Financial Institutions & Services

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CREDIT RATING

A credit rating is a measurement of a person or business entity's ability to repay a financial obligation based on income and past repayment histories. Usually expressed as a credit score, banks and lenders use a credit rating as one of the factors to determine whether to lend money.

The most common factors that affect the credit score are the length of the credit history past repayment history and credit utilization. The three credit reporting agencies take that information and build your credit profile, which will determine the overall credit rating and score.

If we maintain a high credit rating the likelihood of banks and lenders approving (your) us for financing are high. A poor credit rating may represent an inability to repay debt and limit the financing options.

Types Of Credit Rating

1. **Bond / debenture rating :**

Rating the debentures / bonds issued by corporate, government etc is called debenture or bond rating.

2. **Equity rating :**

Rate of equity shares issued by a company is called Equity Rating.

3. **Preference Share rating :**

Rating of preference share issued by a company is called Preference Share rating.

4. **Commercial Paper rating :**

Commercial papers are instruments used for short term borrowing. Commercial papers issued by manufacturing companies finance companies, banks & financial institutions and rating of these instruments are called Commercial paper rating.

5. **Borrowers rating :** Rating of borrowers is referred as Borrowers rating.

6. Fixed deposits rating :

Fixed deposits programmes are medium term unsecured borrowings. Rating of such programmes is called as Fixed Deposits Rating.

7. Individuals rating :

Rating of individuals is called as Individuals Rating.

8. Structured Obligation :

Structured obligation is also debt obligation different to debenture or bond or fixed deposit programmes and commercial papers. Structured obligation is generally asset backed security. Credit rating agencies asessed the risk associated with the transaction with the main trust on cash flows emerging from the asset would be sufficient to meet committed payments, to the investors in worst case scenario.

9. Sovereign rating :

Is a rating of a country which is being considered whenever a loan is to be extended or some major investment is envisaged in a country.

CREDIT RATING AGENCIES

1. MOODY'S INVESTORS SERVICE

Moody's Investors service often referred to as Moody's is the bond credit rating business of Moody's Corporation representing the company's traditional line. Moody's was founded by John Moody in 1909 to produce manuals of statistics related to stocks and bonds and bond ratings. In 1975, the company was identified as a Nationally Recognised Statistical Rating Organisation (NRSRO) by the U.S Securities and Exchange Commission. The company ranks the credit-worthiness of borrowers using a standardised ratings scale which measures expected investor loss in the event of default. Moody's Investor Services rates debt securities in several bond market segments.

2. STANDARD AND POOR'S (S&P)

S&P Global Ratings (Standard & Poor's) is an American credit rating agency and a division of S&P Global that publishes financial research and analysis on stocks, bonds and commodities. S&P is considered the largest of the Big Three Credit-rating agencies that includes Moody's Investors Service and Fitch Ratings. It's head office is located on 55 water Street in Lower Manhattan, New York City. As a credit rating agency, the company issues credit rating for the debt of public and private companies and other public borrowers such as government and government entities. S&P issues both long & ~~long~~ short term credit ratings.

3. FITCH RATINGS

Fitch Ratings Inc. is an American Credit rating agency and is one of the "Big Three Credit Rating Agencies". It is one of the 3 nationally recognised statistical rating organisation (NRSRO) designated by the U.S. The firm was founded by John Knowles Fitch on Dec 24, 1914 in New York City. Fitch Rating's long term credit ratings are assigned on an alphabetic scale from 'AAA' to 'D', first introduced in 1924 & later adopted & licensed by S&P. Fitch's short term ratings indicate the potential level of default within a 12 period.

4. ICRA Limited

ICRA Limited (ICRA) is an independent and professional investment information and credit rating agency in India. It was established in 1991 and was originally named Investment Information and Credit Rating Agency of India Limited (IICRA India). It was a joint venture between Moody's and various Indian commercial banks and financial services companies. ICRA's credit ratings are symbolic representations of its current opinion on the relative credit risks associated with the rated debt obligations / issues.

