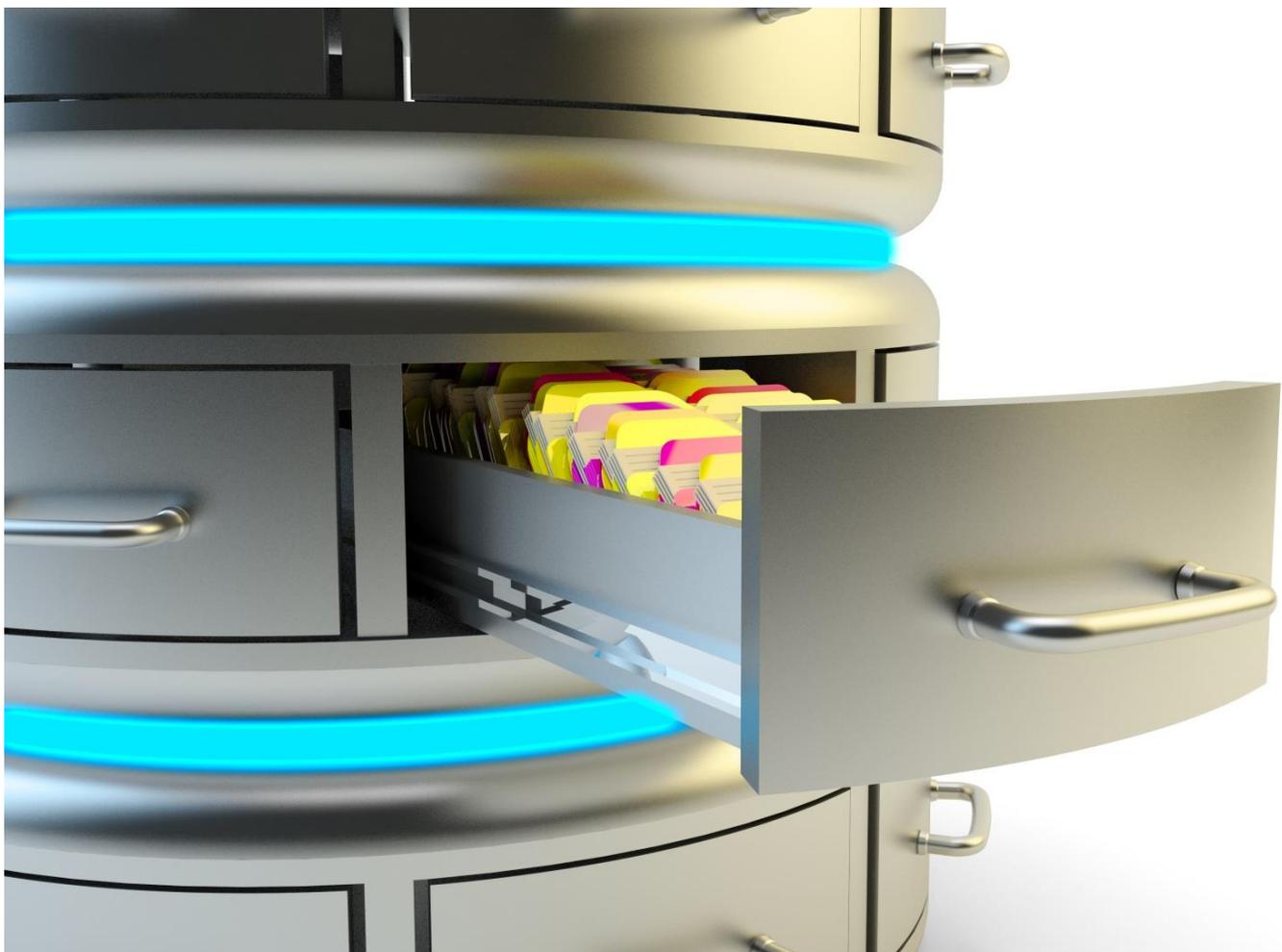


Framework for Assessing Information Adequacy Risk

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Executive Summary

CRISIL's credit ratings on debt obligations represent its opinion on the likelihood of the obligations being repaid in full, and on time. The ratings indicate CRISIL's current opinion on the probability of default on the instruments. It takes into account public and non-public information about the firm to provide a forward-looking assessment of credit quality.

CRISIL believes that investor interest is best served if there is open and transparent information sharing and dialogue between the issuer and CRISIL. This enables CRISIL to incorporate non-public information into its rating decision and also helps it arrive at an independent, forward-looking assessment. CRISIL would like to emphasise that information sharing is not a one-time exercise but is an ongoing and continuous process that is critical to rating surveillance.

Conversely, for issuers who don't share information or engage in interactions with CRISIL, the rating decision is based only on public information, and that, too, only to the extent this information is available to CRISIL. Hence, the rating is based on past performance, lacks a forward-looking flavour, and may not reflect the robustness of ratings that enjoy the benefit of full management cooperation.

