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Credit Rating

Chapter Objectives

This chapter will enable you to develop an understanding of the following :

1 *Meaning of credit rating*

2 *Importance of credit rating*

3 *Origin of the concept of credit rating*

4 *The growth of credit rating industry in India*

5 *Rating methodology*

6 *Credit rating agencies in India—CRISIL, ICRA, CARE, FITCH, and Brickwork Ratings.*

INTRODUCTION

In the post-reforms era, with increased activity in the Indian financial sector both existing and new companies are opting for finance from the capital market. The competition among firms for a slice of the savings cake has increased. New instruments have been designed by companies to attract investors to subscribe to their issues. The market is flooded with a variety of new and complex financial products, such as asset-backed securities and credit derivatives. These new instruments are embodied with complex features very difficult for an ordinary investor to understand and analyse. Besides this, investors no longer evaluate the creditworthiness of the borrowers by their names or size. Credit rating agencies have come into existence to assist the investors in their investment decisions, by assessing the creditworthiness of the borrowers.

Credit rating is the assessment of a borrower's credit quality. Credit rating performs the function of credit risk evaluation reflecting the borrower's expected capability to repay the debt as per terms of issue. Credit rating is merely an indicator of the current opinion of the relative capacity of a borrowing entity to service its debt obligations within a specified time period and with particular reference to the debt instrument being rated. Credit rating is not a recommendation to buy, hold or sell. It is a well-informed opinion made available to the public, and might influence their investment decisions. Credit rating, however, is not a general purpose evaluation nor overall assessment of credit risk of a firm. Ratings neither evaluate the reasonableness of the issue price or possibilities for capital gains nor take into account the liquidity in the secondary market. Ratings also do not take into account the risk of prepayment by issuer. Although these are often related to the credit risk, the rating essentially is an opinion on the relative quality of the credit risk. An agency that performs the rating of debt instruments is known as credit rating agency. At present, the scope of a credit rating agency is not limited to rating of debts. Credit rating agencies now undertake financial analysis and assessment of financial products, individuals, institutions, and governments.

The Importance of Credit Rating

- Credit rating is an opinion of the relative capacity of a borrowing entity to service its debt obligations within a specified time period and with particular reference to the debt instrument being rated.

Credit rating helps in the development of financial markets. Credit rating agencies play a key role in the infrastructure of the modern financial system.

Credit rating enables investors to draw up the credit–risk profile and assess the adequacy or otherwise of the risk–premium offered by the market. It saves the investors, time and enables them to take a quick decision and provides them better choices among available investment opportunities based on their risk-return preferences. Issuers have a wider access to capital along with better pricing. Issuers with a high credit rating can raise funds at a cheaper rate thereby lowering their cost of capital. It acts as a marketing tool for the instrument, enhances the company's reputation and recognition, and enables even lesser known companies to raise funds from the capital market.

Credit rating is a tool in the hands of financial intermediaries, such as banks and financial institutions that can be effectively employed for taking decisions relating to lending and investments.

Credit rating helps the market regulators in promoting stability and efficiency in the securities market. Ratings make markets more efficient and transparent. They play a tremendous role in the growth of financial markets. It also helps in prescribing the requisite eligibility criteria for existing as well as new debt instruments, and monitoring the financial soundness of organizations. Ratings and rating changes influence the pricing of financial instruments.

Ratings help lenders, borrowers, issuers, investors, regulators and intermediaries make sound decisions. Ratings help corporates and investors manage and mitigate risks, take pricing and valuation decisions, reduce time to market, generate more revenue and enhance returns.

Rating agencies also help shape public policy on infrastructure in emerging markets, and thereby help catalyse economic growth and development in these geographies.

Ratings have assumed a much larger role in the global financial markets. Sovereign ratings affect the quantum of financial and investment flows to a country. Fund managers, international banks, and foreign direct investors look at ratings for portfolio allocation as ratings reflect the overall health of the country's economy.

Origin of the Concept of Credit Rating

This concept originated in the US in 1909 AD when the founder of Moody's Investor Service, John Moody, rated the US Rail Road Bonds. However, the relevance of this concept was realized only after the great depression when investors lost all their money. Lack of symmetric information and high costs of collecting information increased the popularity of credit rating agencies. The world's biggest rating agencies are Moody's Investors Service and Standard and Poor's (S&P). They have been into the rating business for decades. Both Moody's and S&P have been rating bonds since 1916 and have captured the lion's share. The nearest competitor of Moody's and S&P is Fitch Investors Service, which does not even share one-fifth of the business. These three rating agencies are given official recognition by the Securities and Exchange Commission (SEC). These agencies have grown so powerful that even sovereign governments are wary of getting a poor rating from them. Journalist Thomas Friedman once said, 'There are two superpowers in the world today. There is the United States and there is Moody's Bond Rating Service. The US can destroy by dropping bombs and Moody's can destroy you by downgrading your bonds.'

Initially, rating agencies in the US rated instruments and published their ratings free of charge. They financed their operations through sale of publications and related materials. But with an increase in the popularity of ratings, they began to charge issuers for ratings. US rating agencies offer both solicited and unsolicited ratings. Unsolicited ratings are made explicit with an asterisk. The rating agency is not compensated by the firm and rating is based on published information in case of unsolicited rating.

- The issuer-pays model has been in vogue across the world.

The rating giants have diversified their service portfolio in order to survive and grow. Besides rating bond issues—their core rating business—they have diversified into rating asset-backed securities, commercial papers, bank loans, and other financial products. These agencies also rate mutual funds, banks, insurance companies, financial institutions, and sovereign governments. There are specialized agencies in the US that rate only financial institutions or insurance companies. Their latest move has been in the field of risk consulting. Sovereign ratings are a new line of business for credit rating agencies. The first industrial country to be rated was France by Standard and Poor's in 1959. Both Moody's and S&P rated a non-industrial country, namely, Venezuela in October 1977. Fitch entered the business of sovereign rating only in 1975. India has been assigned sovereign ratings by Moody's and S&P over a decade. India is also being rated by Fitch, Japan Credit Rating Agency and Japan Bond Research Institute. Moody's started rating India in 1988 with an investment grade rating and S&P started rating India in August 1990. Both these agencies downgraded India's long-term sovereign credit rating to noninvestment grade during the external crisis of 1991. Recently both these agencies affirmed their positive outlook on India. They are yet to increase India's rating to investment grade.

India was first among the developing world to set up a credit rating agency—Credit Rating Information Services of India Limited (CRISIL) in 1988. Then came ICRA in 1990, followed by CARE in 1993. The credit rating function was further institutionalized in the 1990s when the Reserve Bank and the SEBI made credit rating mandatory for the issue of commercial paper (CP) and certain categories of debentures and debt instruments. For any public issue of corporate debts, credit rating has to be obtained from at least one credit rating agency with the SEBI's approval and is disclosed in the offer document. In case where ratings are obtained from more than one agency, all such ratings, including the unaccepted ones, would have to be disclosed in the offer documents. Every rating would be reviewed by registered credit rating agency and revision would have to be disclosed to stock exchange. The issuer can also list debt securities on private placement basis, provided they have been credit rated and meet other regulations. Issuer would have to redeem debt securities in terms of offer documents.

