UNIT 8 : CREDIT RATING SERVICES

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8.1 LEARNING OBJECTIVES

After going through this unit you will be able to:

- explain the meaning of credit rating
- discuss the benefits and disadvantages of credit rating
- describe the types of credit rating
- discuss the methodology of credit rating
- discuss with different credit rating agencies
- analyse the provisions of SEBI regarding credit rating

8.2 INTRODUCTION

It is very difficult for a general investor to know the authenticity, creditworthiness and profitability of an instrument or institution. To take an efficient investment decision, investors perceive the need of an independent and credible agency, which judges impartially and in a professional manner, the credit quality of different companies and assist investors in making their investment decisions. Credit Rating Agencies, by providing a simple system of gradation of corporate securities, assist the investors/lenders to form an opinion on -the relative capacities of the borrowers to meet their obligations. Credit rating is used' extensively for evaluating debt instruments. With the passes of time rating agencies have diversified their area of works. Besides rating bond issues they have diversified into rating of asset-backed securities, commercial papers, bank loans, etc. Credit rating agencies also rate financial institutions like-banks, insurance companies, mutual funds and sovereign government.

The concept of credit rating originated in the United States of America in 1909 AD when John Moody, the founder of Moody's Investor Service rated the US Rail Road Bond. However, importance of the concept was realized after the great depression of 1929 to 1939. After that the concept of credit rating gets popularity. Moody's Investor Service, Standards and Poor's (S&P), Fitch Investor Service are the leading credit rating agencies of the world.

In this unit, we will discuss the meaning, types, benefits,

disadvantages, methods and regulatory aspects of credit rating. We will also have an idea about some credit rating agencies operating in India.

8.3 MEANING OF CREDIT RATING

A credit rating is an opinion on the relative degree of risk associated with timely payment of interest and principal on a debt instrument. The credit worthiness of an individual, company or even country is assessed through credit rating. It is an evaluation made by a credit rating agency about the debtor's ability to pay back the debt and likelihood of default. It tells an investor, whether the debt instrument is safe or risky. It tells whether the issuer will be able to pay the interest and repay the principal amount in time.

The rating is expressed in alphabetical or alphanumeric symbols. For example, CRISIL has prescribed the following symbols for debenture issues:

AAA indicates highest safety of timely payment of interest and principal.

AA indicates high safety of timely payment of interest and principal.

A indicates adequate safety of timely payment of interest and principal.

BBB offers sufficient safety of payment of interest and principal for the present.

BB offers inadequate safety of timely payment of interest and principal.

B indicates great propensity to default.

C indicates vulnerability to default.

D indicates that the debenture is in default in payment of arrears of interest or principal

Before issuing the instrument, the issuing company asks the credit rating agency to rate its instrument. Credit rating is not permanent, it is reviewed periodically.

8.4 TYPES OF RATING

Following are the different types of rating:

i. **Sovereign credit rating**: Sovereign credit rating is the credit rating

of a sovereign entity like a national government. A country may be rated whenever a loan is to be extended or some major investment is to be made in it by international investors. A number of factors such as growth rate, industrial and agricultural production, government policies, inflation, fiscal deficit etc. are taken into consideration to arrive at such rating.

ii. **Short term credit rating**: Short term rating is a probability factor of an individual going in to default within a year. Now a day's short term rating is very common.

iii. **Corporate credit rating**: Corporate credit rating is the rating of financial instruments issued by corporate entities. The credit rating of a corporation is a financial indicator to potential investors of debt securities such as bonds. Investor looks at the credit rating of instrument and issuer before investing.

8.5 BENEFITS OF CREDIT RATING

Credit rating is beneficial for both investors and issuing company. Following are the benefits of credit rating to the investor.

i. **Helps in investment decision**: Credit rating gives an idea of creditworthiness of the issuing company and the risk associated with a particular security. Depending upon the credit rating investor can decide whether to invest in such company or not.

ii. **Freedom of investment decisions**: For common people it is very difficult to take investment decision. Before taking investment decisions they seek advice from the stock brokers, merchant bankers or the portfolio managers. Credit rating service makes the task easy by attaching rating symbols to a particular security. Rating symbol assigned to a particular instrument suggests the creditworthiness of the instrument and indicates the degree of risk involved in it.

iii. **Assurance of safety**: A high rating assures the investor about the safety of the instrument. Companies having high ratings of their instruments maintain healthy financial discipline.

iv. **Choice of instruments**: By rating the securities, credit rating agencies enables an investor to select a particular instrument from many alternatives available.

v. **Dependency on rating**: The ratings assigned to the instruments are authentic and reliable. The rating firms are independent of issuing company and have no business connection with. Hence, they give a fair rating to the instruments. This brings confidence among the investors.

vi. **Continuous monitoring**: Credit rating agencies not only assign rating symbols but also continuously monitor them. The Rating agency downgrades or upgrades the rating symbols depending upon performance and position of the company.