It is CRISIL's endeavour to elicit cooperation from issuers for the rating surveillance process to the best possible extent. In this context, CRISIL seeks information required for surveillance on an ongoing basis. If an issuer fails to respond to requests for information, CRISIL categorises the issuer as non-co-operative. This may mean that CRISIL lacks adequate information to rate the issuer, and in such instance, the rating needs to reflect this information adequacy risk.

The Securities and Exchange Board of India's (SEBI) circular, '*Enhanced standards for credit rating agencies (CRAs)*' issued on November 1, 2016, makes it mandatory for CRAs to continue to rate non co-operative issuers on a best effort basis. To highlight the non-cooperation of issuers, SEBI has insisted that all such ratings will use the suffix 'Issuer not cooperating'¹. This represents a change from earlier industry practice of 'Suspension of Ratings'².

CRISIL believes that investors, lenders, and all other market participants should exercise due caution when using the rating assigned/reviewed with the suffix 'Issuer not cooperating'. That's because these ratings lack a forward-looking perspective as they are arrived at without any management interaction, and are based on best available, or limited, or dated, information about the firm.

CRISIL will use a framework to assess the risk of information adequacy when reviewing its rating on non-cooperative issuers. This framework assesses whether the information available about a non-cooperating issuer is commensurate with the rating category. CRISIL believes that for market participants to have sufficient confidence in higher rated credits, ample information about credit risks should be available and incorporated into ratings. In the absence of such information, the confidence of investors and lenders in the credit quality of such issuers wanes. This represents a higher credit risk and this framework will enable CRISIL to incorporate the risk of inadequate information in ratings. Such ratings are unlikely to be in high safety category or above.

¹ SEBI had, in its original circular, directed CRAs to append 'Issuer did not cooperate; based on best available information' with the rating symbol in the same font size for non-co-operative issuers. However, in joint representation to SEBI, CRAs clarified that, for sake of brevity, they will use the suffix 'Issuer not cooperating'. This will be followed by an asterisk mark, which will read as 'Issuer did not cooperate; Based on best available information'.

² As per the previous policy, for issuers who did not co-operate with CRISIL by providing adequate information required for the rating process, the rating was suspended. This was in line with industry practice

For accessing the previous published document on 'Framework for Assessing Information Adequacy Risk', kindly refer to the following link: https://crisil.com/content/dam/crisil/criteria_methodology/basics-of-ratings/archive/Framework%20for%20Assessing%20Information%20Adequacy%20Risk.pdf

Upon applying this framework, if CRISIL determines that the information available is not commensurate with the non-cooperative issuer's existing rating, CRISIL may take appropriate rating action to align the two. As time passes, on account of prolonged non co-operation, adequacy of information may deteriorate further and the rating may be subjected to further changes.

Scope

This article details the criteria for arriving at credit ratings that are commensurate with the extent of information received from issuers that CRISIL categorises as non-cooperative. The criteria, however, will be applicable only to issuers that CRISIL categorises as non-cooperative on account of lack of cooperation in sharing information.

Framework for assessing information adequacy risk

CRISIL, in its assessment of non-cooperative issuers, will take into account three parameters: availability of past information, confidence in future expectations, and stability attributes of the firm's business. While past information reflects the track record of business and financial performance, future expectations guide the likely direction of the firm's performance. Additionally, certain firm- or industry-specific factors may impact stability or volatility of the credit risk profile of the issuer, which needs to be factored into information adequacy risk. Each of these three parameters can be classified as either low (L) or high (H). The following sections explain each in detail:

Availability of past information

CRISIL's assessment of past information includes analysis of business and financial track record. This helps CRISIL ascertain if there have been any developments in recent past that may have a bearing on the firm's credit risk profile. CRISIL assesses past information as 'high' or 'low':

- In business aspects, CRISIL tries to understand, with reasonable clarity, the strategy adopted by the firm in the last 6-12 months in terms of products, markets and raw material sourcing. These determine the volume and cost structure for the firm. CRISIL also tries to understand the capital expenditure (capex) committed by the firm, the funding means, and liquidity levels required to fund working capital requirements. Further, CRISIL checks whether there has been a change in management or in shareholding pattern that may impact strategic intent and future expectation.
- CRISIL utilises the statements for the last completed financial year, as well as the performance during the current financial year, to understand the financial performance of the company. CRISIL also tries to incorporate feedback from bankers and auditors on issuers on a best-effort basis by soliciting their feedback periodically.
- CRISIL accesses publicly available sources such as filings with the Registrar of Companies or with stock exchanges to capture past information on the issuer. CRISIL makes analytical adjustments to the reported financials of rated firms to reflect their accurate financial position and factors them into its analysis. CRISIL also factors in any public information about the track record of debt being serviced in time and in full.

If CRISIL is able to obtain information that will enable it to analyse a firm's performance during the past year with reasonable confidence, this parameter is classified as 'High' (H) else it will be 'Low' (L).

Confidence in future expectations

CRISIL's assessment of future expectations takes into account a company management's publicly stated stance on future expectations, strategic decisions, capex and debt plans. CRISIL relies on management's discussions and analysis, or investor call, or management's articulation in public domain regarding its strategic intent.