THE GROWTH OF THE CREDIT RATING INDUSTRY IN INDIA

The prominent rating agencies in India are:

- CRISIL Limited
- ICRA Limited
- CARE Ratings
- India Ratings and Research Pvt. Ltd. (formerly Fitch Ratings India Pvt. Ltd.)
- Brickwork Ratings India Pvt. Ltd.
- SMERA Ratings Limited
- Infomerics Valuation and Rating Pvt. Ltd.

The Indian credit rating industry is next to the US in terms of number of ratings issued and in the number of agencies. CRISIL is the market leader in the credit rating industry with a 70 per cent market share.

The regulator's support played an important role in the development of the credit rating industry. In 1992, for the first time, the Reserve Bank introduced the requirement of rating for commercial paper. The SEBI followed up by introducing mandatory rating of bonds. The other growth drivers of the credit rating industry were declining interest rates, a shift towards market borrowings from bank loans and a steep increase in the state government borrowings through special purpose vehicles. Besides these factors the growth in the private placement market of debt increased business volume in the credit rating industry. For private placements, rating is not mandatory but banks and mutual funds ask for a rating. In 1997, the penetration of rating, that is, the number of rated issues out of the total number of issues was 35 per cent. In the year 2002, it was 97 per cent. This means that the credit rating industry has transited from a regulatory-driven market to an investor-driven market in the growing debt markets. Between fiscal 1997 and 2001, rated debt volumes increased from ₹13,743 crore to ₹52,746 crore, which is 84 per cent of the total issuance.

Rating Methodology

In India, the rating exercise starts at the request of the company. The process of obtaining a rating is quite lengthy and time consuming.

The rating of a financial instrument requires a thorough analysis of relevant factors that affect the creditworthiness of the issuer. The primary focus of the rating exercise is to assess future cash generation capability and their adequacy to meet debt obligations in adverse conditions. The analysis attempts to determine the long-term fundamentals and the probabilities of change in these fundamentals, which could affect the credit-worthiness of the borrower. Analysis typically involves at least five years of operating history and financial data as well as company and rating agency forecasts of future performance. Ratings are assigned after an in-depth study of both objective and subjective factors related to business, financial management and so on. Ratings are based on an indepth study of the industry and an evaluation of the strengths and weakness of the company. The analytical framework for rating consists of the following five broad areas:

Rating Methodology

- Economy Analysis
- Business Analysis
- Financial Analysis
- Management Evaluation
- Fundamental Analysis

1. Economy Analysis The Economic environment is assessed to determine the degree of operating risk faced by the company in a given business. Here the economy wide factors which have a bearing on the industry are taken into consideration. The strategic nature of the industry in the prevailing policy environment, regulatory oversight governing industries, etc. are also analysed.

2. Business Analysis This covers an analysis of industry risk, market position in the country, operating efficiency of the company, and legal position.

- An analysis of industry risk focuses on the prospects of the industry and the competitive factors affecting the industry. Investment plans of the major players in the industry, demand supply factors, price trends, changes in technology, international/domestic competitive factors in the industry, entry barriers, capital intensity, business cycles, etc. are key ingredients of industry risk. Industry risk covers an analysis of actual and estimated demand/supply, number of firms and potential entrants in the industry, government policies relating to the industry, the performance of the industry, its future potentiality, and other factors.
- Market position in the industry covers the study of market share of the firms (marketing strengths and weaknesses of the firm vis-a-vis its competitors), marketing arrangements, products, and customers.

- Operating efficiency is a study of production processes of the firm, its cost structure, locational advantages, labour relationships, input availability, and prices.
- Legal position covers a study of prospectus, accuracy of information, and filing of forms, returns, and so on with proper regulatory authorities.

3. Financial Analysis It involves evaluation of past and expected future financial performance with emphasis on assessment of adequacy of cash flows towards debt servicing. Financial analysis includes an analysis of accounting quality, earnings protection, cash flow adequacy, and financial flexibility.

- Accounting quality is known by the study of method of income recognition, inventory valuation, depreciation policies, auditor's remarks, and off-balance liabilities accounts are noted. A review of accounting quality and adherence to prudential accounting norms are examined for measuring the company's performance. Prudent disclosures of material events affecting the company are reviewed. Impact of the auditor's qualifications and comments are quantified and analytical adjustments are made to the accounts, if they are material. Off-balance sheet items are factored into the financial analysis and adjustments made to the accounts, wherever necessary. Change of accounting policy in a particular year which results in improved reported performance is also analyzed.
- Earnings protection is examined with reference to profitability ratios, earnings growth, and projected earnings, among others. Financial ratios are used to make a holistic assessment of financial performance of the company, as also to see the company's performance—intra-firm and inter-firm within the industry.
- Adequacy of cash flows includes a study of future cash flows, working capital needs, and capital budgets. Cash flow analysis forms an important part of credit rating decisions. Availability of internally generated cash for servicing debt is the most comforting factor for rating decisions as compared to dependence on external sources of cash to cover temporary shortfalls.
- Financial flexibility is examined in terms of whether alternative sources of liquidity are available to the company as and when required. It also examines whether financing plans have been developed and the feasibility of such plans. Company's contingency plans under various stress scenarios are considered and examined. Ability to access capital markets and other sources of funds whenever a company faces financial crunch is reviewed. Existence of liquid investments, access to lines of credits from strong group concerns to tide over stress situations, ability to sell assets quickly, defer capital expenditure, etc. are also considered.
- Validation of projections and sensitivity analysis: The projected performance of the company over the life of the instrument is critically examined and assumptions underlying the projections are validated. The critical parameters affecting the industry and the anticipated performance of the industry are identified.

In addition, a sensitivity analysis is performed through several 'what if' scenarios to assess a company's capacity to cope with changes in its operating environment. A scenario analysis is undertaken wherein each critical parameter is then stress tested to arrive at the performance of the company in a stress situation. Debt service coverage for each of the scenarios would indicate the capability of the company to service its debt, under each scenario.

4. Management Evaluation This includes a study of the track record of the management, the management's capacity to overcome adverse situations, goals, philosophy, strategies, control systems, personnel policies, and performance of group companies. An assessment of the management's plan in comparison to those of its competitors can provide important insights into the company's ability to sustain its business.

5. Fundamental Analysis This covers an analysis of liquidity management, asset quality, profitability and interest, and tax sensitivity.

- Liquidity management can be known through a study of capital structure, matching of assets and liabilities, liquid assets, maturing deposits, among others.
- Asset quality includes the company's credit management, policies for monitoring credit, composition of assets, and sector risk.
- Profitability is examined through a study of profitability ratios, spreads, reserves, and non-business income.
- Interest and tax sensitivity is in terms of exposure to interest rate charges, hedge against interest rate, tax provisions, and impact of tax law changes.

