

Importance of Credit Rating and Rating Agencies for Investors in Financial System



Management

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ABSTRACT

Credit rating agencies play an important role in assessing risk and its location and distribution in the financial system. By facilitating investment decisions they can help investors in achieving a balance in the risk return profile and at the same time assist firms in accessing capital at low cost. CRAs can thus potentially help to allocate capital efficiently across all sectors of the economy by pricing risk appropriately. However, in view of the fact that CRAs that rate capital market instruments are regulated by SEBI and that entities regulated by other regulators (IRDA, PFRDA and RBI) predominantly use the ratings, it was felt necessary to institute a comprehensive review of the registration, regulatory and supervisory regime for CRAs. The major motivation for the exercise was to look at inter regulatory coordination so that all interested stake holders have an institutional mechanism for providing inputs feed back to ensure realization of the objective behind the regulation of CRAs. Adding a further dimension to this enquiry, the subprime crisis has attracted considerable adverse attention worldwide on the role of CRAs enhancing the need for this review.

Introduction

A credit rating is technically an opinion on the relative degree of risk associated with timely payment of interest and principal on a debt instrument. It is an informed indication of the likelihood of default of an issuer on a debt instrument, relative to the respective likelihoods of default of other issuers in the market. It is therefore an independent, easy-to-use measure of relative credit risk. Given the universal reliance on rating, and hence the power of the opinion, credit rating is expected to increase the efficiency of the market by reducing information asymmetry and lowering costs for both borrowers and lenders. A simple alphanumeric symbol is normally used to convey a credit rating. Ordinarily the company which issues the debt instrument is not rated. It is the instrument which is rated by the rating agency. But the issuer company which has issued the debt instrument gets strength and credibility with the grade of rating awarded to the credit instrument it intends to issue to the public for raising funds. Though the purpose of rating is to rate instruments, a general perception may be gathered that the organisation issue a highly rated instrument is also sound and a highly rated entity. Thus, credit rating is a mechanism whereby an independent third party makes an assessment, based on different sources of information on the credit quality of the assessed.

Credit Rating Methodology

1.Application

At this stage client's authorized representatives need to register the application officially and to sign an agreement on implementation of rating procedure. At this time company and client's representatives discuss all the questions concerning rating assignment and main aspects of future cooperation.

2.Analytic group

After all the questions are discussed, Credit-Rating agency begins preparation procedure and forms analytic group. Analytic group consists of two or three analysts and group manager (leading analyst) who controls the whole work.

3.Information requirements

To get all the information necessary for analysis, 'Credit-Rating' agency sends a client the letter with information requirements: a list of all the information and documents necessary for credit rating analysis. 'Credit-Rating' guarantees that your confidential information will be kept safe.

4.Meetings with client company managers

Meetings and consultations with client company managers and officials are very important in the process of credit rating assignment. As a rule, we need two or three meetings. In the first meeting analysts would ask questions about financial plans and

further development prospects. This information helps us to remain objective in assessment of client's financial position for the long-term period.

5.Analysis

All the information obtained from a client or other reliable sources is processed with a help of special methodologies, worked out by our agency.

Analysis consists of the following components:

Qualitative analysis – our specialists study management system of the issuer, financial and development plans, conduct SWAT-analysis, pay special attention to documentation, market niche, economic activity.

Quantitative analysis – analysts study accounts coefficients that determine financial activity and financial position of the issuer. We use both standard methods (analysis of internal and external factors, profitability) and special methods worked out by our analysts to determine financial position and development tendencies of the issuer.

Legal analysis – we study financial and economic activity of the issuer to be sure it corresponds to Ukrainian Legislation; analysis also includes studying of management, labor and business relations and legal field of cooperation between central office and affiliates.

After all types of analysis have been conducted, the results are brought together and analytic group sums up pilot analysis. Final meeting with client company managers serves for completing missing information or clearing up some questionable situations. It is necessary for qualified analysis and procession of final analysis results.

Final results represent characteristics of client's business, assessment of its market niche, financial and strategic situation and development trends.

6.Rating committee

Analytic group prepares presentation based on results of analysis and suggests assigning one or another credit rating. The presentation is submitted to rating committee consisting of four or five members. All committee members are qualified in the sphere of client company's activity. Having studied all the materials, rating committee takes a decision about credit rating assignment. A client receives written notice and rating report with detailed grounding of assigned rating.

7.Rating publication

Decision about rating publication is taken by a client individu-

ally. Client may decide not to publish assigned rating. Even if rating is not published the procedure of credit rating assignment remains useful as conclusions of agency analysts written in the rating report may help to determine factors influencing client's credibility. Their improvement in the future may lead to credit rating upgrade. Agency may not submit publication of upgrades/downgrades of once published rating to client's approval.