8.6 BENEFITS OF CREDIT RATING TO THE COMPANY

A company who has got its credit instrument or security rated is benefited in the following ways:

i. **Easy to raise fund**: It become very easy for a company to raise fund from the market if the instruments issued by the company are highly rated. A high rating gives confidence to the investors. Many investors always like to make investments in such instrument, which ensure safety and easy liquidity rather than high rate of return.

ii. **Good corporate image:** High credit rating of securities helps in improving the corporate image of a company. A high credit rating increases the level of confidence among the investors. This helps in creating a good corporate image of the company.

iii. **Lower the cost of public issue**: A company with highly rated instruments has to make least efforts in raising funds through public issue. A good credit rating gives good publicity to the company. Companies with highly rated instrument enjoy better goodwill and corporate image in the eyes of customers, shareholders, investors and creditors. Investors feel secured of their investments and creditors are assured of timely payments of interest and principal.

iv. **Easy and Lowers Cost of Borrowing:** A company with highly rated debt instruments has to make least efforts in raising funds from the market. A high rating indicates low risk. High rated instrument will enable the company to offer low rate of interest. The investors will accept low interest because of low risk involvement. High credit rating gives the company wider spectators for borrowing. It can easily approach financial institutions, banks, investing companies, public etc. for borrowings.

v. **Help Non-popular Companies:** Good credit rating gives exposure to the company. If the instruments issued by a company get publicity, the company with low publicity gets popularity. It will now become easy for the company to raise fund from the market.

vi. **Rating facilitates growth:** Rating motivates the management of the company to undertake expansion of their operations or diversify their production activities thus leading to the growth of the company in future.

8.7 DISADVANTAGES OF CREDIT RATING

i. **Non-disclosure of important information**: The firm being rated may not furnish all material or important information to the credit rating agency. Any decision taken in absence of such important information may put investors at a loss.

ii. **Possibility of biasness**: The rating given by credit rating agency is based on the information collected from the company. The information collected by the rating agency may be subject to personal bias of the rating team.

iii. **Problems for new company**: Rating agencies give ratings on the basis of information supplied by the company. But, a new company may not be able to provide sufficient information to prove its financial soundness. Therefore, it may get lower credit rating. A low credit rating may create problem in raising funds from the market.

iv. **Static in Nature**: Rating is done on the basis of a static study of present and past data of the company at one particular point of time.

There are numbers of political, economical, social and environmental factors which have direct bearings over the affairs of the company. Any changes after the rating may defeat the very purpose of rating.

v. **Rating is not certificate of soundness**: Rating grades by the rating agencies are only an opinion about the capability of the company to meets its interest obligations. Rating symbols do not pinpoint towards financial soundness or quality of products or management or staff etc. In other words rating does not give a certificate of the complete soundness of the company.

vi. **Difference in rating grades:** Same instrument may be rated differently by different rating agencies because of many factors. This may create confusion among the investors.



CHECK YOUR PROGRESS

Q 1: What is meant by credit rating?

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Q 2: Mention different types of credit rating.

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8.8 USERS OF CREDIT RATING

The users of credit rating include the following:

Investors

Investors are the prime users of credit rating. They often use credit ratings to assess credit risk and to compare different issuers and debt issues when making investment decisions. Individual investors, for example, may use credit ratings in evaluating the purchase of a municipal or corporate bond from a risk tolerance perspective.

Institutional investors, including mutual funds, pension funds, banks, and insurance companies often use credit ratings to supplement their own credit analysis of specific debt issues.



Counterparty risk also known as default risk is the risk to each party of a contract that the counterparty will not live up to its contractual obligations. Counterparty risk is a risk to both parties and should be considered when evaluating a contract.

