

How CRISIL Ratings manages conflict of interest

The ratings division of CRISIL Limited (CRISIL) is segregated into a separate legal entity i.e. CRISIL Ratings Limited (CRL or CRISIL Ratings). CRL is registered with SEBI as a Credit Ratings Agency.

The governance practices and philosophies that were adopted by CRISIL in its credit rating activities will henceforth continue to be adopted by CRL. As India's largest and most influential rating agency, CRISIL has always adopted and pioneered best practices relating to transparency, disclosures and good governance.

In keeping with this tradition, going forward, CRISIL Ratings is pleased to present to all its stakeholders its approach on managing conflicts of interest. While conflicts of interest can never be fully eliminated, CRISIL Ratings firmly believes that they need to, and can, be managed effectively. CRISIL's over 20- year-old track record in credit ratings industry stands testimony to its consistently successful approach in managing such conflicts. The key to managing conflicts lies in adequate disclosures and a strong governance architecture comprising codes of conduct and robust firewall mechanisms. This document outlines the nature of the conflicts that CRISIL Ratings faces and its treatment of them.

1. The nature of the conflict

Two types of conflicts of interest are inherent in the ratings operations. These are:

a) The generic conflict of interest inherent in the "issuer pays" rating business model

Theoretically, this could lead to a rating agency assigning higher ratings than warranted in order to increase its revenues from the issuer. In CRISIL Ratings' opinion however, the benefits of the 'issuer pays' model far outweigh any other business model such as investors or regulators paying for ratings.

Ratings are a tool to increase transparency and efficiency in the debt securities market. A model in which investors pay for the ratings would lead to a situation where ratings would enable some investors (subscribers) to price debt securities correctly. In contrast, the 'issuer-pays' model, where ratings are in the public domain and the information is available to the market as a whole, facilitates the functioning of an efficient market. Hence, the latter approach is preferable as it avoids asymmetry of information between various market participants. Moreover, there is the practical difficulty of often not knowing who the investors are at the time of assigning the rating.

In a 'regulator pays' business model, typically, the regulator will only specify minimum standards for rating agencies. In the current model, research quality standards are determined by market demands while investor needs provide the impetus for improving analytical practices. The continuous improvements in analytical standards that are being witnessed today may thus be impaired in a 'regulator pays' model, which may ultimately reduce the flow of information to the financial markets.

Given these limitations of the investor or the regulator paying for ratings, the 'issuer pays' model has, over time, been accepted globally, and in India, as the most efficient and sustainable business model.

b) Conflict of interest due to non-rating engagements with issuers at a group level

CRISIL is the parent company of CRL. CRISIL (along with its subsidiaries) is a global analytical company which provides Research, Risk, Analytics and Policy Advisory Services.

Other engagements by CRISIL and its other Subsidiaries with rating clients could lead to a perception of more favourable ratings being assigned in order to increase revenues for the other businesses of CRISIL.

CRISIL Ratings believes that conflicts of interests need to be managed well rather than attempt to completely eliminate them. The success of the ratings business model is driven by the credibility enjoyed by the agency in the eyes of investors. Any attempt to assign higher than warranted ratings to issuers will result in a clear loss of credibility. This, in turn, will erode the rating agency's future business from issuers. Hence, this is a strong disincentive for rating agencies to let conflicts of interest undermine their rating decisions.

While conflicts of interest do exist, the onus is on the rating agency to manage these conflicts effectively and to reassure all its stakeholders of its ability to do so.

2. How CRISIL Ratings manages such conflicts

CRISIL Ratings believes that the key to managing conflicts lies in adequate disclosure, effective codes of conduct and strong firewall mechanisms. The measures taken by CRISIL Ratings in each of these areas are outlined below:

a) Transparency and disclosure

CRISIL Ratings believes that transparency and adequate disclosure about its businesses, practices and rating criteria enable the market to assess a rating agency's integrity. If need be, that is, if the market perceives that the integrity of the ratings is being compromised because of business considerations, it can then create appropriate pressure on the agency. To this end, CRISIL Ratings makes the following disclosures:

- i. **Non-ratings activities:** CRL does not intend to carry out any non-rating activities. In its financial results, CRL will disclose its non-ratings businesses and their revenues (if any).
- ii. **Measures to avoid conflict of interest:** CRISIL Ratings discloses the measures that it takes to avoid conflicts of interest. In case CRISIL Ratings and the issuer have any common directors, such directors do not participate in the Rating Committee Meeting and rating process. A disclosure to this effect is also made with the announcement for the rating and the credit rating report.
- iii. **"Issuer Pays" model:** CRISIL Ratings publicly discloses the fact that the issuer pays for the ratings.
- iv. **Multi-layer process:** Each rating assigned by CRISIL Ratings has to pass through multiple iterations in the analytical process and is then brought up before a rating committee comprising eminent and experienced professionals. This ensures that individual biases or shortcomings, if any, do not colour its rating opinions.
- v. **Rating criteria:** CRISIL Ratings disseminates its rating criteria through its website, publications and investor discussions. CRISIL Ratings has published criteria for all the major business segments in the corporate, infrastructure and financial sectors in addition to those for structured finance, mutual funds, etc.
- vi. **Rationale for each rating:** Rating Rationales for all the ratings assigned by CRL are publicly available. CRL's analysts are also accessible for discussions on the rationale of any rating. In addition, CRISIL Ratings organizes seminars and workshops to discuss its criteria and rationale for ratings.
- vii. **Default and transition data:** CRISIL Ratings was the first rating agency in India to publish its default and rating transition data. This data can also be used to validate its rating standards at a broader level.

