Ratings

CRISIL
An S&P Global Company

CRISIL's criteria for rating and capital treatment of corporate sector hybrid instruments

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Criteria contacts

Somasekhar Vemuri
Senior Director – Rating Criteria and Product Development
somasekhar.vemuri@crisil.com

Rama Patel
Director – Rating Criteria and Product Development
rama.patel@crisil.com

Chaitali Nehulkar
Associate Director – Rating Criteria and Product Development
chaitali.nehulkar@crisil.com

Venkatesh Balakrishnan
Manager - Rating Criteria and Product Development
venkatesh.balakrishnan@crisil.com

Venkata Sumanth Devarapalli
Analyst - Rating Criteria and Product Development
venkatasumanth.devarapalli@crisil.com

Radhika Uday Patankar
Analyst - Rating Criteria and Product Development
radhika.patankar@crisil.com

In case of any feedback or queries, you may write to us at criteria.feedback@crisil.com

I. Executive summary

Hybrid instruments combine features of debt and equity. They offer greater flexibility to defer debt servicing than traditional debt, and can benefit investors, shareholders and issuers. Indian companies have been issuing hybrid securities such as preference shares, optionally or compulsorily convertible securities, and foreign currency convertible bonds, for years. Corporates prefer to issue hybrids as this helps optimise the debt-equity mix in their capital structure. The features of hybrid issuances include varying tenures, multiple call options, and flexibility to step up the coupon rate.

For the benefit of issuers, investors, and intermediaries, this note discusses two critical aspects of CRISIL's assessment of hybrids: CRISIL's view on the extent of equity-like features embedded in them (and consequently, their treatment in the capital structure), and the rating framework for such instruments.

CRISIL looks beyond the nomenclature or legal construct of the instrument in its assessment of the equity content, and evaluates the overall impact of the instrument's characteristics on the capital structure. The characteristics of equity *(Box 1)* serve as a guide to assessing the equity content in hybrids. Two factors help identify this: the cushion provided by the instrument to conserve cash in an exigency, and the permanence of the instrument. Typically, hybrids offer greater flexibility to issuers than traditional senior debt in their servicing.

CRISIL's rating for the instrument is based on the assumption that the issuer is a going concern. All payments indicated in the instrument are considered as scheduled payments, despite conditions that enable the issuer to skip or defer regular debt servicing. The rating assigned assesses the risk of default or deferment on all scheduled payments. If, for example, an issuer defers payment because of the breach of a trigger, CRISIL treats the missed payment as a default even if the terms of the instrument indicate otherwise. Given that breaches permit issuers to defer payment, hybrids are, hence, at higher risk of default than traditional debt instruments. Therefore, when a hybrid is likely to miss a payment, the risk will be appropriately reflected with the rating on the hybrid notched down from the rating on senior debt instruments. Furthermore, subordination of the instrument is not a key determinant of the rating given that CRISIL's ratings are based on the probability of default scale.

II. Scope

This criteria article highlights CRISIL's approach in determining the equity content (and consequently, their analytical treatment in the capital structure) in hybrids issued by non-financial corporates. It also outlines the methodology adopted for rating them.[1]

[1] Previous criteria for the rating and capital treatment of corporate sector hybrid instruments may be found at https://www.crisil.com/content/dam/crisil/criteria_methodology/criteria-research/archive/crisil-criteria-for-rating-and-capital-treatment-of-corporate-sector-hybrid-instruments-apr2017.pdf

III. Methodology

III.1. Assessment of equity content

As hybrids combine the features of debt and equity, a comparison of features is useful in determining the equity content of hybrids. Box 1 offers a quick understanding of the features of equity in the capital structure of a company.