Intermediaries

Intermediaries like Investment bankers help to facilitate the flow of capital from investors to issuers. They may use credit ratings to benchmark the relative credit risk of different debt issues, as well as to set the initial pricing for individual debt issues and to help determine the interest rate these issues will pay. Intermediaries that structure special types of debt issues may look to a rating agency's criteria when making their own decisions about how to configure different debt issues, or different tiers of debt

Issuers

Issuers use credit ratings to provide independent views of their creditworthiness and the credit quality of their debt issues. Issuers may also use credit ratings to help communicate the relative credit quality of debt issues, thereby expanding the universe of investors. In addition, credit ratings may help them anticipate the interest rate to be offered on their new debt issues. As a general rule, if creditworthiness is more the issuer need to pay lower interest rate to attract investors and issuer with lower creditworthiness will typically pay a higher interest rate to offset the greater credit risk assumed by investors.

Businesses and financial institutions

Businesses and financial institutions may use credit ratings to assess counterparty risk, which is the potential risk that a party to a credit agreement may not fulfill its obligations. For example, in deciding whether to lend money to a particular organization or in selecting a company that will guarantee the repayment of a debt issue in the event of default, a business may wish to consider the counterparty risk. A credit rating agency's opinion of counterparty risk can therefore help businesses analyze their credit exposure to financial firms that have agreed to assume certain financial obligations and to evaluate the viability of potential partnerships and other business relationships.

8.9 CREDIT RATING METHODOLOGY

Credit rating requires throughout analysis and investigation of relevant factors that affect creditworthiness of the issuer or borrower. Rating methodology of each rating agency usually includes business risk analysis, financial risk analysis, management evolution and fundamental analysis.

8.9.1 Business Risk Analysis

To ascertain the business risk the rating agency makes an assessment of the company's environment focusing on the strength of the industry prospects, business cycle as well as competitive factors affecting the industry. The vulnerability of the industry to country risk is also assessed by evaluating political factors, economic factors, industry specific factors and foreign exchange risk. If a company is involved in more than one business, each segment is analyzed separately. The main factors include company position such as - market position, size, diversification, management, operating efficiency and legal position etc; Industry factor such as– industry trend, industry structure, market size, growth potential, competition, technological changes, regulatory environment etc.

8.9.2 Financial Risk Analysis

To assess the financial risk the rating agency takes in to consideration various aspects of the financial management. Financial risk analysis includes accounting quality, earnings protection, adequacy of cash flow and financial flexibility.

Accounting quality is evaluated by analyzing accounting regime, reporting and discloser norms, methods of income recognition, depreciation policy etc. Earnings protection is examined with the help of ratios. Adequacy of cash flow is determined by study of future cash flow, working capital need and capital budgeting. Financial flexibility is measured in terms of whether alternative financial plans have been developed or not.

8.9.3 Management Evolution

This involves a study of the track record of the management, evaluation of management goal, strategies and philosophies, planning and control system, evaluation of capacity to overcome adverse situations.

8.9.4 Fundamental Analysis

This includes analysis of liquidity management, asset quality, profitability and interest and tax sensitivity. Liquidity management of a business organization can be known through a study of capital structure, liquid assets, matching of assets and liabilities etc. Asset quality analysis includes study of credit management policies, credit monitoring policies and composition of assets. Profitability is examined through profitability ratio, reserve and non-business incomes. Interest and tax sensitivity is measured in terms of exposure to interest rate change, tax provisions and changes in tax laws.

8.10 STEPS INVOLVED IN CREDIT RATING

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

8.11 CREDIT RATING IN INDIA

The history of credit rating agency (CRA) in India is not very old. India was first among the developing world to set up a credit rating agency. Credit Rating Information Services of India Limited (CRISIL) is the first credit rating agency established in India in the year 1988. Second is Investment Information and Credit Rating Agency of India (ICRA) established in the year 1990. During this short span of time, the major rating agencies have instilled confidence in the minds of the Investors and Regulatory bodies. The Indian Rating Agencies are providing training and technical assistance in setting up rating agencies in many other countries. In India, credit rating service gets more importance and become popular after 1990 when the Reserve Bank of India and Securities Exchange Board of India made credit rating mandatory for the issue of Commercial Paper and some kinds of debentures and debt instruments. In the following paragraph we will discuss some credit rating agencies of India.