b) Code of conduct

- i. **Rating fees are not in any way linked to issue success or rating level:** Rating fees are decided upfront before the rating exercise commences. The fee payable to CRISIL Ratings is in no way linked to the rating that is assigned to the instrument nor is there any linkage with the potential success or failure of the proposed issue.
- ii. **Separate business development, criteria and analytical teams:** CRISIL Ratings has separate teams for business development, for developing criteria, and for executing assignments. This ensures that business pressures do not in any manner influence the teams involved in developing rating criteria and in assigning the rating.
- iii. **Analyst compensation is not linked to rating fees:** There is no linkage between the analyst's compensation and the rating fees paid by issuers. This ensures that there is no potential conflict of interest faced by the team undertaking the rating assignment.
- iv. **Team approach to avoid individual bias:** CRISIL Ratings ensures that all rating assignments are conducted in teams and the ratings are assigned by a rating committee and not an individual analyst. This ensures that there is always a second opinion and that individual biases, if any, do not influence the rating committee's decision.
- v. **Ethical business development:** The business development function within CRISIL Ratings adheres to the highest ethical standards. Rating mandates are not solicited by promising or assuring specific ratings to issuers.

c) Firewalls

- i. **Separate Legal Entity:** Ratings business is carried out by a separate legal entity i.e. CRL which only undertakes activities that are approved by SEBI for credit rating agencies.
- ii. **Physical and logical separation between CRL and other CRISIL group companies:** CRL has a dedicated area for its business operations with logical, physical firewalls and access controls that segregate its business operations from all the other businesses of CRISIL.
- iii. **Firewalls to regulate information transfer:** CRL has in place rigorous firewalls and a Confidentiality Policy to ensure that CRL and other businesses of CRISIL and its other subsidiaries do not have access to each other's non-public information. The Policy on firewalls between CRL and Other non-rating entities of the CRISIL group, provides comprehensive guidance to CRL employees on sharing of information with group entities.
- iv. Only employees of CRL or Independent Ratings Committee Members can be members of CRL's rating committee. MD of CRL and any person within CRL who has business responsibility cannot be a part of CRL's rating committee.
- v. Only CRL employees¹ (other than employees who are a part of CRL's Business Development team) are allowed access to rating committees.

CRISIL Ratings ensures that all the ratings are assigned by following the documented ratings process, adhering to the criteria, based on the information provided by the issuers and have not been influenced by any business

¹ Including off-roll personnel

relationship. This exemplifies CRL's commitment to maintaining the integrity of its ratings activity and is perhaps the reason why the market has never felt the need to doubt the credibility of CRISIL Ratings. In fact, third-party surveys, default studies etc. reveal that CRISIL Ratings' is highly regarded by both investors and issuers with respect to their credibility, independence and analytical rigour.

CRISIL Ratings believes that maintaining the credibility of its ratings activity is an ongoing process. CRISIL Ratings remains committed to taking all the necessary steps to insulate its ratings activity from any emerging situation that could create a potential conflict of interest.

In order to disclose this document to the public, this document is available without charge to the public on CRISIL Ratings' [public website](#).

However, by making this document available to the public, CRISIL Ratings does not assume any responsibility or liability to any third party arising out of or relating to the contents of this document. This document shall not form a part of any contract with any third party and no third party shall have any right (contractual or otherwise) to enforce any of this document's provisions, either directly or indirectly. CRISIL Ratings in its sole discretion may revise the contents of this document to reflect changes in market, legal and regulatory circumstances and changes to its controls, policies and procedures.

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About CRISIL Ratings Limited (A subsidiary of CRISIL Limited, an S&P Global Company)

CRISIL Ratings pioneered the concept of credit rating in India in 1987. With a tradition of independence, analytical rigour and innovation, we set 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 35,000 large and mid-scale corporates and financial institutions. We have also instituted several innovations in India in the rating business, including rating municipal bonds, partially guaranteed instruments and infrastructure investment trusts (InvITs). CRISIL Ratings Limited ("CRISIL Ratings") is a wholly-owned subsidiary of CRISIL Limited ("CRISIL"). CRISIL

Ratings Limited is registered in India as a credit rating agency with the Securities and Exchange Board of India ("SEBI").

For more information, visit www.crisilratings.com.

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 through businesses that operate from India, the US, the UK, Argentina, Poland, China, Hong Kong and Singapore.

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.

CRISIL Privacy

CRISIL respects your privacy. We may use your personal information, such as your name, location, contact number and email id to fulfil your request, service your account and to provide you with additional information from CRISIL. For further information on CRISIL's privacy policy please visit www.crisil.com/privacy.