The above information is collected and then analysed by a team of professionals in an agency. Companies are asked to fill up the forms and provide the required data. If necessary, meetings with top management suppliers, and dealers, and a visit to the plant or proposed sites are arranged to collect and confirm additional data and issues relating to credit evaluation of a firm. This team of professionals/analysts submits their recommendations to the rating committee. The committee discusses this report and then assigns rating. Once the quantitative data is analysed, it is the seasoned judgement of the rating committee, which makes rating of an agency unique and sometimes controversial. Rating involves a lot of subjectivity in the process; for instance, in case of bond ratings, besides a quantitative analysis of past performance, it is the future debt servicing capacity of a company that is relevant. An analysis of the estimate of this capacity is subjective and subjectivity cannot be ruled out.

The rating assigned is then notified to the issuer and only on his acceptance, the rating is published. A rating agency assures strict confidentiality of information to its client. If the client wants to furnish additional information, he can do so and gets the rating reviewed again. Once the issuer decides to use and publish the rating, the agency has to continuously monitor it over the entire life of the instrument. The rating agency continuously monitors the corporate, and rating is monitored till the life of the instrument. This process is known as surveillance.

Rating may be upgraded, downgraded, or continue unchanged, depending upon new information or developments and their resultant effect on the debt instrument being rated. The revised ratings are also published and made public in financial dailies and newspapers.

Rating Symbols

Rating agencies use symbols such as AAA, AA, BBB, B, C, D, to convey the safety grade to the investor. Ratings are classified into three grades: high investment grades, investment grades and speculative grades. In all, risk is classified into 14 or 15 categories. Signs '+' or '−' are used to show the certainty of timely payment. The suffix + or − may be used to indicate the comparative position of the instrument within the group covered by the symbol. Thus FAA-lies one notch above FA+. To provide finer gradations, rating agencies attach plus or minus symbols to their ratings. The racing symbols for different instruments of the same company need not necessarily be the same.

High Investment Grades

AAA: Triple A denotes highest safety in terms of timely payment of interest and principal. The issuer is fundamentally strong and any adverse changes are not going to affect it.

AA: Double A denotes high safety in terms of timely payment of interest and principal. The issuer differs in safety from AAA issue only marginally.

A: denotes adequate safety in terms of timely payment of interest and principal. Changes in circumstances can adversely affect such issues.

BBB: Triple B denotes moderate safety in terms of timely payment of interest and principal speculative grades.

Speculative Grades

BB: Double B denotes inadequate safety terms of timely payment of interest and principal. Uncertain changes can lead to inadequate financial capacity to make timely payments in the immediate future.

B: Denotes high risk. Adverse changes could lead to inability or unwillingness to make timely payment.

C: Denotes substantial risk. Issue rated is vulnerable to default.

D: Denotes default in terms of timely payment of interest and principal.

These symbols are just a current opinion of an agency and they are not recommendations to invest or not to invest. The rating assigned applies to a particular instrument of the company and is not a general evaluation of the company.

Rating Fees In the credit rating business, the users of rating services, such as investors, financial intermediaries and other end-users, do not pay for it. The issuer of the financial instrument pays fees to the credit rating agency and this is the major source of revenue of the rating agency. Today, issuer's fees constitute 95 per cent of the total revenues of rating agencies. In India, rating agencies charge 0.1 per cent of instrument size as rating fees. They also charge an annual surveillance fees at a rate of 0.03 per cent to monitor the instrument during its life.

SEBI Regulations for Credit Rating Agencies

The SEBI issued regulations for credit rating agencies in 1999. These regulations are called the Securities and Exchange Board of India (Credit Rating Agencies) Regulations, 1999.

CHAPTER I

PRELIMINARY

Short Title and Commencement

1. (i) These regulations may be called the Securities and Exchange Board of India (Credit Rating Agencies) Regulations, 1999. (ii) They shall come into force on the date of their publication in the official gazette.

Definitions

2. (1) In these regulations, unless the context otherwise requires, –

(a) Act means the Securities and Exchange Board of India Act, 1992 (15 of 1992);

(b) Associate, in relation to a credit rating agency, includes a person–

(i) who, directly or indirectly, by himself, or in combination with relatives, owns or controls shares carrying not less than ten per cent of the voting rights of the credit rating agency, or (ii) in respect of whom the credit rating agency, directly or indirectly, by itself, or in combination with other persons, owns or controls shares carrying not less than ten per cent of the voting rights, or (iii) majority of the directors of which, own or control shares carrying not less than ten per cent of the voting rights of the credit rating agency, or (iv) whose director, officer or employee is also a director, officer or employee of the credit rating agency;

(c) Board means the board as defined in clause (a) of sub-section (1) of Section 2 of the Act;

(d) Body corporate means a body corporate as defined in clause (7) of Section 2 of the Companies Act, 1956 (1 of 1956);

(e) Certificate means a certificate of registration granted by the board under these regulations; change in control, in relation to a credit rating agency being a body corporate, means — (i) if its shares are listed on any recognized stock exchange, change in control as defined under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997; (ii) in any other case, change in the controlling interest in the body corporate.

Explanation: For the purpose of sub-clause (ii), the expression–controlling interest means an interest, whether direct or indirect, to the extent of at least fifty-one per cent of voting rights in the body corporate;

(f) Client means any person whose securities are rated by a credit rating agency;

(g) Company means a company incorporated under the Companies Act, 1956 (1 of 1956);

(h) Credit rating agency means a body corporate which is engaged in, or proposes to be engaged in, the business of rating of securities offered by way of public or rights issue;

(i) Economic offence means an offence to which the economic offences (Inapplicability of Limitation) Act, 1974 (12 of 1974), is applicable for the time being;

(j) Form means any of the forms specified in the first schedule;

(l) Fraud has the same meaning as is assigned to it by Section 17 of the Indian Contract Act, 1872 (9 of 1872);

(k) Group companies means group companies as defined in the Monopolies and Restrictive Trade Practices Act, 1969 (54 of 1969);

(l) Inspecting officer means any one or more persons appointed by the board under regulation 29;

(m) Issuer means a person whose securities are proposed to be rated by a credit rating agency;

(n) Net-worth means the aggregate value of the paid up equity capital and free reserves (excluding reserves created out of revaluation), reduced by the aggregate value of accumulated losses and deferred expenditure not written off, including miscellaneous expenses not written of;

(o) Rating means an opinion regarding securities, expressed in the form of standard symbols or in any other standardised manner, assigned by a credit rating agency and used by the issuer of such securities, to comply with a requirement specified by these regulations;

(p) Rating committee means a committee constituted by a credit rating agency to assign rating to a security;

(q) Regulation means a regulation forming part of these regulations;

(r) Relative means a relative as defined in Section 6 of the Companies Act, 1956 (1 of 1956);
(s) Schedule means any of the schedules appended to these regulations; and
(t) Securities has the meaning assigned to it in clause (h) of Section 2 of the Securities Contracts (Regulation) Act, 1956.