8.11.1 Credit Rating Information Services of India Limited (CRISIL)

CRISIL is the largest and first credit rating agency of India and a global leader in research, ratings and risk & policy advisory services. It was established in the year 1987 and commences operations in the year 1988. CRISIL has been promoted by ICICI and UTI as a public limited company with its head quarters at Mumbai. It is one of the top credit rating agencies in India. CRISIL had assessed more than 61000 entities and more than Rs. 47 trillion of debt. It Rates two-thirds of bonds outstanding in India and highest number of outstanding Small and Medium Enterprises in India.

CRISIL's services include credit ratings and risk assessment; research on India's economy, industries and companies; financial research and outsourcing; fund services; risk management and infrastructure advisory services. CRISIL provides rating and risk assessment services to manufacturing companies, banks, non

banking financial companies, and financial institutions, housing finance companies, municipal bodies and companies in the infrastructure sector. It rates long term instruments such as debentures, bonds, preference shares, structured obligations, fixed deposits, commercial paper and short term deposits. It makes credit assessments of various entities including state governments and subsidiaries and joint ventures of multinationals. It also assigns ratings of financial strength to insurance companies.

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

ICRA was incorporated on January 16, 1991 and launched its services on August 31, 1991. ICRA was promoted by Industrial Finance Corporation of India jointly with other leading financial/ investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency. ICRA is a Public Limited Company, with its shares listed in the Bombay Stock Exchange and National Stock Exchange. International Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder. The primary objective of ICRA is to provide information and guidance to the investors and creditors for determining the credit risk associated with a debt instrument and credit obligation.

ICRA undertakes credit assessment for small scale industries, rating of collective investment schemes and claim paying ability of insurance companies. ICRA rates rupee-denominated debt instruments, such as bond and debentures, fixed deposit, commercial paper, certificates of deposit and sector specific debt obligations issued by infrastructure companies. Since 1995, ICRA has been rating equity instruments.

ICRA offers rating services to a wide range of issuers which includes banks and other financial instructions, service company, insurance company, non-banking financial companies, telecom

companies, manufacturing companies, power companies etc. ICRA has developed highly specialized rating methodologies for grading of different entities.

8.11.3 Credit Analysis & Research Ltd. (CARE)

CARE was incorporated in April 1993 as a credit rating information and advisory services company. CARE Ratings' registered office and head office is located at Mumbai. In addition, CARE Ratings has regional offices at Ahmedabad, Bengaluru, Chandigarh, Chennai, Coimbatore, Hyderabad, Jaipur, Kolkata, New Delhi, Pune and Mauritius. It is a credit rating and information services company promoted by the Industrial Development Bank of India (IDBI) jointly with financial institutions, public / private sector banks and private finance companies. It is offering a wide range of services such as rating services, advisory services, information services and equity research services. CARE ratings are recognized by Government of India, Reserve Bank of India and Securities Exchange Board of India. CARE provides rating to industrial companies, public utilities, financial institutions, infrastructure projects, state government and municipal bodies. CARE rates all types of instruments like commercial papers, fixed deposits, bonds, debentures and structures obligations. Apart from rating services, CARE provides advisory services such as project advisory services and financial restructuring services. CARE also prepares confidential reports for companies, which may be useful in taking decisions with regard to financial options, joint ventures, acquisitions and collaborations.

8.11.4 Fitch India Limited

With the acquisition of Duff and Phelps Credit Company in April 2000 by Fitch Ratings, Duff and Phelps Rating India Private Limited became Fitch India Limited. Duff and Phelps Credit Rating

India Private Ltd was the first joint venture rating company promoted by JM Financials, Alliance Group and the international rating agency Duff and Phelps. At present Fitch Group is comprised of: Fitch Ratings - a global leader in credit ratings and research; Fitch Solutions - a leading provider of credit market data, analytical tools and risk services; BMI Research - an independent provider of country risk and industry analysis specializing in emerging and frontier markets; and Fitch Learning - a preeminent training and professional development firm. It has dual headquarters in London and New York. Majority of Fitch Group is owned by Hearst.

