Term Debt

NCA is Net Cash Accruals during the current year

Current ratio is the key driver for determining MPSTD of a company. CRISIL assumes certain target current ratio depending on the credit profile of the issuer while determining the MPSTD.

For NBFCs

The fundamental principle underpinning CRISIL's approach to the permissible short-term debt limit is a comparison between an NBFC's assets and liabilities having a maturity of less than a year. Apart from considering the scheduled maturity profiles of an NBFC's assets and liabilities, CRISIL gives due credence to, inter alia, its refinancing capabilities, its asset quality as reflected in its collection efficiency and delinquency levels, estimated level of prepayment on the loans based on past trends and its unutilised bank.

In the case of NBFCs that have strong credit profiles as evident in their high credit ratings, CRISIL's criteria for computing the short-term debt limit factors in this strength even if there is a mismatch between the maturity profiles of the assets and liabilities in the one-year bucket. This is because of the highly-rated NBFCs' ability to refinance their liabilities. The comfort derived from an NBFC's refinancing capabilities to ensure adequate matching of assets and liabilities reduces in correspondence with its rating.

CRISIL has parameterized this approach by applying a multiple to the level of assets that are expected to mature within one year. Based on this, CRISIL's model for determining an NBFC's maximum permissible short-term debt (STD) limit uses the following algorithm:

Total Permissible STD = Additional permissible STD + Existing STD, where

Additional STD permissible = (Multiplier * Short Term Assets) – Short Term Liabilities

Existing STD = Aggregate of all borrowings with a contracted maturity of less than a year

While arriving at the quantum of maturing assets and liabilities, CRISIL sensitises the NBFC's asset and liability maturity profile for factors such as its collection efficiency, delinquency levels, prepayment levels and the expected trends in these factors, going forward. This is done on the merits of each individual case, based on CRISIL's understanding of the entity's past operations and expected performance.

While an NBFC's permissible short-term debt limit is normally determined through the fundamental principle described above, CRISIL may allow for higher limits to be assigned in the following circumstances:

Availability of unutilized bank lines: In a scenario where an NBFC has unutilized bank lines that are available to meet repayment obligations in the less-than-one-year maturity bucket, the amount of unutilized bank lines is considered as an added comfort while computing the total permissible short-term debt limit. An NBFC can also use the unutilized bank lines to create short-term assets, which can provide an additional cushion to its asset-liability profile.

Growth in short term assets: If an NBFC plans to aggressively increase the level of its short-term assets, CRISIL may appropriately enhance its short-term debt limit based on its estimation of the entity's ability to ramp up its asset base, going forward.

Please refer to Table 2 for an illustration on calculation of total permissible STD for an NBFC.

Table 2: Calculation of NBFC's total permissible STD

Item	Rs. Mn.
Assets maturing in one year (A')	1000
Multiplier (M)	1 #
Assets maturing in one year – sensitized (A = M * A')	1000
Liabilities maturing in one year (B)	750
Gap between assets and liabilities (C = A – B)	250
Existing STD (D)	600 @
Bank lines available (E)	900
Bank lines utilized (F)	450
Unutilized bank lines (G = E – F)	450
Total permissible STD (C + D + G)	**1300**

The multiplier "M" used here reflects CRISIL's estimate of the NBFC's refinancing ability, which is linked to its credit risk profile and indicated by its credit rating. Here "M" is assumed to be = 1.

@ includes bank borrowing and other debt with a contracted maturity of less than one year

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