CHAPTER II

REGISTRATION OF CREDIT RATING AGENCIES

Application for Grant of Certificate Registration

3. (i) Any person proposing to commence any activity as a credit rating agency on or after the date of commencement of these regulations shall apply to the board for the grant of a certificate of registration for the purpose.

Promoter of Credit Rating Agency

4. The board shall not consider an application under Regulation 3 unless the applicant is promoted by a person belonging to any of the following categories, namely:
(a) a public financial institution, as defined in Section 4A of the Companies Act, 1956 (1 of 1956);
(b) a scheduled commercial bank included for the time being in the second schedule to the Reserve Bank of India Act, 1934 (2 of 1934);
(c) a foreign bank operating in India with the approval of the Reserve Bank of India;
(d) a foreign credit rating agency recognized by or under any law for the time being in force in the country of its incorporation, having at least five years experience in rating securities;
(e) any company or a body corporate, having continuous net worth of minimum rupees one hundred crores as per its audited annual accounts for the previous five years prior to filing of the application with the board for the grant of certificate under these regulations.

Eligibility Criteria

5. The board shall not consider an application for the grant of a certificate under Regulation 3, unless the applicant satisfies the following conditions, namely:
(a) the applicant is set up and registered as a company under the Companies Act, 1956;
(b) the applicant has, in its Memorandum of Association, specified rating activity as one of its main objects;
(c) the applicant has a minimum net worth of rupees five crores. Provided that a credit rating agency existing at the commencement of these regulations, with a net worth of less than rupees five crores, shall be deemed to have satisfied this condition if it increases its net worth to the said minimum within a period of three years of such commencement.
(d) the applicant has adequate infrastructure, to enable it to provide rating services in accordance with the provisions of the act and these regulations;
(e) the applicant and the promoters of the applicant, referred to in Regulation, 4 have professional competence, financial soundness and general reputation of fairness and integrity in business transactions, to the satisfaction of the board;
(f) neither the applicant, nor its promoter, nor any director of the applicant or its promoter, is involved in any legal proceeding connected with the securities market, which may have an adverse impact on the interests of the investors;
(g) neither the applicant, nor its promoters and any director of its promoter has at any time in the past been convicted of any offence involving moral turpitude or any economic offence;
(h) the applicant, in its employment, having adequate professional and other relevant experience to the satisfaction of the board;
(i) neither the applicant, nor any person directly or indirectly connected with the applicant has in the past been – (i) refused by the board a certificate under these regulations or (ii) subjected to any proceedings for a contravention of the act or of any rules or regulations made under the act.

Explanation: For the purpose of this clause, the expression “directly or indirectly connected person” means any person who is an associate, subsidiary, inter-connected or group company of the applicant or a company under the same management as the applicant.

(j) the applicant, in all other respects, is a fit and proper person for the grant of a certificate;
(k) grant of certificate to the applicant is in the interest of investors and the securities market.

(Criteria for Fit and Proper Person) Regulations, 2004.

5A. For the purpose of determining whether an applicant or the credit rating agency is a fit and proper person, the board may take into account the criteria specified in Schedule II of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008.

CHAPTER III

GENERAL OBLIGATIONS OF CREDIT RATING AGENCIES

Code of Conduct

6. Every credit rating agency shall abide by the code of conduct contained in the Schedule III.

Agreement with the Client

7. Every credit rating agency shall enter into a written agreement with each client whose securities it proposes to rate, and every such agreement shall include the following provisions, namely:-
(a) the rights and liabilities of each party in respect of the rating of securities shall be defined;
(b) the fee to be charged by the credit rating agency shall be specified;
(c) the client shall agree to a periodic review of the rating by the credit rating agency during the tenure of the rated instrument;
(d) the client shall agree to co-operate with the credit rating agency in order to enable the latter to arrive at, and maintain, a true and accurate rating of the clients securities and shall in particular provide to the latter, true, adequate and timely information for the purpose.
(e) the credit rating agency shall disclose to the client the rating assigned to the securities of the latter through regular methods of dissemination, irrespective of whether the rating is or is not accepted by the client;
(f) the client shall agree to disclose, in the offer document- (i) the rating assigned to the client's listed securities by any credit rating agency during the last three years and (ii) any rating given in respect of the client's securities by any other credit rating agency, which has not been accepted by the client.
(g) the client shall agree to obtain a rating for any issue of debt securities in accordance with the relevant regulations.

Monitoring of Ratings

8. (1) Every credit rating agency shall, during the lifetime of securities rated by it continuously, monitor the rating of such securities.
(2) Every credit rating agency shall disseminate information regarding newly assigned ratings and changes in earlier rating promptly through press releases and websites. In case of securities issued by listed companies, such information shall also be provided simultaneously to the concerned regional stock exchange and to all the stock exchanges where the said securities are listed.

Procedure for Review of Rating

9. (1) Every credit rating agency shall carry out periodic reviews of all published ratings during the lifetime of the securities.
(2) If the client does not co-operate with the credit rating agency so as to enable the credit rating agency to comply with its obligations under regulation 8 of this regulation, the credit rating agency shall carry out the review on the basis of the best available information.

Provided that if owing to such lack of co-operation, a rating has been based on the best available information, the credit rating agency shall disclose to the investors the fact that the rating is so based.

(3) A credit rating agency shall not withdraw a rating so long as the obligations under the security rated by it are outstanding except where the company whose security is rated is wound up or merged or amalgamated with another company.

Internal Procedures to be Framed

10. Every credit rating agency shall frame appropriate procedures and systems for monitoring the trading of securities by its employees in the securities of its clients, in order to prevent contravention of –

(a) the Securities and Exchange Board of India (Insider Trading) Regulations, 1992;
(b) the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to the Securities Market) Regulations, 1995; and
(c) other laws relevant to trading of securities.

Disclosure of Rating Definitions and Rationale

11. (1) Every credit rating agency – (a) shall make available to the general public the definitions of the concerned rating, along with the symbol and, (b) shall also state that the ratings do not constitute recommendations to buy, hold or sell any securities.

(2) Every credit rating agency shall make available to the general public information relating to the rationale of the ratings, which shall cover an analysis of the various factors justifying a favourable assessment as well as factors constituting a risk.

Submission of Information to the Board

12. (1) Where any information is called for by the board from a credit rating agency for the purposes of these regulations, including any report relating to its activities, the credit rating agency shall furnish such information to the board – (a) within a period specified by the board or (b) if no such period is specified, then within a reasonable time.

(2) Every credit rating agency shall, at the close of each accounting period, furnish copies of its balance sheet and profit and loss account to the board.