Box 1: Classification of instruments

	Equity	Hybrid	Debt
Permanence	Perpetual	Based on tenure	Based on tenure
Committed obligation to service	None	Subject to no breach of triggers	Yes
Loss absorption capacity	Very high	Moderate	None

Characteristics of equity

1. **Permanence in the capital structure:** By definition, equity does not have any scheduled maturity or repayment. Issuers have no obligation to redeem or buy back equity. This feature of permanence fortifies the issuer's overall capital structure.
2. **Absence of committed servicing requirement:** The issuer has no ongoing committed payment in the case of equity, as declaration of dividend is discretionary. Equity holders cannot take the issuer into liquidation for non-payment of dividend. This enhances the issuer's ability to absorb losses on an ongoing basis, and the flexibility to conserve cash.
3. **Capacity to absorb losses:** In case of liquidation of the issuer, equity shareholders are the last to be paid. Moreover, equity shareholders are to be paid only if there is enough cash left after paying other creditors. This enhances the loss absorption capacity of equity, and provides a cushion to creditors in the case of bankruptcy of the issuer.

Hybrids have a variety of features, each with varying degree of influence on the equity content. CRISIL uses a framework for non-financial companies, classifying equity content in hybrids as high, intermediate, or low. The parameters considered in the framework are:

III.1.1. Level of fixed component of coupon rate

Most hybrids offer a stated distribution or coupon rate (coupon) to the investor. Some hybrids, such as participating securities, have two components in their coupon: fixed (say, 2% per annum) and variable (linked to the entity's reported profit after tax; say, 10% of EPS2). In such cases, the fixed component on the coupon is payable regardless

[2] EPS= Earnings per share

of the issuer's financial performance, while the variable component is linked to profit, and is dependent on the issuer's financial performance.

A large variable and small fixed component ensures that the amount paid to service the instrument varies in direct proportion to the company's financial performance. Hence, in difficult business conditions, the payout will be low, enabling the company to conserve cash. This feature makes the instrument behave like equity. On the other hand, a high fixed coupon would limit the flexibility available to the issuer in difficult business conditions. The quantum of fixed component in the coupon is, therefore, a key element in evaluating the equity content in the instrument.

CRISIL believes that the fixed component on instruments should be materially lower by at least 5% than a comparable debt market benchmark rate, to be considered for 'high' equity treatment. The greater the difference, the lower the debt content in the hybrid.

III.1.2. Permanence of the instrument

Permanence is a key characteristic of equity (see *Box 1: Characteristics of equity*). The longer the instrument remains in the capital structure, the higher its equity content. Residual maturity is a measure of the instrument's permanence: **the longer the residual maturity, the lower the debt content in the instrument** (*see Box 2: CRISIL's evaluation of the replacement capital covenant*). However, the tenure stated in the terms of the instrument is not the primary factor in determining residual maturity. That's because most issuers can redeem the instrument well before maturity, often in the form of a call option.

In instruments where the issuer has a call option, the date of the first call determines residual maturity. The call option is built into the instrument to provide the issuer with an early exit option, and curtails the instrument's permanence. Instruments with a residual maturity of less than 5 years do not, therefore, merit treatment as equity, as the period is too short to provide any cushion to the issuer for losses.

Box 2: CRISIL's evaluation of the replacement capital covenant

Issuers may structure their hybrids with a legally binding capital replacement clause. This provides senior-debt holders of a company the comfort that cash flow will not be affected by redemption of hybrids. Additionally, debt holders also retain their seniority in the capital structure. While the replacement capital covenant (RCC) may be structured in many ways, a common variant is one that allows for the redemption of the instrument only through issue of common equity, or instruments with similar equity content. CRISIL believes that for the covenant to be effective in helping preserve credit quality, it should force the issuer to replace a hybrid security, if it is called, redeemed, or repurchased, with an instrument of similar or better equity-like characteristics, in terms of payment deferability, permanence, and degree of subordination. The RCC, thus, ensures that even if the instruments are not redeemed, they will stay in the capital structure for as long as the covenant remains enforceable. The RCC, therefore, positively affects the residual maturity of the instrument, thereby reinforcing its permanence. CRISIL, however, factors the RCC into its assessment of equity content only if it substantially extends the instrument's residual maturity.