5. DBRS

DBRS Morningstar is a global credit rating agency founded in 1976 (Dominion Bond Rating Service). DBRS was acquired by the global financial services firm, Morningstar Inc in 2019 for approximately $ 700 million. DBRS Morningstar provides independent credit rating services for financial institutions, corporate and sovereign entities and structured finance products and instruments throughout all geographies where it operates. DBRS Limited is the operating company in Canada

Process And Methodology Of Credit Rating Agencies

The process of credit rating begins with the prospective issuer approaching the rating agency for evaluation. The experts in analyzing banks should be given a free hand and they will collect data and informant and will investigate the business strength and weakness in detail.

The rating is based on the investigation analysis, study and interpretation of various factors. The world of investment is exposed to the continous onslaught of political, economic, social and other forces. The key factors generally considered are :

1. **Business Analysis or Company Analysis :**

This includes an analysis of industry risk, market position of the company operating efficiency of the company and legal position of the company.

2. **Economic Analysis :**

Inorder to evaluate an instrument an analyst must spend a considerable time in investigating the various economic activities and also analyze the characteristics peculiar to the industry whose issue the analyst is concerned with. Hence the relevance of the economic variables such as growth rate, national income & expenditure cannot be ignored. The analysis while doing the economic forecasting use surveys, various economic indicators and indices.

3. Financial Analysis :

This includes an analysis of accounting, quality, earnings, protection adequacy of cash flows and financial flexibility.

4. Management Evaluation :

- Track record of the management, planning & control system, depth of managerial talent, succession plants.
- Evaluation of capacity to overcome adverse situations.
- Goals, philosophy and strategies.

5. Geographical Analysis :

- Location advantages and disadvantages
- Backward area benefit to the company / division / unit.

6. Fundamental Analysis :

Fundamental analysis is essential for the assestment of finance companies. This includes an analyses of liquidity management protitability and financial position and interest and tax security of the company.

Country's credit rating denotes its ability to source debt from the international market at a reasonable cost. Country's credit rating envolves evaluation of external financial accounts and macro economic factors and is directed towards future trends.

Credit rating of any country involves evaluation of :

① Economic growth and development.

② Balance of trade and balance of payments

③ Debt service ratio

④ Debt composition.

⑤. Liquidity

⑥. Political and internal stability.

⑦. Inflation and price stability.

Importance of Credit Rating Agencies for Investors

1. Safeguards against Bankruptcy :

Credit rating of an instrument done by credit rating agency gives an idea to the investors about degree of financial strength of the issuer company which enables him to decide about the investment. Highly rated instrument of a company gives an assurance to the investors of safety of instrument and minimum risk of bankruptcy.

2. Recognition of Risk :

Credit rating provides investors with rating symbols which carry information in easily recognisable manner for the benefit of investors to perceive risk involved in investment. Rating symbol gives them the idea about the risk involved or expected advantages from the investment.

3. Credibility of Issuer :

Rating gives a clue to the credibility of the issuer company. The rating agency is quite independent of the issuer company and has no business connections. Absence of business links between the rater and the rated films establishes ground for credibility and attract investors.

4. Easy Understability of Investment Proposal :

Rating symbol can be understood by an investor which needs no analytical knowledge on his part. Investor can take quickly decisions about the investment to be made in any particular rated security of a company.

5. Saving of Resources :

Investors rely upon credit rating. This relieves investors from the botheration of knowing about the fundamentals of a company, its actual strength, financial standing, management details etc. The quality of credit rating done by professional experts of the credit rating agency reposes confidence in him to rely upon the ratings for taking investment decisions.

6. Independence of Investment Decisions :

For making investment decisions investors have to seek advice of financial intermediaries, the stock brokers, merchant bankers, the portfolio managers etc about the good investment proposal but for rated investments, investors need not depend on the advice of these financial intermediaries as the rating symbol assigned to a particular instrument and indicates the degree of risk involved in it and suggests the credit worthiness of the instrument.

7. Choice of Investments :

Several alternative credit rating instruments are available at a particular point of time for making investments in the capital market and the investors can make choice depending upon their own risk profile and diversification plan.