CRISIL
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CRISIL's criteria for rating short-term debt

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Criteria contacts

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

Ramesh Karunakaran
Director – Rating Criteria and Product Development
Email: ramesh.karunakaran@crisil.com

Wazeem M A
Senior Analyst – Rating Criteria and Product Development
Email: wazeem.a@crisil.com

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

Executive summary

CRISIL assigns ratings to instruments with an original contracted maturity of up to one year, like commercial paper (CP) and, on a short-term scale. Such short-term instruments are generally rolled over or refinanced on maturity. The ability of the issuer to refinance the short-term debt depends on the long-term credit profile of the issuer. Hence, CRISIL derives the short-term rating from the long-term rating of the issuer. CRISIL uses a mapping framework for capturing the linkage between long-term and short-term ratings. CRISIL requires liquidity backup to address the refinancing risk associated with confidence sensitive instruments such as commercial papers (CPs) and short-term non-convertible debentures (NCDs).

CRISIL has refined its criteria for rating short-term debt, especially the provisions related to liquidity backup for confidence-sensitive instruments like CPs and short-term NCDs. As per the previous criteria[1], CRISIL used to insist on liquidity backup for such instruments in all rating categories. However, the prevalent market for commercial papers has evolved over the years, and has not witnessed any widespread contagion. Hence, for the highest safety (CRISIL AAA) and high safety (CRISIL AA) rating categories, CRISIL will seek to understand the liquidity plan (instead of a liquidity back-up) from the company for meeting the liabilities on the commercial paper. For other rating categories, CRISIL will continue to obtain liquidity backup considering that the market for commercial papers in these rating categories is still evolving and constitute only a very small proportion of the commercial paper market. Liquidity back-up, which will be sought in the form of an undertaking from the issuer, is an alternate liquidity arrangement which can be used by issuers to redeem their CP issues if they find it difficult to roll over their CP issues. Some examples of liquidity back-up are: Drawing power available against unutilized bank lines; investments in liquid mutual funds; and unencumbered cash/fixed deposits. Liquidity plan is an understanding on the ability of the company to meet the CP redemptions, in case there is a widespread disruption in the CP market.

Scope

This article covers CRISIL's criteria for arriving at short-term ratings of issuers. It covers the mapping framework for deriving short-term ratings from long-term ratings and the analysis of the liquidity position of issuers undertaken in conjunction with the mapping framework. It also details the liquidity backup requirements for confidence-sensitive short-term instruments.

Methodology

Short-term debt (STD) including CP is different from the long-term debt; while long-term debt is expected to be repaid out of the internal accruals of the business, short-term debt is usually rolled over.

[1] Please refer to
https://www.crisil.com/Ratings/Brochureware/RR_ASSES/CRISIL-Ratings-research-commercial-paper-std_2013.pdf
https://crisil.com/Ratings/Brochureware/RR_ASSES/CRISIL-Ratings-research-computing-std-limits-NBFCs_2007.pdf

While arriving at the short-term rating of a company, CRISIL follows the following steps:

Step 1: Assess the underlying credit quality of the issuer, as reflected in its long-term rating

Step 2: Assess the liquidity position and analyze the monthly bank limit utilization of the issuer

Step 3: Arrive at a short-term rating, using a mapping framework

Step 4: Arrive at the quantum of CP/STD consistent with the rating

Step 5: Evaluate the liquidity backup

Step 6: Evaluate credit enhancement options, if applicable

Step 1: Assess the underlying credit quality of the issuer

CRISIL's rating on a CP or STD is primarily dependent on its opinion of the issuer's fundamental credit quality. The analytical approach adopted by CRISIL for assigning a CP or STD rating is very similar to that of its long-term rating as there is a strong linkage between the two. While the tenure of a CP can range from 7 days to 365 days, the short-term rating's time horizon extends well beyond this period because even short-term ratings are expected to endure over time rather than change frequently. Moreover, if a CP or STD issue's maturity cannot be met through subsequent CP or STD issues (roll-over) for any reason, the issuer has to rely on fresh borrowings. In such a case, the issuer's ability to refinance will largely depend on the company's fundamental credit quality, as reflected in its long-term rating.

