

Credit Rating

Subject : Commerce IV

SYBCOM

Credit Rating

- An estimate of credit worthiness of a financial security, a corporation, local government or even a country.
- It tells a lender or investor the probability of the subject being able to meet payment requirements for interest and principal repayment.
- A Credit Rating Agency is a company that is responsible for assessing the financial strength of a company or government entity.

Origin

- 1841 – Louis Tappan established the first mercantile credit agency in New York.
- 1849 – John Bradstreet set up a rating agency which published a rating book in 1857.
- 1924 – Fitch Publishing was set up.
- 1933 – Robert Dun & John Bradstreet was merged to form Dun & Bradstreet , which later became the owner of Moody's Investor Service in 1962.
- 1941 – Standard & Poor's corporation started credit rating operations.
- 1970 – Number of credit agencies set up world wide.

Evolution of Credit Rating in India

- 1987 – CRISIL (Credit Rating and Information Services of India Ltd.) was setup as the first rating agency.
- 1991 – ICRA Ltd. (Investment Information & Credit Rating Agency of India Ltd.) came into existence.
- 1994 – CARE (Credit Analysis and Research Ltd.)was setup.

Features of Credit Rating

- Facilitate investment decisions.
- Assess credit worthiness of an individual , corporation or country.
- Increase investor confidence
- Healthy financial discipline
- Allocate capital efficiency

Functions of Credit Rating

- Providing information
- Low cost information
- Basis for proper risk analysis
- Maintaining healthy discipline on corporate borrowers
- Greater credence to financial and other representations
- Formation of public policy.
- Investor protection

Advantages of Credit Rating

Benefits to Investor

- Safety of investment
- Constant reviews
- Freedom of investment decision
- Saves time, effort and money
- Wider choice of investments
- Quick assessment of investment proposal

Benefits to the company

- Cheaper credit
- Enhance corporate image
- Facilitate growth and expansion
- Act as a marketing tool
- Recognition to un – known companies
- Wider access to investor

Limitations of Credit Rating

- Rating watch
- Industry specific rather than company specific
- Cost benefit analysis
- Conflict of interest
- Corporate governance issues
- Dominant market
- transparency

Regulatory Framework

- Credit Rating agencies are regulated by SEBI.
- The SEBI (Credit Rating Agencies) Regulations, 1999 govern the credit rating agencies.
- To protect the interest of investors, SEBI has mandated that every credit agency should continuously monitor the ratings of securities.
- SEBI does not play any role in assessment made by the rating agency.

The following regulations have been specified by SEBI:

- Conditions for setting up a Credit Rating Agency
- Process of getting Certificate of Registration
- Obligations of Credit Rating Agency towards SEBI
- Conditions to be followed while assigning ratings.
- Restrictions on ratings.
- Inspection and investigation by SEBI
- Liability in case of default
- Internal audit of Credit Rating Agencies
- Transparency and disclosure norms

Credit Rating Process

- Request from issuer
- Submit the application form, relevant document and fees
- Site visit and management interview
- Rating assessment process
- Rating committee rating decision
- Rating dissemination
- Monitoring of the assigned rating
- Rating watch
- Confidentiality of the information
- Rating credibility
- Rating coverage

Credit Rating Symbols

- The SEBI has standardized the rating symbols.
- Indian rating agencies (IND – RA) has revised its rating symbols.

Credit Rating Agencies In India

CRISIL (Credit Rating and Information Services of India Ltd.)

- Largest credit rating agency in India
- Established in 1987
- Standard & Poor holds a majority stake in CRISIL.
- Its ratings reflect current opinion on the relative safety of timely payment of interest and principal on the rated financial obligations.
- Uses simple alphanumeric symbols to convey credit ratings.

Services offered by CRISIL are as follows :

- Credit rating services
- Advisory services
- Credibility first rating and evaluation services
- Training services

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- CRISIL's ratings process is designed to ensure that all ratings are based on the highest standards of independence and analytical rigor.
 - Launches CRISIL foundation to increase financial awareness and conservation of environment.

ICRA (Investment Information and Credit Rating Agency)

- Has been in operation since January 1991.
- Moody's is the largest shareholder.
- Dedicated team of professionals for the MSME sector.
- Was promoted by Industrial Finance Corporation of India (IFCI)
- The ratings depend on the nature of the borrowing entity.
- Provide intermediaries with a tool to improve efficiency in the funds raising process.

Services provided are:

- Rating services
- Grading services
- Industry research
- Consulting services
- Knowledge process outsourcing and online software

CARE (Credit Analysis and Research Limited)

- Incorporated in April 1993.
- UTI, IDBI and Canara Bank are the major promoters.
- Covers ratings of all types of debt instruments such as debentures, fixed deposits, commercial paper and structured obligations.
- Undertakes credit analysis of companies for the use of bankers, other lenders and business enterprises.

SMERA

- India's first rating agency primarily focusing on the Indian Micro, Small and Medium Enterprise segment
- Primary objective is to provide ratings that are comprehensive, transparent and reliable.
- Aims to enhance the market standing of the applicant amongst lenders, trading partners, and prospective customers.