8. Appeal

If a client thinks that in the process of rating assignment some important factors have not been taken into consideration, client's authorized representatives may appeal to rating committee within the next ten days after rating assignment. The appeal will be accepted only if a client can bring new data and documents that are important for rating procedure. After examination of these documents, credit rating committee will take a decision which cannot be appealed.

Top Credit Rating Agencies in India November 5, 2015

Here is a list of top 10 credit rating agencies in India; these are the best companies in credit rating industry providing risk assessment, ratings and analytic solutions. Ranking process of these credit rating agencies in India is frequently being updated by our expert team.

1 CRISIL Limited

Corporate office – Mumbai, Maharashtra, Establishment – 1987
Business – Credit Rating, Risk & Policy Advisory, Website – www.crisil.com

CRISIL headquartered at Mumbai is India's largest and first credit rating agency; and a global leader in research, ratings and risk & policy advisory services. It is one of the top credit rating agency in India which has won many prestigious awards in the credit rating category and had assessed more than 61000 entities.

2 Credit Information Bureau India Limited -(CIBIL)

Corporate office – Mumbai, Maharashtra, Establishment – 2000
Business – Credit Rating information, Website – www.cibil.com

CIBIL headquartered at Mumbai is an Credit Information Company which maintains records of an individual's payments related to credit cards and loans. The information about users credit cards and loans is later used by the CBIL to generate Credit information reports which are used to approve loan applications.

3 Fitch Ratings India Private Ltd.

Corporate office – New York, USA, Establishment – 1913
Business – Financial Information Services, Website – www.fitch-ratings.com

Fitch Ratings, a Fitch Group company is a among the top credit rating agencies in India incorporated in 1913 in New York, USA. Fitch Ratings provides financial information services in more than 30 countries and has over 2000 employees working at 50+ offices worldwide.

4 Equifax

Corporate office – Atlanta, United States, Establishment – 1899
Business – Credit rating, Website – www.equifax.co.in

Equifax Inc started operations in 1899 and has managed to be among the top credit rating agencies in India and at global level. Equifax Inc provides information management services that process thousands of records of its members which can be used by them for various purposes and to supply risk management solutions, credit risk management and analysis, fraud detection triggers, decision technologies, marketing tools etc.

5 .Credit Analysis & Research Ltd. (CARE)

Corporate office – Mumbai, Maharashtra, Establishment – 1993
Business – Credit Rating, Website – www.careratings.com

CARE Ratings is second-largest among the credit rating agencies in India as far as Indian origin company is concerned. CARE's rating businesses can be divided into various segments like for banks, IPO grading and sub-sovereigns. Company's shareholders includes leading domestic banks and financial institutions in India.

6. ICRA Limited

Corporate office – Gurgaon, Haryana, Establishment – 1991
Business – Investment Information and Credit Rating, Website – www.icra.in

ICRA limited is a joint venture between Moody's Investors and various financial services companies is a part of ICRA group which was founded in 1991. It is a Credit rating agency listed on the National Stock Exchange and Bombay Stock Exchange. ICRA has four subsidiaries ICRA Management Consulting Services Ltd, ICRA Techno Analytics Ltd, ICRA Online Ltd, PT. ICRA Indonesia and ICRA Lanka Ltd.

7 .ONICRA

Corporate office – Gurgaon, Haryana, Establishment – 1993
Business – Research, Risk & Ratings, Website – www.onicra.com

Onicra Credit Rating Agency is a Credit and Performance Rating company based in Gurgaon and founded in 1993. Onicra is among the top 10 credit rating agencies in India offering smart and innovative solutions like risk assessment, analytical solutions and ratings to MSMEs, corporate and individuals.

8.High Mark Credit Information Services

Corporate office – Mumbai, Maharashtra, Establishment – 2005
Business – Financial Services, Website – www.highmark.in

High Mark Credit Information Services is a recognized credit rating company in India. It provides bureau services, analytic solutions and risk management to banks and financial institutions operating in Micro-finance, Retail consumer finance, MSME, Rural & Cooperative Sectors.

9. SME Rating Agency of India Ltd. (SMERA)

Corporate office -Mumbai, Maharashtra, Establishment – 2005 .
Business – Website – www.smera.in

SMERA Ratings Ltd a Mumbai based company now expanded to 13 more locations was founded in year 2005. SMERA a joint venture of SIDBI, several private sector banks in the country and Dun & Bradstreet Information Services India Pvt. Ltd. (D&B). Since 2005 SMERA rated over 23,000 MSMEs pan India.