Additionally, *ceteris paribus*, the RCC ensures that the issuer's capital structure will have similar or higher equity content for as long as the covenant remains applicable. It is also important to examine the conditions under which the covenant will be applicable, and the likelihood of its termination. If a termination event occurs making the RCC unenforceable, the equity content of the instrument would diminish to that extent. CRISIL assesses the RCC for its enforceability and the conditions for its termination in evaluating the equity content in the instrument.

III.1.3. Deferability of payment obligation

Typically, hybrid capital instruments have a stated dividend or coupon. However, the payment may be deferred or skipped, contingent on certain pre-specified covenants or threshold, or at the discretion of the management or a regulator (such as the Reserve Bank of India [RBI] for perpetual issuances by banks and non-banking financial companies). If the deferral is for conservation of cash, especially in a difficult business environment, the instrument possesses the characteristic of equity. So a link between the deferral and the entity's debt obligation or financial performance may result in higher equity content being accorded to the instrument, provided the deferral is mandatory, and not at the discretion of the management. From an issuer's perspective, discretionary flexibility to defer or skip payments is optimal. However, while such deferrals provide sufficient leeway to the management to make payments to investors, non-payment may be viewed negatively by the market, and may constrain the management's fund-raising ability in future.

CRISIL believes instruments that enable mandatory deferral have higher equity content. Mandatory deferral binds the issuer to defer payments on the hybrid, and thus eliminates subjectivity from the issuer's intent. This feature provides comfort to other debt holders, and compensates for the non-permanence of the instrument to a large extent. In some cases, the deferral is linked to non-payment of dividend on equity shares. In such cases, CRISIL assesses the issuer's stance on, and track record in, payment of dividends. It also evaluates the effect that the deferment may have on the issuer's capital-raising ability. CRISIL classifies hybrids with a mandatory deferral clause as having higher equity content than instruments which give issuers an option to defer payment**.**

III.1.4. Relevance of triggers for deferring/skipping payments

Mandatory triggers for deferral do not necessarily merit a case for higher equity content. If deferrals are contingent on the breach of a trigger, CRISIL assesses the equity content by evaluating the likelihood of a breach, in the light of the issuer's business and financial performance. Furthermore, the threshold for the trigger must be realistic. For instance, the trigger for deferral for a highly rated issuer cannot be the diminution of net worth by 80%, for such a trigger is unlikely to be breached. Therefore, to qualify for higher equity content, the triggers need to be such that there is reasonable probability of them being breached.

CRISIL believes higher rated entities may opt to pay dividend to their equity shareholders, even in times of poor financial performance, by dipping into their reserves. Instruments wherein payments are subject to dividends distributed to equity shareholders will, therefore, have a relatively lower equity content, than those where payments are subject to a more objective parameter, such as profits earned by the company in a given period.

Additionally, issuers in the international markets have included features such as dividend stoppers or look-back triggers to restrict payments on other instruments. These features are structured to restrict the issuer from making payment on instruments that are equal, or junior to, the hybrids in the capital structure, unless the arrears due to deferral on the hybrids are paid. Such clauses, which give the instrument a debt-like characteristic, restrict the issuer's ability to defer dividend.

III.1.5. Cumulation of payments

If a hybrid's coupon can be deferred, it is a cumulative instrument; if there is no obligation to make up for missed payments, it is non-cumulative. The latter has a higher equity content, as there is no continuing liability on the instrument. Additionally, it is easier for issuers of non-cumulative hybrids than cumulative ones to improve their financial risk profiles. However, the issuer may be more reluctant to defer payments on non-cumulative instruments, given that a missed payment to an investor is not subsequently made up.