Compliance with Circulars etc., Issued by the Board

13. Every credit rating agency shall comply with such guidelines, directives, circulars and instructions as may be issued by the board from time to time, on the subject of credit rating.

Appointment of Compliance Officer

(1) Every credit rating agency shall appoint a compliance officer who shall be responsible for monitoring the compliance of the act, rules and regulations, notifications, guidelines, instructions, etc., issued by the board or the central government.
(2) The compliance officer shall immediately and independently report to the board any non-compliance observed by him.

Confidentiality

14. Every credit rating agency shall treat information as confidential supplied to it by the client and no credit rating agency shall disclose the same to any other person except where such disclosure is required or permitted by under or any law for the time being in force.

Rating Process

15. (1) Every credit rating agency shall – (a) specify the rating process; (b) file a copy of the same with the board for record; and file with the board any modifications or additions made therein from time to time.

(2) Every credit rating agency shall, in all cases, follow a proper rating process.
(3) Every credit rating agency shall have professional rating committees, comprising members who are adequately qualified and knowledgeable to assign a rating.
(4) All rating decisions, including the decisions regarding changes in rating, shall be taken by the rating committee.
(5) Every credit rating agency shall be staffed by analysts qualified to carry out a rating assignment.
(6) Every credit rating agency shall inform the board about new rating instruments or symbols introduced by it.

(7) Every credit rating agency shall, while rating a security, exercise due diligence in order to ensure that the rating given by the credit rating agency is fair and appropriate.
(8) A credit rating agency shall not rate securities issued by it.
(9) Rating definition, as well as the structure for a particular rating product, shall not be changed by a credit rating agency without prior information to the board.
(10) A credit rating agency shall disclose to the concerned stock exchange through press release and websites for general investors, the rating assigned to the securities of a client, after periodic review, including changes in rating, if any.

CHAPTER IV

RESTRICTION ON RATING OF SECURITIES ISSUED BY PROMOTERS OR BY CERTAIN OTHER PERSONS

Definitions

16. In this Chapter, unless the context otherwise requires;-
(a) Associate means, in relation to a promoter, includes a body corporate in which the promoter holds ten per cent or more, of the share capital;
(b) Promoter means a person who holds ten per cent or more of the shares of the credit rating agency.

Securities Issued by Promoter

17. (1) No credit rating agency shall rate a security issued by its promoter.
(2) In case promoter is a lending institution, its chairman, director or employee shall not be a chairman, director or employee of credit rating agency or its rating committee.
Provided that sub-regulation (2) shall come into force within three months from commencement of these regulations.

Securities issued by Certain Entities, Connected with a Promoter, or Rating Agency not to be Rated

18. (1) No credit rating agency shall rate a security issued by an entity, which is:-
(a) a borrower of its promoter; or (b) a subsidiary of its promoter; or (c) an associate of its promoter, if (i) there are common chairman, directors between credit rating agency and these entities; (ii) there are common employees; (iii) there are common chairman, directors, employees on the rating committee.
(2) No credit rating agency shall rate a security issued by its associate or subsidiary if the credit rating agency or its rating committee has a chairman, director or employee who is also a chairman, director or employee of any such entity.
Provided that the credit rating agency may, subject to the provisions of sub-regulation (1), rate a security issued by its associate having a common independent director with it or rating committee, if (i) such an independent director does not participate in the discussion on rating decisions, and (ii) the credit rating agency makes a disclosure in the rating announcement of such associate (about the existence of common independent director) on its board or of its rating committee, and that the common independent director did not participate in the rating process or in the meeting of its board of directors or in the meeting of the rating committee, when the securities rating of such associate was discussed.

Explanation: For the purposes of this sub-regulation the expression “independent director” means a director who, apart from receiving remuneration as a director, does not have any other material pecuniary relationship or transactions with the company, its promoters, its management or its subsidiaries, which in the judgment of the board of the company, may affect the independence of the judgment of such director.

CREDIT RATING AGENCIES IN INDIA

There are seven credit rating agencies registered with the SEBI. The RBI also has accorded accreditation to seven rating agencies registered with market regulator SEBI. The Reserve Bank of India has decided to review and monitor the performance of credit rating agencies, for continuation of their accreditation. The move is aimed at ensuring greater accountability in the quality of the rating process and methodologies. The seven credit rating agencies are:

CRISIL Limited (Formerly the Credit Rating Information Services of India Limited)

CRISIL Limited was set up in January 1998 jointly by ICICI Limited, UTI, GIC, United India Insurance Company, LIC, and domestic and foreign banks as the first credit rating agency in India.

It rates rupee-denominated debt instruments of Indian companies, preference shares, fixed deposits, commercial paper, and structured obligations. CRISIL is the prominent provider of rating and advisory services. It provides advisory services in the areas of energy, transport, urban infrastructure, tourism, economy, corporates, capital markets, and financial services. It also undertakes credit and counter-party ratings for corporates.

CRISIL provides corporate reports regularly on public sector and private sector companies that contain information on their financial, business, and technical aspects. It also undertakes industry studies on requests covering topics, such as structure of industry, basis of competition, and demand and supply estimates.

In 1993–94, it made a public offer of 20,00,000 equity shares of ₹10 each at a premium of ₹40 per share. The offer was over subscribed by 2.47 times. Its issued and subscribed capital is ₹62,00,000 equity shares of ₹10 each, fully paid up, aggregating ₹6,20,00,000.

Since 1996, CRISIL has had a strategic tie-up with Standard and Poor's USA, the world's leading credit rating agency. The tie-up which was initially in the nature of a 'technical tie-up', culminated with S&P acquiring an equity stake of 9.68 per cent in CRISIL in 1996 enabling it to leverage on S&P's global rating experience. S&P acquired 3,120,948 equity shares of CRISIL from CRISIL shareholders through an open offer taking S&P holding in CRISIL to 58.46 per cent.

CRISIL is now majority owned by S&P Global Inc., a leading provider of transparent and independent ratings, benchmarks, analytics and data to the capital and commodity markets worldwide.

CRISIL is a publicly listed company on India's leading stock exchanges. About 58.46 per cent (as on March 31, 2009) of CRISIL's shareholding is owned by Standard and Poor's, the world's leading credit rating agency; 17.93 per cent is owned by banks, mutual funds, and insurance companies; and 23.61 per cent by Indian individual and foreign institutional investors.

CRISIL has provided technical assistance and training to new rating agencies, such as Rating Agency Malaysia Berhad (RAM) and MALLOT—the Israel securities rating company. It is perhaps the only rating agency outside the USA to provide technical know-how overseas.

CRISIL has launched innovative rating products for entities like banks, financial institutions, greenfield projects, and new instruments such as asset-backed securities and other structured obligations. It has also developed rating methodology for various segments, for example, real estate developers, parallel marketers of liquified petroleum gas (LPG) and debt issues of large infrastructure projects, mutual funds, and municipal bonds. CRISIL has also launched hospital grading and is currently grading a dozen healthcare institutes all over India. CRISIL publishes a journal 'rating scan', containing reviews, news, and articles related to ratings.

