

## Understanding CRISIL's Ratings and Rating Scales

### ■ Introduction

A CRISIL credit rating indicates CRISIL's current opinion on the rated instrument's 'probability of default'. In other words, the credit rating indicates the probability of the investor receiving the interest and principal payments due on the instrument on time and in accordance with the terms of the initial contract. This probability is reflected in the form of an easily understandable "alphabetical scale" such as AAA, AA, A, BBB and the like.

A credit rating is assigned to debt instruments alone and NOT to equity instruments. Typically, instruments such as non-convertible debentures, partially convertible debentures, bonds, fixed deposits, commercial paper, short-term debt and structured debentures are rated.

A credit rating is NOT a recommendation by the rating agency to invest in any particular instrument. Instead, it is one of the several inputs (such as coupon rate, tenor and redemption pattern) that an investor can consider while making an investment decision. A CRISIL rating is not a recommendation to buy, sell or hold the rated instruments; nor is it a comment on the market price or the suitability of the rated instrument for a particular investor. CRISIL'S rating is based on a qualitative and quantitative analysis of the information provided by the issuer and obtained from other sources considered reliable, and is not an audit of the issuer / company.

Moreover, a credit rating of an instrument does NOT indicate that the recovery of interest and principal is completely certain. There are definitive non-zero probabilities of default for any rating category including the highest one, 'AAA'. For example, if the probability of default of a rating agency's 'AAA' category is 0.1% in three years, it indicates that out of 1000 'AAA' ratings that the agency has assigned, ONE instrument could default on the interest or principal within a period of three years of assigning / reaffirming the rating.

Thus, a credit rating indicates to the investors, the 'ability and willingness' of the borrower to repay the interest and principal amount of the rated instrument on time. The rating agency assigns the rating on the basis of its analysis of the company's business and financial risks as well as on its evaluation of the company's management. Once a rating is assigned and accepted, the rating agency continuously monitors the credit quality of the company and reflects the same periodically through an upgrade, downgrade or reaffirmation of the rating. CRISIL's ratings may be changed, suspended, withdrawn or placed on Rating Watch based on any specific event or events. Accordingly, CRISIL notifies investors of the same from time to time.

### ■ CRISIL's rating scales

CRISIL assigns ratings only to rupee-denominated debt instruments. CRISIL's rating is assigned to the issue or instrument alone and not to the issuer.

Broadly, CRISIL's credit ratings fall under three categories: long-term, short-term and fixed deposit ratings. Long-term instruments include all securities such as debentures and bonds that have an original maturity of more than one year. Long Term rating categories range from AAA to D; CRISIL may apply '+' (plus) or '-' (minus) signs as suffixes for ratings from 'AA' to 'C' to reflect comparative standing within the rating category. In the case of preference shares, the letters 'pf' are prefixed to the long-term rating symbols of such issues.

Short-term instruments refer to securities with an original maturity of upto one year and include commercial paper, short-term debentures and the like. Short Term rating categories range from P1 to P5; CRISIL may apply '+' (plus) sign for ratings from P1 to P3 to reflect a comparatively higher standing within the category. In addition, CRISIL also assigns fixed deposit ratings (with a prefix 'F') to the fixed deposit programmes of corporates, banks and financial institutions. Fixed Deposit rating categories range from FAAA to FD; CRISIL may apply '+' or '-' signs for ratings from FAA to FC to indicate the relative position within the rating category.

*Please refer to end of this booklet for complete Definitions of these rating scales.*

## ■ CRISIL's speculative grade ratings

A clear categorisation of speculative grade ratings is necessary to enable investors to determine the state of the issuer or obligor with reference to his ability and willingness to meet the rated debt obligations on time under various circumstances.

Instruments rated in the 'BB', 'B', 'C' and 'D' categories are regarded as having significant speculative characteristics. While these obligations may have a certain degree of debt protective characteristics, these may be outweighed by large uncertainties or exposure to adverse conditions.

CRISIL's criterion for the lowest rating, Default or 'D', is normally "event-specific": Any delay in the repayment of interest/principal of the rated debt would result in a rating revision to 'D'. **CRISIL applies this definition strictly to all the rated debt instruments** and even a few days' delay on the rated debt would be tantamount to

a downgrade to the Default ('D') rating. The criteria for the 'BB', 'B' and 'C' categories are based on aspects such as solvency and liquidity conditions, long-term business prospects, re-alignment of debt payments and the like.