CRISIL uses these articulations as well as its view on industry outlook to project financials. If CRISIL believes that it can project the financials with reasonable accuracy, it classifies confidence in future expectations as 'High' (H), otherwise classifies it as 'Low' (L)

Stability attributes

CRISIL assesses the stability attributes of the credit to evaluate if the credit risk profile of the firm is expected to be stable or volatile. The credit risk profile can derive stability from a variety of factors such as stable cash flows (of industry or firm), prudent management and external support. For firms that lack stability attributes either on account of inherent volatility in the industry, or due to firm-specific reasons, the risk of information adequacy can cause sharper changes in ratings if past information or future expectations are already classified as low. CRISIL assesses stability attributes based on the following factors:

- **Cash flow stability:** Stability of cash flows based on cyclicalities in industry or dependence on volatile sources of income (such as proprietary trading for financial institutions)
- **Liquidity position:** Surplus liquidity helps absorb any shortfall or volatility in cash flows. Therefore, a history of maintaining surplus cash liquidity in the past and expectation of it continuing in future is viewed as a positive stability factor. In the case of financial sector issuers, this would mean better matching of assets and liabilities.
- **Management stability:** Management risk profile is considered stable if there is limited churn in middle to top tier management and management has a history of adhering to its articulated medium term strategy.
- **Parent support:** The support, wherever articulated, has been adhered to and there is strong expectation of it continuing in future. However, adequate information of the parent firm should be available. Additionally, if the firm is part of a larger group, the holding structure of the group should be simple and not involve complex cross linkages.

If CRISIL has reasonable confidence on the factors highlighted above, it classifies stability attributes as 'high' (H) else they would be classified as 'low' (L).

Application of framework

Once CRISIL evaluates the three parameters as high or low, it uses the framework highlighted in the table below to ensure that the rating category of a non-cooperative issuer is consistent with the extent of available information. If there is a difference between the two, CRISIL may take appropriate rating action and release the rating rationale in the public domain.

For BB/B rating categories, on account of narrower business profile and limited financial cushion, susceptibility to external events (regardless of industry characteristics) is high. Therefore in absence of financial statements and management access, stability attributes are hard to quantify.

Bucket	Past information	Future expectation	Stability attributes	Action
1	L	L	-	Low past information and future expectation, make the rating consistent usually with 'CRISIL BB' category or lower
2	H	L	L	High past information coupled with low future expectation and stability attributes make the rating consistent usually with 'CRISIL BBB' category or lower
3	H	L	H	High past information and stability attributes coupled with low future expectation, makes the rating consistent usually with 'CRISIL A' category or lower
4	H	H	L	These buckets carry some risk of information inadequacy. Therefore ratings are based on fundamental credit attributes but are usually restricted to 'CRISIL A' category or lower.
5	H	H	H	
6	L	H	L	
7	L	H	H	Unlikely scenario ³

Time value of information adequacy

With each passing year of non-cooperation, past information becomes dated and the confidence on stability attributes of the issuer may wane. That's because the factors that CRISIL had taken into account when arriving at the last rating may have changed significantly. In such cases, unless the issuer turns cooperative, or CRISIL is able to receive adequate information about the issuer from public sources, the extent of available information would deteriorate, ultimately shifting the information adequacy risk to Bucket 1 – leading CRISIL to take appropriate rating action.

Conclusion

CRISIL uses the aforementioned framework to determine whether the information available for a non-cooperative issuer is consistent with its outstanding rating. For this, CRISIL considers three parameters: availability of past information, confidence in future expectations and stability attributes. CRISIL rates these factors as high or low. Depending on the scores on these parameters, CRISIL determines the appropriate rating category. If there is inconsistency between the rating commensurate with the information adequacy framework and the issuer's outstanding rating, CRISIL may take appropriate rating action.

³ An informed view regarding future expectations is highly unlikely without availability of past information; therefore, such a scenario is not envisaged (unless it is a firm incorporated to execute a single project; if such a project falls in bucket 7, its rating can be based on fundamental credit attributes).

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.

About CRISIL Rating

CRISIL Ratings is part of CRISIL Limited ("CRISIL"). We pioneered the concept of credit rating in India in 1987. CRISIL is registered in India as a credit rating agency with the Securities and Exchange Board of India ("SEBI"). With a tradition of independence, analytical rigour and innovation, CRISIL sets the standards in the credit rating business. We rate the entire range of debt instruments, such as, bank loans, certificates of deposit, commercial paper, non-convertible / convertible / partially convertible bonds and debentures, perpetual bonds, bank hybrid capital instruments, asset-backed and mortgage-backed securities, partial guarantees and other structured debt instruments. We have rated over 24,500 large and mid-scale corporates and financial institutions. CRISIL has also instituted several innovations in India in the rating business, including rating municipal bonds, partially guaranteed instruments and microfinance institutions. We also pioneered a globally unique rating service for Micro, Small and Medium Enterprises (MSMEs) and significantly extended the accessibility to rating services to a wider market. Over 1,10,000 MSMEs have been rated by us.

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