III.1.6. Availability and timing of call options

The presence of a call option with the issuer brings the permanence of the instrument into question. The call option enables the issuer to redeem or retire the instrument. The date of the first call, therefore, determines the residual maturity. The presence of a call option raises concerns on whether the instrument will remain outstanding after the initial call date, as it typically allows the issuer to redeem the instrument much before the scheduled maturity. **Therefore, the shorter the period to the call date, the lower is its equity content and shorter would be the period for which the instrument will remain in the capital structure.**

Some instruments may allow issuers to have multiple call dates (typically on an annual basis), and therefore, additional flexibility. The issuer may choose not to call the instrument on the first available date, especially if the market conditions favour a deferral of the call option. CRISIL, however, believes that multiple call dates do not significantly affect the instrument's equity content, as the issuer will need to manage investor expectation that the issue will be called at first date.

III.1.7. Presence of a step-up

The call option is usually paired with a provision for stepping up the coupon, whereby the coupon rate on the instrument increases if the call option is not exercised. Such combinations are structured specifically to induce the issuer to call, and thus to avoid a step-up. Coupon step-up options increase the issuers' debt-servicing burden, and serve as a strong incentive for issuers to exercise the call option, redeem the instrument, and replace it with a much cheaper debt instrument. Therefore, this feature reduces the permanence of instruments, and hence, lowers the equity content.

However, the inclusion of a coupon step-up does not always mean lower equity content. The quantum of the step-up must be high enough to induce the issuer to call. **CRISIL believes step-up options add debt-like features to hybrids, and that instruments without step-ups have higher equity content than those with step-ups.**

III.1.8. Position in the capital structure

The capital treatment is based on the degree to which hybrids are subordinated to the issuer's debt instruments. The greater the subordination of a hybrid to debt, the higher its equity content will be, for it enhances the cushion available to the issuer in case of bankruptcy. It is, therefore, important to evaluate the nomenclature and regulatory treatment of the instrument. However, mere subordination alone will not mean high equity content for the instrument. Nevertheless, it is unlikely that non-subordinated hybrids will be treated as equity, even if other features warrant such treatment. Additionally, if the terms of the instrument allow investors to initiate winding up proceedings against a company, if the instrument is not serviced for extended periods (2 or more years), it will resemble debt more than equity.

III.2. Assessing the overall equity content

The overall assessment of equity content in an instrument will be based on the interplay of all parameters discussed above. However, the first four parameters in the framework—quantum of coupon rate, permanence, deferability of payment obligation, and triggers for deferability—should be accorded higher weightage when arriving at the overall equity content of the instrument.

Based on the framework discussed, the instrument is classified into one of three buckets, as indicated in ***Table 1*****.**

Table 1: Classification of hybrids based on quantum of equity content

Classification	Low	Intermediate	High
Equity content	0-25%	26-50%	51-75%

The presence of hybrids benefits an issuer's capital structure. Nevertheless, CRISIL believes that common equity is the best form of equity capital for issuers. That's because common equity is permanent and enhances the issuer's loss-absorption capacity at all times. Therefore, issuers with a balanced capital structure and common equity will be viewed more favourably than those with an excessive dependence on hybrid securities. CRISIL limits the total equity content for hybrids for an issuer to 20% of its adjusted net worth.

III.3. Capital treatment of some common hybrid securities

Typically, hybrids issued by Indian companies include optionally convertible securities, compulsorily convertible securities, foreign currency convertible bonds (FCCBs), and preference shares. CRISIL evaluates each instrument's characteristics in relation to its maturity profile, coupon payments, and loss absorption capacity. Accordingly, it treats such securities as equity or debt when calculating its financial and capital ratios.

Optionally convertible securities are usually considered as debt. However, if they possess equity-like features, the equity content is assessed and classified as either high, low, or moderate.

FCCBs are mostly treated as debt, except in rare instances where the characteristics (such as very low yield, or conversion price less than or within a reasonable range of the current market price) resemble equity, and the intent of the issuer and investor indicate that the instrument is perceived as equity rather than debt.

Compulsorily convertible securities are typically treated as pure equity.

