

Brief Overview of Basel II Ratings and Professional Opportunities



Awareness of important aspects

- Necessity and use of credit rating for corporate
- What credit ratings are and not?
- Basel II Rating agencies in India
- What do the various credit rating symbols mean?
- Types of Services by Rating Agency
- Rating Process



Necessity and use of credit rating for corporate

- ✓It is an opinion expressed by an independent professional organization, after making a detailed study of all relevant factors, which assists investors in making investment decisions.
- ✓It helps the issuers of debt instruments to price their issues correctly and to reach out to new investors.
- ✓Regulators like Reserve Bank of India (RBI) and Securities & Exchange Board of India (SEBI) often use credit rating to determine eligibility criteria for some instruments.
- ✓Credit ratings are also used for determination of risk weight for calculation of capital Adequacy for Banks as per Basel II guidelines in India.



What credit rating are and not?

❖ What Credit Ratings are?

- ☑ Credit rating is essentially the opinion of the rating agency on the relative ability and willingness of the issuer of a debt instrument to meet the debt service obligations as and when they arise.
- ☑ Ratings are relative measures of risk; as a result, the assignment of ratings in the same category to entities and obligations may not fully reflect small differences in the degrees of risk.



What credit rating are and not?

❖ What Credit Ratings are not?

- ☒ A credit rating is not a recommendation to buy, hold, or sell a debt instrument.
- ☒ Different investors have different views regarding the level of risk to be taken and rating agencies can only express their views on the relative credit risk.
- ☒ The credit rating should not be viewed as assurance of credit quality or as a precise measure of probability of default.



Basel II Rating Agency in India

- ▶ CRISIL
- ▶ ICRA
- ▶ CARE
- ▶ India Ratings (Fitch)
- ▶ Brickwork Ratings
- ▶ SMERA



What do the various credit rating symbols mean?

- All the Rating agencies uses common simple alphanumeric symbols to convey credit ratings
- as per the guidelines from SEBI.
- Rating agencies assigns credit ratings to debt obligations for the long-term and the short-term debt instruments.
- To illustrate, long-term credit rating scale and the description associated with each category is given below:

Symbol	Rating Category [Description w.r.t. likelihood of meeting the debt obligation on time]	
AAA	Highest Degree of Safety	Investment Grade
AA	High degree of safety	
A	Adequate degree of safety	
BBB	Moderate degree of safety	
BB	Moderate risk of default	Below Investment grade
B	High risk of default	
C	Very high risk of default	
D	Default or are expected to be in default soon	



➤ To illustrate, short-term credit rating scale and the description associated with each category is given below:

Symbol	Rating Category [Description w.r.t. likelihood of meeting the debt obligation on time]	
A1	Very strong degree of safety	Investment Grade
A2	Strong degree of safety	
A3	Moderate degree of safety	
A4	Minimal degree of safety	Below Investment grade
D	In default or expected to be in default	

➤ Modifiers {"+" (plus) / "-"(minus)} can be used with the rating symbols for the categories AA to C. The modifiers reflect the comparative standing within the category.

➤ Modifier {"+" (plus)} can be used with the rating symbols for the categories A1 to A4. The modifier reflects the comparative standing within the category.



- ◆ Basel II is a new capital adequacy framework applicable to all Scheduled Commercial Banks in India as mandated by RBI.
- ◆ “Capital Adequacy Ratio (CAR)” is the ratio of capital fund to risk weighted assets.

$$\text{CAR} = \frac{\text{(Tier I + Tier II) capital}}{\text{Risk weighted assets}}$$

Tier I capital = Paid up equity capital
+ Statutory reserves
+ Capital reserves
- Equity investments in subsidiaries
- Intangible assets
- Current and Accumulated Losses, if any

Tier II capital = Cumulative perpetual preference shares
+ Revaluation Reserves
+ General Provisions and Loss Reserves
+ Hybrid Debt Capital Instruments
+ Subordinated Debts

It is permanently and freely available to absorb the losses without the bank being under the obligation to cease their trading.

It can absorb losses in the event of a winding-lesser degree of protection to depositors. In nature or, are not readily available.



What would be the risk weights applicable to various ratings assigned?

Long Term Ratings:

Rating	AAA	AA	A	BBB	BB & Below
Risk Weight (%)	20	30	50	100	150
CAR(%)	1.8	2.70	4.5	9	13.5

Short Term Ratings:

Rating	A1 +	A1	A2	A3	A4 & below
Risk Weight (%)	20	30	50	100	150

- For example, if the entire loan assets (say Rs. 100 crore) of a bank were to carry a 'AAA' rating, the risk weighted assets would be Rs. 20 crore and the required capital to achieve the min CAR of 9% would be only Rs. 1.8 crore instead of Rs. 9 crore, as per Basel I guidelines which prescribes uniform 100% risk weight for all the assets of Rs 100 crore. In effect, the bank would achieve a 'capital relief' of Rs. 7.2 crore in case it gets its exposure rated.