Instruments rated in the 'C' category indicate a highly-strained financial position of the issuer and in all likelihood, such entities would be defaulting on borrowings other than the rated borrowings. In terms of the business outlook, even if it is positive in the long term, the same may not help the company in recovering from its current financial crisis unless some external support / restructuring or reorganisation materializes.

Instruments rated in the 'B' category indicate a strained financial position and / or weak business prospects of the issuer. The issuer is expected to reschedule forthcoming debt repayments by extending their maturity or may have already initiated the process for the same. CRISIL might also assign a 'B' rating to a long-term instrument where it has doubts over the willingness of the management to honour its obligations.

Instruments rated in the 'BB' category indicate that all repayments of rated as well as unrated paper to all investors are currently being met on time. However, the intrinsic business / financial position has speculative characteristics, which might adversely affect the timely payment of the interest and principal in future.

## ■ CRISIL's ratings in the 'NM' category

CRISIL assigns a "Not Meaningful" (N.M.) rating to outstanding ratings of companies, where the existing rating on the instrument is rendered meaningless. For instance, in the case of instruments that are issued by a company that has been referred to the Board of Industrial and Financial Reconstruction (BIFR) or in other words, has been declared sick, or in a case where the repayment obligation is under dispute in a court or under other similar circumstances, CRISIL would revise the outstanding rating to 'N.M.'

If a corporate is referred to the BIFR, the outstanding rating is not meaningful as the company cannot make any payments towards meeting any of its debt obligations till such time as a revival package is effected by the operating agency. Similarly, cases where the interest / principal is under dispute in a court, no payments can be made until the court delivers a judgement on the specific case.

This category is applicable to all three of CRISIL's credit rating scales: the long-term rating scale, the fixed deposit rating scale and the short-term rating scale.

## ■ CRISIL's ratings for structured obligations

CRISIL assigns "structured obligation" ratings based on the same long-term rating scale ('AAA' to 'D') with a suffix "so" in parenthesis. The assessment for such structured obligations takes into consideration any credit enhancement structure or mechanism that supports the payment of interest and principal on the instrument. Typical structures include:

- Full guarantee by a bank, a corporate or government
- Partial guarantee
- Asset-backed securities such as collateralised debt obligations, auto loan securitisations, mortgage-backed securities, trade receivables and the like
- Future flow structures such as escrow of octroi or property tax receivables, lease receivables and the like

Structured obligation ratings are specific to particular debt instruments. Hence, different debt issues of the same company may carry different "so" ratings depending on the "structure" provided for each instrument. This is unlike long-term ratings, where all long-term issues of a single issuer typically carry the same long-term rating.

CRISIL also assigns 'foreign structured obligations' ratings for rupee-denominated debt obligations of Indian companies that are supported by credit enhancements extended by entities based outside the country. The issues considered while assigning the rating include, inter-alia, the creditworthiness of the offshore entity, the nature and structure of the credit enhancement mechanism to ensure timely payments on the rated debt obligations and regulatory issues regarding the transfer and convertibility risk. At present, there are regulatory controls on inward remittances in India. Since these ratings have been assigned in the current regulatory framework with respect

to the transfer risk, any change thereon could impact the ratings. Also, due to the controls on inward remittances, CRISIL would require a suitable liquidity mechanism to be put in place to ensure the timely payment of the rated obligations.

Foreign structured obligation ratings are based on the same scale ('AAA' to 'D') as CRISIL's ratings for long-term instruments. The suffix 'fso' in parenthesis is added to the long-term scale to denote the foreign structured obligation rating.

## ■ CRISIL's rating for instruments carrying non-credit risk

CRISIL's long-term rating scale addresses credit risk, which represents the possibility of a company not being able to meet its financial obligations on time. CRISIL also rates several debt instruments such as fully-convertible debentures, which contain non-credit risks (such as market risk and liquidity risk). For instance, the returns to an investor in a fully-convertible debenture are based on the market price of the stocks on the date of the conversion. CRISIL does not attempt to estimate such future stock prices and hence, the same are not factored in the rating assigned to such issues. In order to disclose the impact of such non-credit risks to investors in these debt instruments, CRISIL suffixes such ratings with the symbol 'r'. This denotes that the rating does not address the variability of returns, which may arise on account of non-credit risks.

## ■ CRISIL Rating Watch

CRISIL may place a rating under Rating Watch, which lists positive, negative or developing implications, if events have occurred which might affect the accuracy of the rating. An instrument is placed on Rating Watch only when any event that may affect the credit quality of the company occurs, and the impact of which could not be accurately assessed at that point in time. However, a listing under Rating Watch does not imply that a rating will necessarily change. CRISIL may also revise any rating without first placing the rating under Rating Watch.