CRISIL offers a comprehensive range of integrated product and service offerings—real time news, analysed data, incisive insights and opinion, and expert advice—to enable investors, issuers, policy makers de-risk their business and financial decision-making, take informed investment decisions and develop workable solutions. It has emerged as a premier advisor in the infrastructure and energy sectors. It is the largest and best-regarded financial and business research and news service. It is the only ratings agency in India to operate on the basis of a sectoral specialization.

CRISIL Ratings and Standard & Poor's collaborate on several projects in USA and East Asia, and jointly promote business and services in India.

It set up **IISL** in 1997–98, a Joint Venture between CRISIL and National Stock Exchange for undertaking index business and related activities. The new Company entered into a Consultancy and Licence Agreement with **Standard & Poor's**.

During 2001–02, it launched Mutual Fund Composite Performance Rankings (CRISIL CPRs), Fund Risk Analytics Model and CRISIL Mutual Funds Portfolio Tracker. In September 2003, Crisil Fund Services launched a rating of asset management companies (AMC), which examines, among other things, overall management quality and fund management practices of AMCs. The ratings are not only useful for retail investors but also for institutional and long-term investors such as pension funds and insurance companies for asset allocation. It also gives various quantitative ratings of mutual funds like credit rating of assets, which focuses on credit risk of mutual fund assets, and volatility rating based on the market risk of the mutual fund portfolio.

AMFI has mandated CRISIL to provide daily fund indices as benchmarking standards for the mutual fund industry. In 2008, it launched the CRISIL Complexity Levels Service—an initiative aimed at strengthening Indian capital markets through greater transparency for investors.

CRISIL's businesses operate from India, the US, the UK, Argentina, Poland, China, Hong Kong and Singapore.

CRISIL is India's foremost provider of ratings, data, research, analytics and solutions. CRISIL has delivered independent opinions, actionable insights, and efficient solutions to over 100,000 customers. CRISIL's businesses operate from India, the US, the UK, Argentina, Poland, China, Hong Kong and Singapore.

CRISIL's clients range from micro, small and medium companies to large corporates, investors, top global financial institutions, commercial and investment banks, insurance companies, private equity players and asset management companies globally. CRISIL also works with governments and policy makers in the infrastructure space in India and in other emerging markets.

CRISIL launched Education Grading, beginning with business schools, Solar grading, Gold and Gilt Index in 2011. CRISIL acquired UK-based Coalition, a company providing high-end analytics to global investment banks in 2012.

CRISIL transforms the lives of 1000 rural citizens through 'Pragati', a series of financial awareness workshops.

CRISIL launched in 2012 four fixed income indices to measure the performance of government securities in the Sri Lankan capital markets in association with NDB Capital Holdings PLC. In 2013, CRISIL launched CRISIL Foundation, a platform for achieving its twin goals of increasing financial awareness and conservation of the environment and CRISIL Inclusix, India's most comprehensive financial inclusion index which accurately measures the extent of financial inclusion in the country, right down to each of the 632 districts. In 2014, CRISIL rated India's first Commercial Mortgage Backed Securities and introduced Fund Management Capability Ratings for the mutual fund.

CRISIL has rated more than 14000 companies and more than 45000 SMEs.

CRISIL is the market leader, with a 70 per cent share in the credit rating industry. It is globally the fourth largest and India's most influential rating agency.

ICRA Limited (Formerly Investment Information and Credit Rating Agency of India Limited)

ICRA was incorporated on January 16, 1991 as an independent and professional credit rating agency providing investment information and credit rating services. It was promoted by the Industrial Finance Corporation of India jointly with other leading investment institutions, commercial banks, and financial service companies. The agency commenced its commercial activities from August 31, 1991. The primary objective of ICRA is to provide information and guidance to investors/creditors for determining the credit risk associated with a debt instrument/credit obligation. ICRA Limited is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange.

ICRA launched two services in 1992.

- **Credit assessment:** ICRA gives ratings to companies so as to enable them to obtain loans from banks, financial institutions, and so on.
- **General assessment:** At the request of the bank and other potential users, the ICRA comes out with the general assessment of the companies.

ICRA has tied up with Moody's Investors Services which is also one of its major shareholders. Moody's Investment Company India (Pvt.) Limited is the largest shareholder in the ICRA.

Since mid-1995, ICRA has been rating equity instruments also. Its Earning Prospects and Risk Analysis (EPRA) group offers two different services: equity assessment and equity grading/rating. The former is done at the instance of investors while the latter is done on the request of the issuer. These services provide reliable and authentic information on the relative quality of equity in diverse corporates, with respect to the earnings prospects and the risks inherent in these earnings prospects. Equity grading is in the form of a symbolic indicator and is kept under surveillance once the company accepts and uses the equity grade while equity assessment is in the form of a report and is a one-time exercise.

ICRA has a broad-based its services to the corporate and financial sectors, both in India and overseas. It presently offer five types of services: Rating Services, Information Grading and Research Services, Advisory Services, Economic Research, and Outsourcing.

Rating Services ICRA rates rupee-denominated debt instruments, such as bonds and debentures (long-term), fixed deposit programmes (medium-term), commercial paper and certificates of deposit (short-term), and structured obligations and sector-specific debt obligations (issued by Power, Telecom, and Infrastructure companies). The other rating services offered include Corporate Governance Rating, Stakeholder Value and Governance Rating, Corporate Governance Assesment, Credit Risk Rating of Debt Mutual Funds, Rating of Claims Paying Ability of Insurance Companies, Project Finance Rating, and Line of Credit Rating. ICRA, along with National Small Industries Corporation Limited (NSIC), has launched a Performance and Credit Rating Scheme for small-scale enterprises in India. The service is aimed at enabling small and medium enterprises (SMEs) improve their access to institutional credit, increase their competitiveness, and raise their market standing. ICRA also evaluates/rates parallel marketers of LPG and kerosene. It has also carried out credit opinion for municipal corporations.

Grading Services ICRA has developed highly specialized evaluation methodologies for grading of construction entities; real estate developers and projects; healthcare entities; maritime training institutes; and initial public offers (IPOs). These grading methodologies have been developed in association with reputable and specialized bodies associated with the domain.

ICRA Management Consulting Services Limited, a subsidiary of ICRA Limited, offers advisory/consulting services to clients based in the USA and in the Philippines. It also launched Consulting Services for Carbon Management in 2008.

ICRA undertakes economic and industry research exercises, which are customized to address the unique needs and requirements of clients.

It has been appointed as a consultant by the Disinvestment Commission. It completed specific studies for 13 PSUs spread across a wide industry spectrum.

ICRA offers its rating services to a wide range of issuers including manufacturing companies, banks and financial institutions, power companies, service companies, construction companies, insurance companies, municipal and other local bodies, non-banking financial service companies, telecom companies and companies involved in infrastructure such as ports, dams, roads, and highways.