Fitch introduced a rating scale to meet the growing demand for independent analysis of financial securities. Fitch was one of the three rating agencies that were first declared as nationally recognized statistical rating organizations by the Securities and Exchange Commission in 1975. Fitch Group is a global leader in financial information services with operations in more than 30 countries. Fitch has 49 offices worldwide with the coverage of more than 3,000 financial institutions, more than 1,200 corporate issuers. The company has over 8,600 structured finance transactions and also maintains surveillance of more than 1,200 European structured finance transactions and 200 Asian structured finance transactions. Fitch India analysis have access to Fitch internationals large global information network. The credit rating of Fitch apply to a variety of entities and issues which includes Financial Institutions, Insurance, Sovereigns and Supranational, Corporate Finance, Public Finance, Structured Finance, Islamic Finance, Global Infrastructure and Project Finance.

8.11.5 ONICRA Credit Rating Agency of India Limited

ONICRA Credit Rating Agency is one of the leading Credit and Performance Rating agencies in India. The company is based in Gurgaon and founded in 1993. It provides ratings, risk assessment

and analytical solutions to Individuals, MSMEs and Corporates. Third party credit and performance rating and assessment help to create "trust" between players in markets that underpins transactions. ONICRA has pioneered individual credit rating services in India. ONICRA plays a central and critical role in collecting and analyzing a variety of financial, operational, industry and market information, synthesizing that information, and providing autonomous, reliable assessments of the entity, thereby providing stakeholders with an important input into their decision making process. It has developed over the years the methodology to assess the financial risks in respect of various types of transactions related to individuals and small and medium enterprises. ONICRA is presently operating at commercial scale. It provides pre and post disbursement and activation solutions so as to bridge the gap between the principals and their customer. It also serves clients in auto finance, consumer finance, credit card issues and cellular phones service provider.

8.11.6 Brickwork Ratings India Pvt. Limited (BWR)

Brickwork Rating India Pvt. Ltd. was founded in 2007 by group of professionals to provide rating of public issues and others to help investors take information decisions. BWR has its corporate office in Bangaluru and a countrywide presence with its offices in New Delhi, Chandigarh, Chennai, Guwahati, Hyderabad, Kolkata, Mumbai and Ahmedabad along with representatives in more than 150 locations. Brickwork Ratings (BWR) is registered with SEBI accredited by RBI and empanelled by National Small Industries Corporation. It offers bank loan, Commercial papers, MSME rating and grading services. NABARD has empanelled Brickwork for MFI and NGO grading.

Brickwork assigns two types of credit ratings- one to the issuers and the other to specific debt issues or other financial obligations. The rating of issuer, which is called "Brickwork

counterparty credit rating", reflects the current opinion about an issuer's overall capacity to fulfill its financial obligations. The other type of rating is the rating of issues, mainly the debt issues. Four types of analysis were made on debt issues namely business analysis, industry analysis, financial analysis and management analysis.

BWR has rated debt instrument such as bands, bank loans, securitized paper of over Rs.9, 30,000 Crore. BWR has also rated about 5000 MSMEs, Fixed Deposit and Commercial Papers of over 19,700 crore.

8.11.7 SME Rating Agency of India Limited (SMERA)



Basel II is a set of international banking regulations put forth by the Basel Committee on Bank Supervision, which leveled the international regulation field with uniform rules and guidelines.

SMERA commenced its operations in 2005 as 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 a joint venture started by Small Industrial Development Bank of India (SIDBI), Dun & Brand Street Information Services India Private Limited (D& B) and several leading banks in India. SMERA is the country's first rating agency that focuses primarily on small and medium enterprises (SME) in India. The main objective of rating SMEs is to facilitate greater and easier flow of credit to SMEs from the banking sector. 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 makes two types of analysis- business risk analysis and financial analysis. SMERA has assigned more than 44,000 ratings since inception.

SMERA has achieved the reputation of providing comprehensive, transparent and reliable ratings, thus providing comfort and confidence to lenders and investors alike in decision making. SMERA ratings have gained wide acceptability and are

now an integral part of the risk assessment process within the lending and investing community.

SMERA has its Registered and Head Office in Mumbai, branches at 9 cities and representatives in more than 50 clusters across India.



CHECK YOUR PROGRESS

Q 3: Name two credit rating agencies in India.

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Q 4: Name two users of credit rating service.

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8.12 SEBI REGULATIONS OF CREDIT RATING AGENCIES

The Securities and Exchange Board of India (Credit Rating Agencies) Regulations, 1999 empower SEBI to regulate CRAs operating in India. Following are the some regulatory provisions related to Credit Rating Agencies in India:

Registration of Credit Rating Agencies: Registration with SEBI is mandatory for carrying on the rating business in India. The application for the certificate of registration should be made to the SEBI in Form A of first schedule of Securities and Exchange Board of India (Credit Rating Agencies) Regulations, 1999 and shall be accompanied by a nonrefundable fee of Rs.25000.