Step 2: Assess the liquidity position

Once the long-term rating is assessed, CRISIL's rating methodology takes into account the issuer's current liquidity position. For non-financial sector entities, this entails a detailed analysis of the adequacy of the issuer's internal sources of funds for covering short-term uses, including working capital requirements. This includes an assessment of the monthly bank limit utilization for the past 12 months, as well as an assessment of the variations in the working capital cycle of the issuer. Where applicable, assessment of the variations in the drawing power during the past 12 months as a proportion of the sanctioned bank limits also serves as additional input into the analysis.

For financial sector entities, the liquidity assessment focuses on the cumulative asset-liability mismatches over various maturity buckets, and the adequacy of liquid assets to cover maturing liabilities. Within financial sector entities, banks and primary dealers enjoy more liquidity compared to non-banking finance companies (NBFCs) and housing finance companies (HFCs) due to their access to the Reserve Bank of India's (RBI's) liquidity adjustment facility (LAF) and call money markets.

Step 3: Mapping framework

While the short-term ratings are linked to the long-term ratings, the assessment made in Step 2 provides some flexibility in determining the exact mapping of a given long-term rating into the short-term scale. The long-term rating scale has more levels than the short-term scale and hence there may not be a one-to–one mapping between the two scales (see Table 1). The mapping adopted for financial sector companies may be different from manufacturing companies, primarily on account of better liquidity position and easier access to funds by finance companies as compared to their peers in the manufacturing sector.

Table 1: Mapping between short term and long term ratings (ratings within brackets only in exceptional cases)

LT rating	Corporates	Other Fin sector entities (other than banks & PDs)	Primary Dealers	Banks
AAA	A1+	A1+	A1+	A1+
AA+	A1+	A1+	A1+	A1+
AA	A1+	A1+	A1+	A1+
AA-	A1+	A1+	A1+	A1+
A+	(A1+) A1	A1+ (A1)	A1+	A1+
A	A1 (A2+)	(A1+) A1 (A2+)	A1+ (A1)	A1+
A-	(A1) A2+	A1 (A2+)	A1	A1+ (A1)
BBB+	(A2+) A2	A2+, A2	(A1) A2+	A1 (A2+, A2)
BBB	(A2) A3+ (A3)	(A2) A3+ (A3)	(A2+) A2	(A1) A2+, A2
BBB-	(A2, A3+) A3	(A2, A3+) A3	(A2) A3+, A3	A3+, A3
BB+	A4+	A4+	A4+	A4+
BB	A4+	A4+	A4+	A4+
BB-	A4+ (A4)	A4+ (A4)	A4+(A4)	A4 + (A4)
B, C categories	A4	A4	A4	A4

CRISIL may deviate from its mapping framework when it has a particular reason to ascribe a relatively stronger (or weaker) short-term credit quality, and may assign a higher (or lower) short-term rating. The ratings within brackets in Table 1 above indicate the typical deviations that CRISIL may take. The deviations will be based on the analysis of the liquidity position of the company, wherein CRISIL evaluates the extent of the company's short-term sources of funds vis-à-vis its short-term funding requirements.

Step 4: Arrive at the quantum of CP/STD consistent with the rating

While assigning the short-term ratings, CRISIL assesses the quantum of rated short-term debt that a company can issue based on its business plan. This assessment is based on an analysis of the maturity profile of the issuer's assets and liabilities, its assessment of the liquidity position of the company, and its refinancing ability. In some instances, CRISIL may put a ceiling on the allowable quantum of short-term debt based on the company's cash flow and liquidity position.

Please refer to Annexure for CRISIL's approach for computing short-term debt limits for issuers.

Step 5: Evaluate the liquidity backup

Liquidity backup is typically provided to confidence-sensitive instruments, on which the issuer may default in times of temporary financial stress. Confidence-sensitive instruments are those instruments that are susceptible to default due to loss of confidence among investors, which may jeopardize the financing options of the issuer as well as other issuers of the same instrument class and lead to a series of defaults. For instance, if depositors lose confidence in a bank, they may queue up for premature withdrawal leading to a run on the bank's deposits.