ICRA assists a local credit rating agency in Kuwait to provide credit rating services.

ICRA has launched a quarterly publication—*Money and Finance*. This research journal contains various articles that analyse contemporary developments in the Indian money and capital markets.

Credit Analysis and Research Limited (CARE) Ratings

This was launched in November 1993. It has been set up by the IDBI in collaboration with some banks and financial institutions. The IDBI Bank, SBI, and Canara bank are its major shareholders. The main services offered by it are

- Credit rating of debentures/preference shares/fixed deposits/commercial papers.
- Information services.
- Equity research—extensive study of the shares listed on major stock exchanges through EIL (Economy, Industry, Company) analysis.

CARE is a full service rating company offering a wide range of rating and grading services which includes rating debt instruments/enterprise ratings of corporate banks, financial institutions (FIs), public sector undertakings (PSUs), state government bodies, municipal corporations, non-banking finance companies (NBFCs), SMEs, micro-finance institutions, structured finance securitization transactions. In addition, CARE Ratings undertakes corporate governance ratings, mutual fund credit quality ratings, IPO grading, claims paying ability rating of insurance companies, grading of construction entities and issuer ratings. CARE Ratings offers advisory services, relating to securitization transactions, structuring financial instruments, financing of infrastructure projects, mergers and amalgamation, and financial restructuring.

It has set up an advanced service division on power sector and municipal finances. It has completed a number of studies on different manufacturing sectors. It has also completed studies for 17 public sector enterprises for the Disinvestment Commission.

It prepares credit reports of Indian companies on request and undertakes credit assessment of companies for use by banks and financial institutions. CARE assists the Disinvestment Commission in equity valuation of a number of state owned companies and for suggesting disinvestment strategies for these companies. CARE Ratings has during the last 24 years rated over ₹92 Lakh crore of debt, served more than 15000 clients and has domain expertise in more than 80 industries in banks. It has launched CARE Advisory Research and Training Ltd, a subsidiary of CARE Ratings, which Provides Financial Advisory and Management Consultancy services. It has also launched a new international credit rating agency 'ARC Ratings' with 4 partners from Brazil, Portugal, Malaysia and South Africa and established a subsidiary CARE Ratings (Africa) Private Limited (CRAF) in Mauritius. It has also entered into a strategic alliance with Japan Credit Rating Agency Limited and another one to establish a credit rating agency in Nepal.

It has developed and launched a Debt Quality Index called CDQI. The Index denotes the quality of debt in the country that can be interpreted over time and juxtaposed with other developments in the financial sector.

It is empanelled by Government of Karnataka for rating of Tourism sector in the state. It has rated the first Green Infrastructure bond and launched rating of Real Estate Investment Trusts (REITs).

It has assigned rating to India's first Alternate Investment Fund (AIF) and rated India's First Securitization Transaction backed by Mortgage Guarantee.

India Ratings and Research (Ind-Ra) Limited

India Ratings and Research (Ind-Ra) was formerly known as DCR India—Duff and Phelps Credit Rating Co. Fitch Ratings, USA and DCR India merged to form a new entity called Fitch India. Fitch India is a 100 per cent subsidiary of Fitch Ratings, USA and is the only wholly owned foreign operator in India. Fitch is the only international rating agency with a presence on the ground in India. Now Fitch Rating is known as India Ratings and Research (Ind-Ra) Limited. It rates corporates, banks, financial institutions, structured deals, securitized paper, global infrastructure and project finance, public finance, SMEs, asset management companies, and insurance companies.

Ind-Ra is a 100% owned subsidiary of the Fitch Group.

Ind-Ra is recognized by the Securities and Exchange Board of India, the Reserve Bank of India and National Housing Bank. It has gained significant market presence in India's fixed income market.

Brickwork Ratings

It is the fifth agency in the ratings business which commenced its activities from September 24, 2008.

Brickwork Ratings is founded by bankers, credit ratings professionals, former regulators as well as professors. Canara Bank, a leading public sector bank, is its promoters and strategic partner. Brickwork Ratings (BWR) is a SEBI registered credit rating agency and has also gained accredited by RBI and empanelled by National Small Industries Corporation (NSIC). It is also accredited by Indian Renewable Energy Development Agency Ltd. (IREDA) and the Ministry of New and Renewable Energy (MNRE), Government of India, to grade energy companies seeking credit facilities from IREDA, Renewable Energy Service providing Companies (RESCOs) and System Integrators (SIs).

BWR has rated debt instruments, bonds, bank loans, securitised paper, MSMEs, Fixed Deposits, Commercial Papers, PSU/ Public Sector Banks and private corporates, debt mutual funds, Basel bonds and Principal Protected Market Linked Debentures (PPMLD). It has a major presence in Urban Local Bodies (ULB) rating – rated ULBs of more than 100 cities, and securities receipts.

SME RATING AGENCY OF INDIA LIMITED (SMERA)

SME Rating Agency of India Limited (SMERA), set up by SIDBI, Dun and Bradstreet Information Services India Private Limited (D&B) and several leading banks, is the first rating agency that focuses primarily on the Micro, Small and Medium (MSME) segment.

SMERA Ratings Limited is a full service Credit Rating Agency, registered with the Securities and Exchange Board of India (SEBI), and accredited by Reserve Bank of India (RBI) as an External Credit Assessment Institution (ECAI), for Bank Loan Ratings under BASEL-II norms. SMERA is empanelled with National Small Industries Corporation (NSIC), the nodal agency of the Ministry of MSME, Government of India to provide SMERA-D&B-NSIC Micro & Small Enterprises Rating for MSEs in India. SMERA has assigned more than 44,000 ratings since inception.

Ratings help SMEs to get access to credit faster and cheaper (at reduced rates) from banks, financial institutions and private equity (PE) funds. SMEs use ratings as a tool to build customer relations and confidence as ratings foster financial discipline and good governance practices. Ratings also enable SMEs to foray into foreign markets successfully.

INFOMERICS VALUATION AND RATING PRIVATE LIMITED (Integrated Financial Omnibus Metrics Research of International Corporate Systems)

INFOMERICS Valuation and Rating Private Limited is a SEBI registered Credit Rating Agency founded by eminent finance professionals, former bankers and administrative services personnel.

INFOMERICS was founded with the objective to offer credible and reliable rating/grading and research services with inputs based on historical data and industry benchmarks using proprietary software designed to be dynamic to changes in any sector of economy.

INFOMERICS commenced its operations in 2015 by providing Management Consultancy in the areas of Corporate Valuation, Ratings of different sectors and companies (including SME sector), disinvestments, mergers, demergers and acquisitions.

INFOMERICS is a full-service rating agency. It provides rating and grading services for the entire range of money market & capital market instruments and borrowing programmes: Non-Convertible Debentures, Commercial Papers, Tier II and Tier III Bonds, Perpetual Bonds, Guarantee Backed Debt, Initial Public Offerings and Equity Grading. Its rating and grading services also encompass Corporate Governance rating, Grading of Construction entities, Grading of Engineering & Management institutions.