Promoter of Credit Rating Agency: A credit rating agency can be promoted by a:

(i) Public financial institutions as defined in section 4-A of the companies Act.

(ii) Scheduled Bank included for the time being in the second schedule to the Reserve Bank of India Act, 1934.

(iii) Foreign Bank Operating in India with RBI approval

(iv) Foreign credit rating agency having at least five years experience in rating securities and

(v) Any company incorporated under the companies Act/ body corporate, having continuous net worth of a minimum of Rs.100 crores as per its audited annual accounts for the previous five years prior to filling of the application with the SEBI for registration.

Grant of Certificate of Registration: The SEBI will grant a certificate of registration to eligible applicants on the payment of a fee of Rs.5, 00,000, subject to the following conditions:

(A) The CRA would comply with the provisions of the SEBI Act/ regulations and guidelines/ directions/circulars and instructions issued by the SEBI, from time to time, on the subject of credit rating.

(B) (i) where any information/particulars furnished to the SEBI by a CRA is found to be false/misleading in any material particular or has undergone changes subsequent to its furnishing at the time of application, it would immediately inform SEBI in writing and

(ii) The certificate of registration is valid for a period of three years, renewable for subsequent three years.

Renewable of Certificate: An application for renewal of certificate of registration shall be made not less than three months before expiry of the period of validity of the certificate. The application shall be accompanied by a renewal fee of Rs. 3, 00,000.

Restrictions on Rating of Securities: Credit Rating Agencies are Restricted from rating of securities issued by (i) promoters and (ii) certain other entities such as a borrower of its promoter; or a subsidiary of its promoter; or an associate of its promoter and the associate or subsidiary of the Credit Rating Agency.

General Obligations: Following are the some of the general obligations specified in the SEBI (Credit Rating Agencies) Regulations which need to be followed by the credit rating agencies.

- Code of Conduct stipulated by SEBI
- Agreement with the client
- Monitoring of ratings

- Procedure for review of rating
- Internal procedures to be framed by the CRA
- Disclosure of rating definitions and rationale by the CRA
- Submission of information to the board
- Compliance with circulars etc., issued by the board
- Appointment of Compliance Officer
- Maintenance of Books of Accounts records, etc.
- Confidentiality
- Rating process

8.13 SEBI Code of Conduct

SEBI's code of conduct for CRAs is designed to ensure transparent and independent functioning of CRAs. Some of the provisions of the Code of Conduct are:

1. A credit rating agency shall make all efforts to protect the interests of investors.
2. A credit rating agency, in the conduct of its business, shall observe high standards of integrity, dignity and fairness in the conduct of its business.
3. A credit rating agency shall fulfill its obligations in a prompt, ethical and professional manner.
4. A credit rating agency shall at all times exercise due diligence, ensure proper care and exercise independent professional judgment in order to achieve and maintain objectivity and independence in the rating process.
5. A credit rating agency shall have a reasonable and adequate basis for performing rating evaluations, with the support of appropriate and in depth rating researches. It shall also maintain records to support its decisions.
6. A credit rating agency shall have in place a rating process that reflects consistent and international rating standards.
7. A credit rating agency shall not indulge in any unfair competition nor shall it wean away the clients of any other rating agency on assurance

of higher rating.

8. A credit rating agency shall keep track of all important changes relating to the client companies and shall develop efficient and responsive systems to yield timely and accurate ratings. Further a credit rating agency shall also monitor closely all relevant factors that might affect the creditworthiness of the issuers.
9. A credit rating agency shall disclose its rating methodology to clients, users and the public.
10. A credit rating agency shall, wherever necessary, disclose to the clients, possible sources of conflict of duties and interests, which could impair its ability to make fair, objective and unbiased ratings. Further it shall ensure that no conflict of interest exists between any member of its rating committee participating in the rating analysis, and that of its client.
11. A credit rating agency shall not make any exaggerated statement, whether oral or written, to the client either about its qualification or its capability to render certain services or its achievements with regard to the services rendered to other clients.
12. A credit rating agency shall not make any untrue statement, suppress any material fact or make any misrepresentation in any documents, reports, papers or information furnished to the board, stock exchange or public at large.
13. A credit rating agency shall ensure that the Board is promptly informed about any action, legal proceedings etc., initiated against it alleging any material breach or non-compliance by it, of any law, rules, regulations and directions of the Board or of any other regulatory body.
14. A credit rating agency shall maintain an appropriate level of knowledge and competence and abide by the provisions of the Act, regulations and circulars, which may be applicable and relevant to the activities carried on by the credit rating agency. The credit rating agency shall also comply with award of the Ombudsman passed under the Securities and Exchange Board of India (Ombudsman) Regulations,

2003.