Most preference shares in India are close to debt, despite them being promoter-held because of short maturity and higher interest rate. However, if they do show equity-like features, CRISIL classifies them as low, intermediate, high, or pure equity.

CRISIL evaluates a hybrid in terms of how closely it resembles equity and its impact on the issuer's capital structure. This is a starting point for the analysis on whether a particular hybrid is incrementally positive, negative, or neutral for the issuer's capital structure. Moreover, CRISIL analyses the behaviour of such instruments in a distress situation, especially the liquidity or refinancing risk for servicing the fixed commitments of a hybrid. In general, based on the hybrid securities that have been vogue in India, the following categories are common:

- **Preference shares**
- **Optionally convertible securities**
- **Compulsorily convertible securities**
- **FCCBs**

CRISIL's treatment of each category of hybrid is detailed below:

III.3.1. Preference shares

These are probably the oldest and most popular form of hybrid securities in India.

Maturity profile: Preference shares have a fixed tenure and have to be repaid at the end of it. In most cases, the tenure is 3-5 years if the investors are institutions, and slightly longer if the investors are promoters. Long-dated

preference shares are rare in the Indian context. Also as per current regulations, preference shares cannot be issued with an original maturity of more than 20 years. Thus, in terms of maturity profile, preference shares closely resemble debt. If the preference shares have early call options, their effective maturity reduces. CRISIL considers this reduced maturity in its analysis.

Coupon payment: Typically, preference shares in India are non-participating and have a fixed dividend rate, imparting debt-like characteristic. Furthermore, the dividend rate is typically close to the market rate of debt. However, CRISIL may assign some equity-like character if there is evidence that the instruments have a low coupon rate.

Loss absorption capacity: Deferability and non-cumulation are not usually observed in practice, despite a large number of these being promoter-subscribed. However, if such terms are observed, CRISIL gives some equity benefit. Moreover, if the instruments are not promoter subscribed, conditions on deferral and cumulation shall be viewed critically. However, in such cases, deferral may be treated as default, even if the instrument does not specify so.

Furthermore, the preference dividend is included in calculations of interest coverage and other debt service coverage ratios.

The treatment of preference shares in the capital structure is largely similar to hybrids as outlined in Section III.1 and Section III.2.

III.3.2. Optionally convertible securities

An optionally convertible security gives investors the option of converting the principal amount into the company's equity shares, usually on maturity and at a pre-determined price.

Maturity profile: While these securities have a fixed tenure for repayment, the final conversion itself would be contingent on the underlying share price. Normally, the strike price at the time of issue is higher than the existing price. The liquidity risk of repayment or refinancing is eliminated if investors exercise the option of converting the securities into equity shares. As it is difficult to predict share prices, and hence, there is uncertainty on whether investors will exercise the conversion option, it is prudent to assume that the company will have to repay the principal.

Coupon payment: As the investor has the option of participating in the company's potential gains, the coupon rates on such securities are typically lower than traditional debt. Like traditional debt, however, the securities carry a fixed charge, which needs to be paid with no deferral option.

Loss absorption capacity: For a going concern, loss absorption capacity refers to the ability to defer, suspend, or waive dividend/interest payments on the instrument in case of a loss. As optionally convertible securities mirror traditional debt till such time the investors actually convert them into common shares, their loss absorption capacity is similar to that of debt.

- **How CRISIL treats optionally convertible securities**

Optionally convertible securities resemble debt more than equity, given the uncertainty over their conversion into equity shares. A hybrid is required to provide a cushion in times of distress. But since stock prices would, in all likelihood, be lower than the conversion price in such times, investors are unlikely to exercise the conversion option. Therefore, CRISIL treats such instruments as debt while computing capitalisation ratios. However, if the instrument has more equity-like features (such as extremely low yield to maturity, option to reduce the conversion price, and low differential between current market price and conversion price), and the intent of the issuer and investor indicates that the instrument is perceived as equity rather than debt, CRISIL may treat such instrument as equity.