IPO GRADING BY CREDIT RATING AGENCIES

The IPO scam of 2005 shook the confidence of retail investors in the capital market. Many retail investors were deprived of allotment of IP shares as a large number of shares were cornered through multiple share applications and opening of *benami* dematerialized accounts by few scamsters. In order to protect the interest of small investors, SEBI made amendments to the SEBI (Disclosure and Investor Protection) Guidelines, 2000.

SEBI recommended a new service ‘IPO Grading’ that provides an independent assessment of fundamentals to aid comparative assessment that would prove useful as an information and imvestment tool for the investors. Moreover, such a service is particularly useful for assessing the offerings of companies accessing the equity markets for the first time where there is no track record of their market performance. Credit rating agencies registered with SEBI carry out IPO grading for any individual issue, which would represent a relative assessment of the fundamentals of that issue in relation to other listed equity shares. Such grading is assigned on a five-point scale with a higher score indicating stronger fundamentals. IPO grading is a one-time assessment done prior to the IPO issue during the draft prospectues stage. The grading is mandatory for the issuing company and the cost of grading IPOs would be borne by the issuer.

Limitations of Credit Rating in India

The rating business in India grew tremendously in the 1990s. New rating agencies came into existence and competition among them increased. There has been a significant increase in volume of rated debt. The rating business is going strong because of mandatory rating of IPOs, roll out of Basel II norms, rating of security receipts of public–private partnership projects, increased market access by real estate companies, rating of urban municipal bonds, and RBI’s stipulations that companies with borrowings of ₹10 crore and above need to get rated. Despite the increase in popularity of rating, the credit rating business suffers from certain limitations.

- The credibility of rating is questionable. The institutions whose instruments were given the highest rating have not performed well. For example, CARE gave the highest rating to CRB Capital, which failed. The CRB scam created a panic among investors and credit agencies alike. While investors queued up to prematurely retire their deposits with NBFCs, rating agencies started downgrading almost every company irrespective of their status.
- A frequent revision of grading by credit rating agencies, that is, sometimes upgrading and sometimes downgrading, creates a confusion among investors questioning again the credibility of the expertise of rating agencies.
- Around a third of the ratings done by credit rating agencies are not accepted by the clients. This has led to a competitive relaxation of rating standards by credit rating agencies. It should be mandatory to obtain at least two ratings as risk perception of rating agencies differ. Both the ratings should be mandatory published in the prospectus, advertisements, and newspapers,
- The rating agencies do not perform an audit but rely solely on information provided by the issuer. If the information provided is inaccurate and incomplete, the rating process is compromized.

- Often a credit rating agency gives a high rating to one instrument of a particular company on the one hand and on the other, frequently downgrades the rating of another instrument of the same company. The rating exercise appears biased and investors not only get confused but lose their investments by depending on these ratings.
- Rating agencies often fail to correctly predict a borrower's financial health in the short-term. The latest case is the non-convertible debenture (NCD) issue of BPL which was downgraded by CRISIL from A to D in one stroke. In other words, CRISIL downgraded the instrument by 12 stages. The investor, who depends on these ratings, is not given any warning by rating agencies to wind down his investment in time.
- Rating agencies offer consultancy and financial advice to the clients whose papers they rate. This leads to a conflict of interest and compromise on their rating process to favour their clients. This has been highlighted by the financial crisis in the US. Hence, the government is working with regulators on the new regulatory framework for credit rating agencies.

Conclusion

Ratings are opinions on creditworthiness based on objective and subjective analysis. Rating agencies play an important role in the world markets; they can best serve markets when they operate independently, adopt and enforce internal guidelines to avoid conflicts of interest, and protect confidential information received from issuers. Credit rating agencies cannot afford to commit too many mistakes as it is the investor who pays the price for their mistakes. Credit rating agencies should be made accountable for any faulty rating by penalizing them or even de-recognizing them, if needed. Competition in the rating industry should be enhanced by creating niche rating agencies specializing in information technology, or state governments.

KEY TERMS

Credit rating   rating agencies

SUMMARY

1. Credit rating is the assessment of a borrower's credit quality. Credit rating performs the function of credit risk evaluation reflecting the borrower's expected capability to repay the debt as per terms of issue.
2. Credit rating agencies now undertake financial analysis and assessment of financial products, individuals institutions, and governments.
3. This concept originated in the US in 1909 AD when the founder of Moody's Investor Service, John Moody, rated the US Rail Road Bonds. The rating giants have diversified their service portfolio in order to survive and grow.
4. India was first among the developing world to set up a credit rating agency—CRISIL Limited in 1988. Then came ICRA Limited in 1990, followed by CARE in 1993, and Fitch Ratings India Private Limited.
5. The Indian credit rating industry is next to the US in terms of number of ratings issued and in the number of agencies. CRISIL Limited is the market leader in the credit rating industry with a 70 per cent market share.
6. Ratings are based on an in-depth study of the industry and an evaluation of the strengths and weakness of the company. The analytical framework for rating consists of the following four broad areas: business analysis, financial analysis, management evaluation, and fundamental analysis.
7. Rating agencies use symbols such as AAA, AA, BBB, B, C, D, to convey the safety grade to the investor. Ratings are classified into three grades: high investment grades, investment grades, and speculative grades.
8. CRISIL Limited was set up in January 1998 jointly by ICICI Limited, UTI, GIC, United India Insurance Company, LIC, and domestic and foreign banks as the first credit rating agency in India. It offers a comprehensive range of integrated product and service offerings—real time news, analysed data, incisive insights and opinion, and expert advice—to enable investors, issuers, policy makers de-risk their business and financial decision-making, take informed investment decisions and develop workable solutions.
9. CRISIL is the market leader, with a 70 per cent share in the credit rating industry. It is globally the fourth largest and India's most influential rating agency.
10. ICRA Limited was promoted by the Industrial Finance Corporation of India jointly with other leading investment institutions, commercial banks, and financial service companies. The agency commenced its commercial activities from August 31, 1991.
11. CARE was set up by the IDBI in collaboration with some banks and financial institutions in November 1993. It offers services such as credit rating of debentures/preference shares/fixed deposits/commercial papers, information services and equity research—extensive study of the shares listed on major stock exchanges through EIL (economy, industry, company) analysis.

REVIEW QUESTIONS

1. What is credit rating? Explain the importance of credit rating.
2. How do credit rating agencies rate an instrument?
3. What are the limitations of credit rating in India?
4. Give a brief profile of CRISIL, ICRA, and CARE.
5. What is grading of IPOs?
6. Explain the rating process and methodology.

7. Would the rating methodology in case of banks differ from that of a manufacturing concern? Why?
8. Why have the business volumes of credit rating agencies expanded in India?

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