Similarly, in the short term debt (STD) market, default by one issuer may cause nervousness among investors about other issuers and may prompt the investors to not roll over the STD facilities. Therefore, it is essential for the issuers to maintain liquidity backup on STD to prevent such financial contagion. The importance of liquidity backup is reflected in the fact that a majority of CPs are being primarily carved out of working capital limits, despite the RBI allowing the issuance of CP as a distinct product. The maintenance of liquidity backup allows issuers to weather wide-spread disruptions in the CP market or lack of investor interest in the CP issued by the corporate.

Liquidity backup for non-financial sector entities

CRISIL may not insist on liquidity backup for non-financial sector issuers rated “CRISIL AA-” or above on the long-term scale. This is because such highly rated issuers typically have high liquidity, and enjoy high refinancing ability based on their reputation in the market. However, CRISIL may obtain liquidity backup on a case-to-case basis if CRISIL believes that a liquidity backup is warranted depending on the analysis of the liquidity profile of the issuer, its capital structure, cash flow stability and the characteristics of the industry in which the issuer operates. While analyzing the liquidity profile, CRISIL considers the ability of the issuer to meet short-term uses of funds like working capital additions, maturing debt obligations and a portion of capital expenditure, without having to resort to additional borrowings. In all cases, however, CRISIL evaluates the liquidity plan articulated by the issuer.

CRISIL insists on liquidity backup for corporates rated “CRISIL A+” or below. CRISIL assesses the liquidity back-up requirements for STD under two options:

- **Liquidity back-up to the extent of 100 per cent of outstanding STD** - CRISIL insists on 100 per cent liquidity back-up for the value of outstanding STD until the maturity of the STD.
- **Liquidity back-up for STD maturing over the next few days on a rolling basis** - CRISIL believes that stipulation of 100 per cent liquidity back-up for the entire outstanding STD of highly rated entities may not be necessary in all cases. This is because many highly rated entities have strong liquidity profile as they consistently maintain sufficient liquid assets on their balance sheet to meet short-term liquidity requirements. Hence, for such highly rated companies, CRISIL may stipulate a rolling liquidity back-up for total STD (rated and unrated) maturing, say in the next “N” days. CRISIL’s stipulation of “N” - number of days - for maturing STD is based on evaluation of specific liquidity plan and other factors like gearing, current ratio, debt repayments in the near to medium term, availability of alternate options to meet STD redemptions and propensity of the issuer to rely on STD.

The various forms in which a corporate can provide liquidity backup are:

- Drawing power available against unutilized bank lines
- Investments in liquid mutual funds
- Cash/unpledged fixed deposits in a bank, of similar or higher short-term rating in comparison with the issuer

CRISIL also assesses the quality of the liquidity back-up facility while assigning the short-term rating. For issues that are carved out of existing working capital bank limits, the same would function as a liquidity back-up. For other forms of liquidity back-up facilities, CRISIL looks at the nature and commitment of the facility, its tenure, the strength of the relationship between the issuer and facility provider, and the covenants/restrictions affecting the issuer's ability to access the facility. CRISIL does not insist on a liquidity backup for companies who have availed of only bank facilities.

Liquidity backup for financial sector entities

Financial sector entities (FSEs) typically have superior access to liquidity than entities engaged in manufacturing, trading, and infrastructure do. Hence, CRISIL may not insist on pre-arranged liquidity back-up facility for all classes of financial sector entities. CRISIL's analysis of the liquidity of an FSE involves understanding the extent of mismatches in its asset-liability maturity profiles. CRISIL also considers the liquidity plan presented by the issuer with specific emphasis on its policies regarding maintaining liquid assets on the balance sheet, staggering of the debt maturities so as to avoid bunching up of repayments, and ease of access to systemic liquidity.