For example: ABC Ltd approach bank for funding.
(Loan Amount involved Rs. 100)

	Bank Ltd	ABC Ltd
Scenario I (Rated BB+ or below, Speculative Grade)	1. Risk weight 150% 2. Has to maintain Rs. 13.5 as CRR 3. Let say Bank charges 13% ROI	Company have to pay Rs. 13 as interest.
Scenario II (Rated BBB- or above, investment Grade)	1. Risk weight 100% 2. Has to maintain Rs. 9 as CRR so by keeping Rs. 13.5 as CRR Bank can lend upto Rs. 150. 3. Lets say Bank give concession and charges 12%	Company will have to pay Rs. 12 as interest and at the same time Bank will earn Rs. 18 even after reducing ROI by 1%. Thus WIN WIN situation for both borrower and lender.



Types of Ratings

- ▶ **BLR Rating.**
- ▶ **SME Rating.** – Registration certificate issued by micro and small enterprise is not required.
- ▶ **NSIC Ratings.** – Registration certificate issued by micro and small enterprise is required
- ▶ **Real Estate Grading.**
- ▶ **IPO & Hospital Grading.**
- ▶ **Education Institutes Grading**
- ▶ **Issuer Ratings.** – Same Rating Scale As BLR
- ▶ **Corporate Governance Ratings.**
- ▶ **Insurance Ratings** – Same Rating Scale As BLR.
- ▶ **Mutual Fund Ratings** - Same Rating Scale as BLR
- ▶ **Customized Research Services** – Industry / Company Research, Risk Management Services. etc



SME Rating Scale

SME Rating	Meaning
SME 1	Highest Degree of Safety
SME 2	High Degree of Safety
SME 3	Above Average Degree of Safety
SME 4	Average Degree of Safety
SME 5	Below Average Degree of Safety
SME 6	Inadequate Degree of Safety
SME 7	Poor
SME 8	Default



NSIC Rating Scale

Performance Capability	Financial Strength		
	High	Moderate	Low
Highest	SE1A	SE1B	SE1C
High	SE2A	SE2B	SE2C
Moderate	SE3A	SE3B	SE3C
Weak	SE4A	SE4B	SE4C
Poor	SE5A	SE5B	SE5C



Real Estate Grading Scale

Rating	Meaning
DA1 -Excellent	The Developer's ability to execute real estate projects as per the specified quality level and within the stipulated time schedule, and ability to transfer clean title is Excellent .
DA2 -Very Good	The Developer's ability to execute real estate projects as per the specified quality level and within the stipulated time schedule, and ability to transfer clean title is Very Good .
DA3 -Good	The Developer's ability to execute real estate projects as per the specified quality level and within the stipulated time schedule, and ability to transfer clean title is Good .
DA4 -Below Average	The Developer's ability to execute real estate projects as per the specified quality level and within the stipulated time schedule, and ability to transfer clean title is Below Average .
DA5- Poor	The Developer's ability to execute real estate projects as per the specified quality level and within the stipulated time schedule, and ability to transfer clean title is Poor .
Note: Rating Agency may apply '+' (plus) sign for ratings from 'DA1' to 'DA3' to reflect comparative standing within the category.	



IPO Grading Scale

Symbols	Meaning
5	Strong Fundamentals
4	Above Average Fundamentals
3	Average Fundamentals
2	Below Average Fundamentals
1	Poor Fundamentals



Hospital Gradings

Stars	Meaning
5	Delivers Excellent Quality The institution has facilities, equipment, human resource and service quality levels which are consistent with the Excellent Standards in the Indian Healthcare Industry
4	Delivers Very Good Quality The institution has facilities, equipment, human resource and service quality levels which are consistent with the Very Good Standards in the Indian Healthcare Industry
3	Delivers Good Quality The institution has facilities, equipment, human resource and service quality levels which are consistent with the Good Standards in the Indian Healthcare Industry
2	Delivers Fair Quality The institution has facilities, equipment, human resource and service quality levels which are consistent with the Fair Standards in the Indian Healthcare Industry. Needs some more progress
1	Delivers Satisfactory Quality The institution has facilities, equipment, human resource and service quality levels which are below the Satisfactory Standards in the Indian Healthcare Industry. Needs up gradation to standards