10. Brickwork Ratings India Private Ltd

Corporate office – Bengaluru, Karnataka, Establishment – 2007.
Business – Website – www.brickworkratings.com

Brickwork Ratings was established in 2007 by Sangeeta Kulkarni as a credit rating firm. The company is registered with SEBI, RBI & NSIC and operates in wide range of areas such as NCD, Bank Loan, Commercial paper, MSME ratings. It is among the leading credit rating companies in India having already rated Rs 200,000 crores of bonds and bank loans. Systemic Importance of Rating and Rating Agencies

Importance of Rating and Rating Agencies

The institution of credit rating as a mechanism for addressing the considerable degree of information asymmetry in the finan-

cial markets has travelled a long way from the times of the US rail road companies in the mid-19th century. The need for an independent rating agency capable of assessing creditworthiness of borrowers was felt when corporate started mobilizing resources directly from savers instead of accessing it through banks which hitherto assumed the credit risk in such cases. The history of systematic credit rating, however, is a century old beginning with rating of US railroad bonds by John Moody in 1909. During this one century of growth and adaptation, CRAs progressed from rating simple debt products to rating complex derivatives to national economies and altered their business models to cover a range of activities/products. There are three major credit rating agencies operating internationally Fitch, Standard and Poor's, Moody's Investor Services: between them they share the bulk of the \$5 billion rating business globally relegating other 60 plus local/regional players into just competitive fringes.

In India, credit ratings started with the setting up of The Credit Rating Information Services of India (now CRISIL Limited) in 1987. CRISIL was promoted by premier financial institutions like ICICI, HDFC, UTI, SBI, LIC and Asian Development Bank. Now CRISIL is an S&P company with a majority shareholding. Apart from CRISIL four more rating agencies have been registered by SEBI in India. These are ICRA, promoted by IFCI and now controlled by Moody's, CARE promoted by IDBI, Fitch India a 100% subsidiary of Fitch, and a new born Brickworks. In India, CRAs that rate capital market instruments are governed by Securities and Exchange Board of India (Credit Rating Agencies) Regulations, 1999. The regulation provides detailed requirements that a rating agency needs to fulfill to be registered with SEBI.

Rating related products and activities

CRAs in India rate a large number of financial products:

1. Bonds/ debentures- [the main product]
2. Commercial paper
3. Structured finance products
4. Bank loans
5. Fixed deposits and bank certificate of deposits
6. Mutual fund debt schemes
7. Initial Public Offers (IPOs)

Non-rating related activities

CRAs often undertake a variety of non rating related activities. These include the following:

1. **Economy and Company Research:** Some Indian CRAs have set up research arms to complement their rating activities. These arms carry out research on the economy, industries and specific companies, and make the same available to external subscribers for a fee. In addition, they disseminate opinions on the performance of the economy or specific industries, available through releases to the media. The research would also be used internally by the rating agencies for arriving at their rating opinions. SEBI permits CRAs to carry out this activity subject to relevant firewalls.

2. **Risk consulting:** With the application of Basel II regulations for banks, there is considerable demand for tools and products that will allow banks to compute their capital adequacy ratios under the revised guidelines. The risk consulting groups of credit rating agencies would leverage the agencies' understanding of credit risk to develop and provide the tools and data that bank would require. The products in this area include tools for internal ratings, operational risk evaluation, and overall capital calculation.

3. **Funds research:** Some CRAs have diversified from mutual fund ratings into mutual fund research. The services that are available under this head include fund rankings, performance attribution tools (to help users understand the reasons for funds' performance), desktop tools, and fixed income research.

4. **Advisory services:** CRAs offer various kinds of advisory services, usually through dedicated advisory arms. Most of this is in the nature of developing policy frameworks, bid process management, public private partnership consulting, and creating an enabling environment for business in India and globally.

5. **Knowledge Process Outsourcing:** Some Indian CRAs (CRISIL and ICRA) have KPO arms that leverage their analytical skills and other process and manpower capabilities. These arms provide services to the CRAs' affiliates in developed markets, and also to other clients outside India.

CONCLUSION

It is an undisputed fact that CRAs play a key role in financial markets by helping to reduce the informative asymmetry between lenders and investors, on one side, and issuers on the other side, about the creditworthiness of companies (corporate risk) or countries (sovereign risk). An investment grade rating can put a security, company or country on the global radar, attracting foreign money and boosting a nation's economy. Indeed, for emerging market economies, the credit rating is key to showing their worthiness of money from foreign investors. Credit rating helps the market regulators in promoting stability and efficiency in the securities market. Ratings make markets more efficient and transparent.

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