15. A credit rating agency shall ensure that there is no misuse of any privileged information including prior knowledge of rating decisions or changes.

16. (a) A credit rating agency or any of his employees shall not render, directly or indirectly any investment advice about any security in the publicly accessible media.

    (b) A credit rating agency shall not offer fee-based services to the rated entities, beyond credit ratings and research.

17. A credit rating agency shall ensure that any change in registration status/any penal action taken by board or any material change in financials which may adversely affect the interests of clients/investors is promptly informed to the clients and any business remaining outstanding is transferred to another registered person in accordance with any instructions of the affected clients/investors.

18. A credit rating agency shall maintain an arm's length relationship between its credit rating activity and any other activity.

19. A credit rating agency shall develop its own internal code of conduct for governing its internal operations and laying down its standards of appropriate conduct for its employees and officers in the carrying out of their duties within the credit rating agency and as a part of the industry. Such a code may extend to the maintenance of professional excellence and standards, integrity, confidentiality, objectivity, avoidance of conflict of interests, disclosure of shareholdings and interests, etc. Such a code shall also provide for procedures and guidelines in relation to the establishment and conduct of rating committees and duties of the officers and employees serving on such committees.

20. A credit rating agency shall provide adequate freedom and powers to its compliance officer for the effective discharge of his duties.

21. A credit rating agency shall ensure that the senior management, particularly decision makers have access to all relevant information about the business on a timely basis.

22. A credit rating agency shall ensure that good corporate policies and corporate governance are in place.
23. A credit rating agency shall not, generally and particularly in respect of issue of securities rated by it, be party to or instrumental for—(a) creation of false market; (b) price rigging or manipulation; or (c) dissemination of any unpublished price sensitive information in respect of securities which are listed and proposed to be listed in any stock exchange, unless required, as part of rationale for the rating accorded.



8.14 LET US SUM UP

In this unit we have discuss the following points:

- Credit rating is an opinion on the relative degree of risk associated with timely payment of interest and principal on a debt instrument.
- The rating is expressed in alphabetical or alphanumeric symbols.
- Credit rating is beneficial for the issuing company, investors and lenders.
- Investors, intermediaries, issuer, Businesses and financial institutions are the users of credit rating.
- Rating methodology of each rating agency usually includes business risk analysis, financial risk analysis, management evolution and fundamental analysis.
- Credit Rating Information Services of India Limited (CRISIL) is the first credit rating agency established in India in the year 1988.
- The Securities and Exchange Board of India (Credit Rating Agencies) Regulations, 1999 empower SEBI to regulate CRAs operating in India.



8.15 FURTHER READINGS

1) Arora, M. (2003) “Credit Rating in India –Institutions, Methods and Evaluation”, New Century Publications, Delhi.

2) Verma, J.C. (2000) "Credit Rating Concepts: Practices and Procedures", Bharat Publishing House, New Delhi.



8.16 ANSWERS TO CHECK YOUR PROGRESS

Ans to Q No 1: Credit rating is an opinion on the relative degree of risk associated with timely payment of interest and principal on a debt instrument.

Ans to Q No 2: Different types of credit rating are Sovereign credit rating, short term credit rating, and corporate credit rating.

Ans to Q No 3: Two credit rating agencies in India are Credit Analysis and & Research Ltd. and SME Rating Agency of India Limited.

Ans to Q No 4: Investors and issuers are the two users of credit rating service.



8.17 MODEL QUESTIONS

Q 1: What are the benefits of Credit Rating for both investors and issuing company?

Q 2: Discuss the Credit Rating Methodology.

Q 3: Discuss the SEBI regulations issued to regulate the Credit Rating Agencies in India.

Q 4: Write a brief note on CRISIL.

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