Education Institutes Grading

- ▶ Engineering College Grading Scale/ Management College Grading Scale

Grading Scale	Meaning
EG1/EB1	The institution has resources and processes that can deliver very high quality education.
EG2/EB2	The institution has resources and processes that can deliver high quality education.
EG3/EB3	The institution has resources and processes that can deliver good quality education.
EG4/EB4	The institution has resources and processes that can deliver moderate quality education
EG5/EB6	The institution has resources and processes that can deliver low quality education

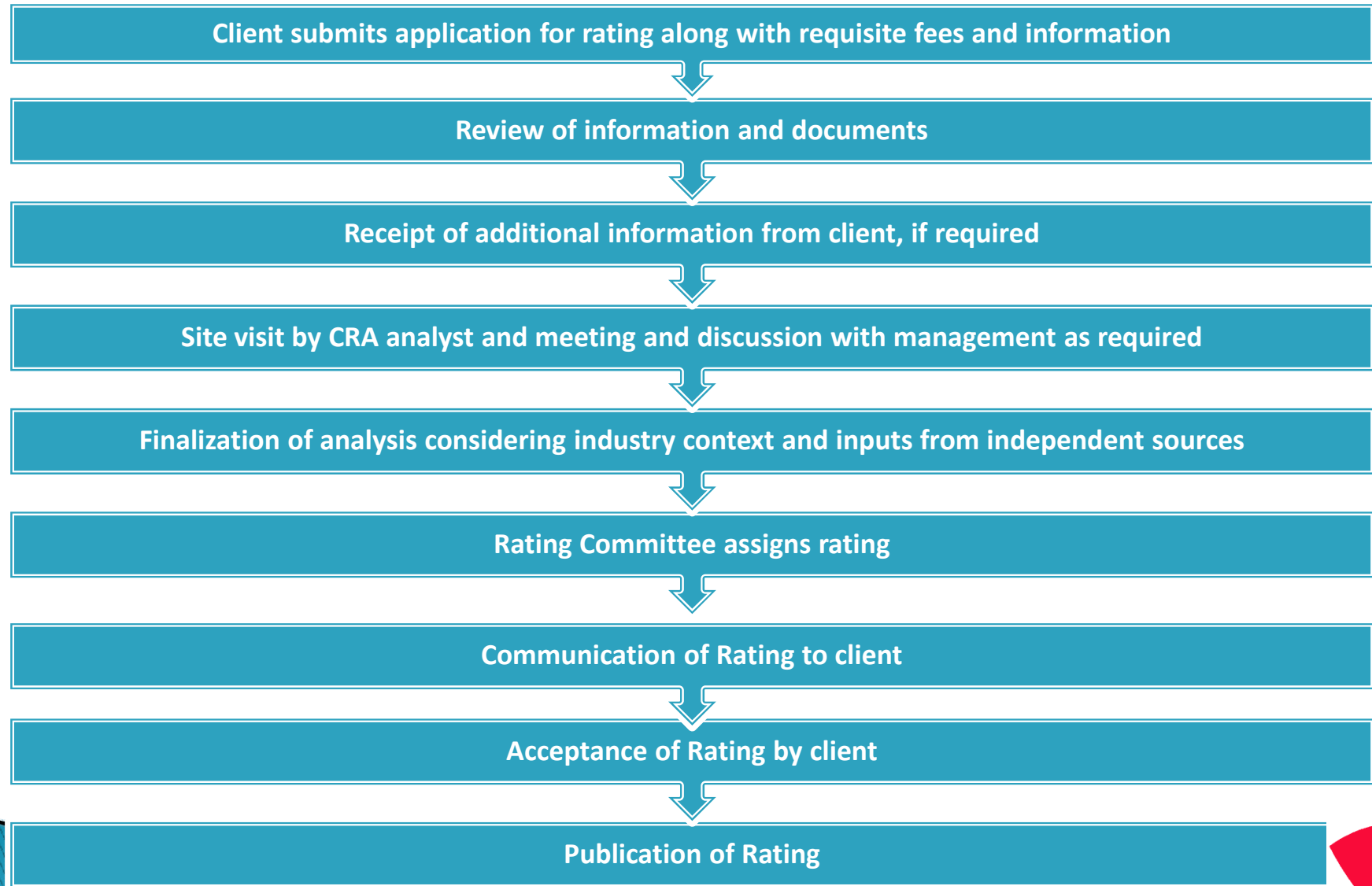


Corporate Governance Rating Scale

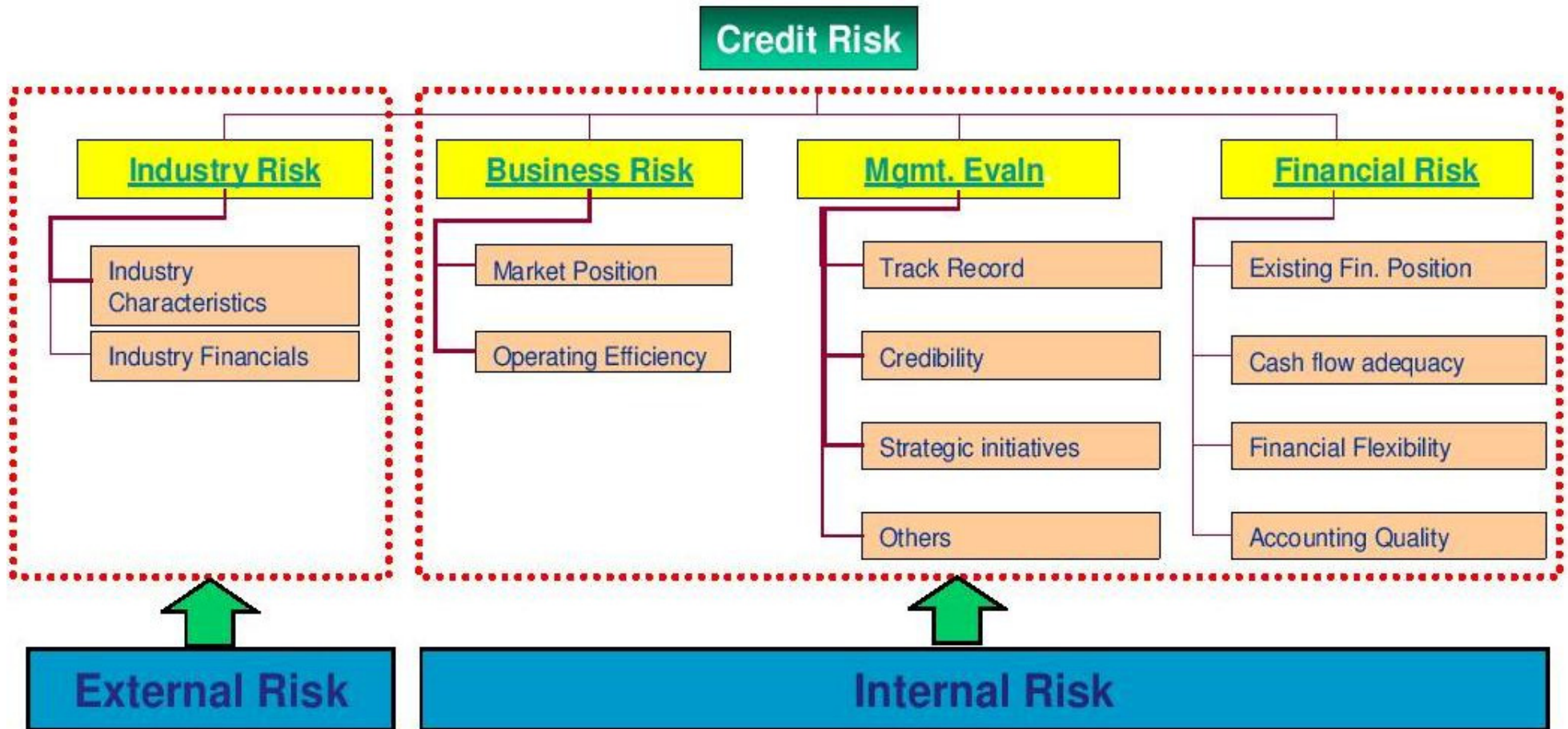
Rating	Meaning
CG1	Quality of Corporate Governance is the highest
CG2	Quality of Corporate Governance is very high
CG3	Quality of Corporate Governance is high
CG4	Quality of Corporate Governance is adequate
CG5	Quality of Corporate Governance is moderate
CG6	Quality of Corporate Governance is inadequate
CG7	Quality of Corporate Governance is low
CG8	Quality of Corporate Governance is the lowest



Rating Process



Credit Rating Process



★ For Companies with Capex, Project Risk is also considered



SEBI Circular on Enhanced Standards for Credit Rating Agencies (CRAs)

Major Standards As advised	Description
Criteria based rating	<p>Each CRA shall frame detailed rating criteria, include the same in its operations manual / internal governing document.</p> <ol style="list-style-type: none">1. Default recognition2. Financial Ratios etc.. <p>Each criteria shall be reviewed periodically by CRA. The same shall be placed on CRA's website in user friendly manner.</p>
Accountability of rating analyst	Roles and responsibilities of the rating analysts of CRAs shall be clearly laid out
Standardisation of press release	It has been decided that all CRAs shall follow a standardized template
Publish of unaccepted rating	Each CRA shall disclose on its website details of all ratings assigned by them, irrespective of whether the rating is accepted by the issuer or not.
Multiple notch moment rating list	Prescribed standard formats for reporting by CRA's



Any Questions Please?



Thank You