III.3.3. Compulsorily convertible securities

Traditional debt, wherein the final repayment is through the issuance of common equity to investors based on a fixed conversion rate (or a band), are called compulsorily-convertible securities (given such conversion is without any condition).

Maturity profile: As these securities are compulsorily convertible into the company's equity shares, they fully eliminate the credit risk of repayment or refinancing.

Coupon payment: These instruments would have specific interest payments till the point of conversion and claim a fixed charge out of the company's cash flow.

Loss absorption capacity: With compulsory conversion, these securities have a higher loss-absorption capacity. This capacity increases as the conversion date approaches.

- **How CRISIL treats compulsorily convertible securities**

Given that the only cash outflow in case of compulsorily convertible securities is fixed interest payment till the point of conversion, these securities are more like equity. CRISIL, therefore, treats them as part of common equity while computing capitalisation ratios, in most cases.

III.3.4. FCCBs

Convertible securities issued in foreign currency are termed FCCBs, which are similar to convertible securities.

- **How CRISIL treats FCCBs**

CRISIL has treated most FCCB issues as debt and a handful as equity, given that they typically resemble debt.

The debt or equity characteristics of FCCBs are determined by analysing parameters such as

- yield to maturity
- forced conversion option
- option to reset conversion price downward
- differential between conversion price and current market price
- size of issue
- current dilution in promoters' holding on conversion

CRISIL regularly reviews these parameters and takes an appropriate view on debt or equity on that basis. The capital treatment decided upon is included in the calculation of all its ratios.

IV. Assigning ratings to hybrids

Although this note has so far focussed on CRISIL's assessment of the equity content in hybrids, these instruments do possess debt-like characteristics as well. CRISIL, therefore, also assigns credit ratings to such instruments. This section will outline CRISIL's methodology and approach for such ratings.

CRISIL rates hybrids on the same scale as traditional bonds. CRISIL's ratings are an opinion on the probability of default. The subordination of the instrument is, thus, not a key determinant of the rating, as subordination becomes relevant only in the event of bankruptcy, which is a post-default event.

Potential equity treatment for rating analysis: The capital treatment of a particular instrument must not be directly related to the rating accorded to the instrument. That's because, for the assessment of equity content in an instrument, CRISIL also factors in the support provided by the instrument in terms of distress or bankruptcy, as well as permanence. However, CRISIL assigns the rating assuming that the entity is a going concern, and hence, the notch-down of the rating will not necessarily be proportional to the equity content of the instrument. Therefore, it is possible that an instrument with low equity content is also notched down from the rating on its traditional debt, or vice versa.

Likelihood of deferral criterion: Unlike traditional debt instruments, hybrids offer flexibility to issuers to defer payment. As a result, investors are exposed to a greater degree of risk of non-payment on hybrids than on debt. The key to determining the rating, therefore, is CRISIL's view on the likelihood of payment on the instrument being missed (or deferred) on account of a breach of trigger. CRISIL evaluates these aspects on a case-to-case basis after analysing the triggers, and the likelihood of the issuer breaching them in future.

In the case of optional deferrals, CRISIL's approach is governed largely by the issuer's stance on, and track record in, deferring payments. In the international markets, optional deferrals are typically linked to profitability. Therefore, in case an optional deferral, issuers with a higher rating on their traditional debt instrument would typically have a lower notch-down (typically 0-1 notch) than issuers with a lower rating. This is because higher-rated issuers will have stronger profitability than those with a low rating, and hence, will be in a better position to service the instrument regularly.

Additionally, if the likelihood of a breach of the deferral trigger is high and the trigger is not discretionary, CRISIL assesses such instruments as having high probability of missing payments. Consequently, the instruments will be notched down by at least two notches. CRISIL also assess all additional features of the instrument that can lead to a default in payment on the instrument.