- **Banks and primary dealers:** In case of banks and primary dealers (PDs), access to systemic liquidity under the Liquidity Adjustment Facility (LAF) of the RBI and access to unsecured borrowing in the call money markets enable them to be in a comfortable position to manage their liquidity. Hence, CRISIL may stipulate liquidity back up requirements for banks or PDs only in exceptional circumstances. Lack of access to refinance from the regulator and a low long-term rating would typically necessitate a financial sector issuer to provide liquidity backup for availing a CRISIL rating for its confidence sensitive short-term debt instruments.
- **Other financial sector entities (NBFCs, HFCs, FIs):** For NBFCs, HFCs and FIs, CRISIL may not insist on liquidity backup if the issuer is rated "CRISIL AA-" or above on the long-term scale. This is because such highly rated issuers typically follow prudent asset liability management, and enjoy high refinancing ability. However, CRISIL may obtain liquidity backup on a case-to-case basis if it believes that liquidity backup is warranted based on the analysis of the asset quality of the issuer, its asset-liability management (ALM), and the presence of liquid assets to cover asset-liability mismatches. In all cases, however, CRISIL evaluates the liquidity plan articulated by the issuer.

  CRISIL insists on liquidity backup for NBFCs, HFCs, and FIs rated "CRISIL A+" or below. The liquidity backup may be a combination of the following:

- Sanctioned and unutilized bank lines
- Sanctioned and unutilised refinance limits from financial institutions such as RBI, NABARD, NHB, SIDBI, EXIM
- Investments in liquid mutual funds (MFs) or money market instruments
- Investments in listed equity shares subject to suitable hair cuts
- Finance limits provided by parent/group company (rated in at least the 'AA' category)
- Unpledged fixed deposits
- Loan against shares (LAS) facility from a 'AAA' rated NBFC provided it is accompanied by a board resolution and other relevant authorisations required for the facility

Although liquidity back-up facilities are a pre-requisite for rating a CP, CRISIL does not enhance CP ratings based on a liquidity back-up facility. This is because most liquidity back-up facilities are technically revocable by the facility provider, if the credit quality of the issuer deteriorates during the time when the rated instrument is outstanding. In its purest sense, the liquidity facility's purpose is to cover temporary shortfalls in the issuer's cash flows. This means that even the strongest form of backup does not enhance the underlying credit and does not lead to a higher rating than indicated by the company's own creditworthiness. Thus, liquidity back-up facilities provide support only in times of market disruption and not in times of fundamental credit quality

deterioration of the CP or STD issuer. Hence, the presence of a liquidity facility does not, per se, enhance the CP's credit rating. CRISIL enhances short-term ratings only based on unconditional and irrevocable credit-support facilities, which, if available, are evaluated in the next step of the rating process.

Step 6: Evaluate credit enhancement options

Commercial banks may provide back-stop facilities for credit enhancement, such as a standby credit facility. Such facilities provided by banks are distinct from liquidity facilities, and work like a guarantee. Corporate entities may also provide guarantees for a CP issue. A standby credit facility or a guarantee is unconditional and irrevocable and is available under all circumstances to meet the obligations on the issue, if the primary obligor (the issuer) fails to do so. In such cases, the CP/STD rating is generally equated to that of the facility provider irrespective of the issuer's standalone rating.

For more details, please refer to "CRISIL's criteria for rating guaranteed instruments", available on www.crisil.com.

Conclusion

CRISIL assigns short-term ratings to instruments with original contracted maturity of less than one year, like commercial papers and short-term debt. These short-term ratings are derived from the long-term ratings of issuers as per a mapping framework that captures the linkages between long-term and short-term ratings. The mapping is different for financial sector and non-financial sector entities to account for inherent differences in their liquidity profiles. CRISIL also analyses in detail the liquidity position of the issuer to arrive at the exact mapping level as per the mapping framework. CRISIL typically insists on liquidity backup for CPs and STD, except for certain financial sector entities and highly rated issuers with strong liquidity profiles.

Annexure: Computation of short-term debt limits for issuers of CP / STD

For non-financial sector entities

The total amount of rated STD may be the higher of the "Maximum Permissible Short Term Debt" or the total sanctioned bank limits. This ensures that there is adequate liquidity to back up the short term debt.