Conclusion

Hybrids are instruments which have both debt and equity like characteristics. Based on their features, CRISIL classifies hybrids as either low equity (0-25% equity), intermediate equity (25-50% equity), or high equity (50-75% equity). While analysing the equity content of hybrids, CRISIL considers a number of parameters such as the fixed coupon rate, permanence, deferability, triggers for deferral, cumulation, availability and timing of call options, coupon step-up, and position in the capital structure. CRISIL analyses these factors not only from the perspective of the legal and economic structure of the instrument, but also in terms of cash outflow implications on debt servicing by the issuer.

The criteria article also focusses on the rating of hybrids. Once the equity content of the instrument has been determined, CRISIL arrives at the rating by notching down from the rating on the senior unsecured debt of the issuer. CRISIL centrally factors in likelihood of breach of deferral trigger and discretionary nature of trigger while deciding the degree of notch down.

Annexures

Box 3: Essential features of common equity replicated in hybrids

From a lender‘s perspective, common equity is the best form of capital. As issuers of hybrids try to replicate the essential features of equity, it is appropriate to identify some of the characteristics of common equity that will reveal how successful the replication is. The primary characteristics of equity are:

Capital structure: A company‘s capital structure, commonly referred to as gearing, leverage, or the debt/equity ratio, reflects the extent of borrowed funds in its funding mix. The equity component in a company’s employed capital has no fixed obligation; returns to the investor depend on the profit made by a company. Debt, on the other hand, carries specified obligations of interest and principal, which have to be honoured, irrespective of the vicissitudes in business.

Absence of maturity or principal repayment: Under no circumstance is an issuer required to contractually return common equity to shareholders. Unlike equity, debt needs to be repaid at maturity or in fixed instalments. Common equity does not give the investor a fixed claim on the issuer’s cash flow, by way of either gradual or full repayment. In the case of debt, however, the gradual repayment of principal and regular interest outflow places an ongoing fixed demand on the issuer’s cash flow. Therefore, the need to fund maturing debt with cash flow from operations, or through refinancing, increases the issuer‘s credit risk.

The risk is exacerbated if the issuer encounters any type of financial stress that limits cash flow or impedes ability to refinance. Fixed obligations introduce the risk of default, cross-default to other debt, or even bankruptcy. Common stock imposes no such demands. Although many companies have bought back their shares in the recent past, these are mostly discretionary. Moreover, the risk of equity buybacks is mitigated by restrictions on such repurchases, such as a one-year gap between repurchases and limitations on the debt-equity ratio post-repurchase. It must, however, be recognised that the average duration of equity will reduce over the long term and equity need not be perpetual.

Absence of recurring payments: Dividend payments on common equity shares are largely discretionary. The ability to reduce or eliminate fixed payments is a characteristic of common equity, which can provide significant cushion to a company‘s cash flow. Thus, in a stress situation, or when profits are lower because of a recession in the business cycle, an issuer can choose to either reduce or skip its dividend payouts without triggering an event of default. In the case of new projects as well, an issuer can skip dividend payments until the project begins to generate profits. Such flexibility is not available in the case of traditional debt, where skipping interest payments usually triggers an event of default, which if not addressed, may eventually lead to bankruptcy.

Significant loss absorption: A firm’s net worth represents the residual value after paying off all liabilities. As losses and impairment in assets can be written off against the net worth, it provides cushion to reduce the likelihood of a liquidation event. Common equity has the largest loss absorption quality of all financing options available to a company; because shareholders are the last to receive any distribution in a liquidation situation. Thus, equity protects the company from any unforeseen distress situations and allows it to continue its business. In case of distress, equity provides the first layer of loss absorption followed by hybrids, unsecured and secured creditors.

About CRISIL Limited

CRISIL is a leading, agile and innovative global analytics company driven by its mission of making markets function better.

It is India's foremost provider of ratings, data, research, analytics and solutions, with a strong track record of growth, culture of innovation and global footprint.

It has delivered independent opinions, actionable insights, and efficient solutions to over 100,000 customers.

It is 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.

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