Maximum Permissible Short Term Debt (MPSTD) = 0.75*EGCA – CL – CPLTD + (90/360)*NCA

EGCA is Effective Gross Current Assets (Current Assets – Loans and Advances to group companies)

CL is Current Liabilities

CPLTD is Current Portion of Long Term Debt

NCA is Net Cash Accruals during the current year

Current ratio is the key driver for determining MPSTD of a company. CRISIL assumes certain target current ratio depending on the credit profile of the issuer while determining the MPSTD.

For NBFCs

The fundamental principle underpinning CRISIL's approach to the permissible short-term debt limit is a comparison between an NBFC's assets and liabilities having a maturity of less than a year. Apart from considering the scheduled maturity profiles of an NBFC's assets and liabilities, CRISIL gives due credence to, inter alia, its refinancing capabilities, its asset quality as reflected in its collection efficiency and delinquency levels, estimated level of prepayment on the loans based on past trends and its unutilised bank.

In the case of NBFCs that have strong credit profiles as evident in their high credit ratings, CRISIL's criteria for computing the short-term debt limit factors in this strength even if there is a mismatch between the maturity profiles of the assets and liabilities in the one-year bucket. This is because of the highly-rated NBFCs' ability to refinance their liabilities. The comfort derived from an NBFC's refinancing capabilities to ensure adequate matching of assets and liabilities reduces in correspondence with its rating.

CRISIL has parameterized this approach by applying a multiple to the level of assets that are expected to mature within one year. Based on this, CRISIL's model for determining an NBFC's maximum permissible short-term debt (STD) limit uses the following algorithm:

Total Permissible STD = Additional permissible STD + Existing STD, where

Additional STD permissible = (Multiplier * Short Term Assets) – Short Term Liabilities

Existing STD = Aggregate of all borrowings with a contracted maturity of less than a year

While arriving at the quantum of maturing assets and liabilities, CRISIL sensitises the NBFC's asset and liability maturity profile for factors such as its collection efficiency, delinquency levels, prepayment levels and the expected trends in these factors, going forward. This is done on the merits of each individual case, based on CRISIL's understanding of the entity's past operations and expected performance.

While an NBFC's permissible short-term debt limit is normally determined through the fundamental principle described above, CRISIL may allow for higher limits to be assigned in the following circumstances:

Availability of unutilized bank lines: In a scenario where an NBFC has unutilized bank lines that are available to meet repayment obligations in the less-than-one-year maturity bucket, the amount of unutilized bank lines is considered as an added comfort while computing the total permissible short-term debt limit. An NBFC can also use the unutilized bank lines to create short-term assets, which can provide an additional cushion to its asset-liability profile.

Growth in short term assets: If an NBFC plans to aggressively increase the level of its short-term assets, CRISIL may appropriately enhance its short-term debt limit based on its estimation of the entity's ability to ramp up its asset base, going forward.

Please refer to Table 2 for an illustration on calculation of total permissible STD for an NBFC.

Table 2: Calculation of NBFC's total permissible STD

Item	Rs. Mn.
Assets maturing in one year (A')	1000
Multiplier (M)	1 #
Assets maturing in one year – sensitized (A = M * A')	1000
Liabilities maturing in one year (B)	750
Gap between assets and liabilities (C = A – B)	250
Existing STD (D)	600 @
Bank lines available (E)	900
Bank lines utilized (F)	450
Unutilized bank lines (G = E – F)	450
Total permissible STD (C + D + G)	**1300**

The multiplier "M" used here reflects CRISIL's estimate of the NBFC's refinancing ability, which is linked to its credit risk profile and indicated by its credit rating. Here "M" is assumed to be = 1.

@ includes bank borrowing and other debt with a contracted maturity of less than one year

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CRISIL Limited: CRISIL House, Central Avenue, Hiranandani Business Park, Powai, Mumbai – 400076. India

Phone: + 91 22 3342 3000 | Fax: + 91 22 3342 3001 | www.crisil.com

/company/crisil @CRISILLimited /CRISILLimited /user/CRISILLimited

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