

Role of Credit Rating Agencies in India

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ABSTRACT

Credit rating is the symbolic indicator of the current opinion of rating agencies regarding the relative capability of issuer of debt instrument, to service the debt obligations as per contract .The credit rating agencies today have ample opportunities to play a unique role in strengthening the capital market and building the investors' confidence in the financial system. Credit Rating Agencies use their understanding of companies business and operations and their expertise in building frameworks for relative evaluation, which are then applied to arrive at performance grading of various instruments of the companies, without disclosing the private information of the issuer companies. A rating is one of the inputs that are used by the investors to make an investment decision. Credit rating facilitates the borrower company or the issuer of securities to mobilize savings from the prospective investors. Rating helps investors to compare the issues by providing them a short and clear guide. A fair and impartial rating motivates the investors to invest their savings in various securities. In this paper an attempt is made to introduce the role and importance of credit rating agencies in Indian economy.

1. Introduction

A Credit Rating is an opinion of an agency on future ability of the issuer or borrower to make timely payment of principal & interest. According to the European Parliament Council on credit rating agencies (2009) "A credit rating can be defined as an opinion regarding the creditworthiness of an entity, a debt or financial obligation, debt security, preferred share or other financial instrument, or of an issuer of such a debt or financial obligation, debt security, preferred share or other financial instrument, issued using an established and defined ranking system of rating categories". Similar definitions of credit ratings are given by other authorities also like Capital Market Division, Ministry of Finance (2009) "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." Jakob - de Haan and Fabian Amtenbrink (2011) commented on the scope of credit ratings by stating "A rating only refers to the credit risk;

other risks, like market risk (the risk due to unfavorable movements in market prices) or liquidity risk (the risk that a given security or asset cannot be traded quickly enough in the market to prevent a loss) are not covered." Therefore credit ratings measure the credit risk associated with an issuer. The credit rating agencies in India are regulated by the Securities and Exchange Board of India under the SEBI (Credit Rating Agencies) Regulations, 1999 of the Securities and Exchange Board of India Act, 1992. According to Section 2 (1) (h) of SEBI (Credit Rating Agencies) Regulations, 1999, Credit Rating Agency means a body corporate which is engaged in, or proposes to be engaged in, the business of Rating of securities offered by way of public or rights issue. This definition states that the primary objective/function of Rating Agency is Rating of securities issued by the companies and/or offered to general public.

1.1. Definitions

Some important definitions of credit rating given by various national and international rating agencies are as under:

| Moody's Investor Service | ICRA | CARE |
|--|---|--|
| "Ratings are designed exclusively for the purpose of grading bonds according to their investment qualities". | "Credit rating is a simple and easy to understand symbolic indicator of the opinion of a credit rating agency about the risk involved in a borrowing programme of an issuer with reference to the capability of the issuer to repay the debt as per terms of issue. This is neither a general purpose evaluation of the company nor a recommendation to buy, hold or sell a debt instrument". | "Credit rating is essentially, the opinion of the rating agency on the relative ability and willingness of the issuer of a debt instrument to meet the debt service obligations as and when they arise". |

2. Credit rating Agencies in India - Overview

In India, the first credit rating agency- The Credit Rating Information Services of India 'CRISIL' was established & promoted by State Bank of India (SBI), erstwhile Industrial Credit and Investment Corporation of India Limited ICICI, Unit Trust of India Limited UTI, Housing Development Finance

Corporation Limited(HDFC), Life Insurance Corporation of India LIC and Asian Development Bank in 1987. In 1991, Investment Information and Credit Rating Agency of India Limited(now ICRA) was established by a group of Indian Banks & Financial Institutions. Similarly in 1994, IDBI & CANARA Bank started Credit Analysis & Research Ltd CARE. In 1996,

first international Credit Rating Agency, Duff & Phelps Credit Rating Co. opened its subsidiary in India. Soon many International Credit Rating Agencies started acquiring stakes of the Indian Credit Rating Agencies. E.g. Standard & Poor's Rating Services acquired stakes in CRISIL (1997), Moody's Investors Service in ICRA (1998) and Fitch International in Duff & Phelps India (1999). In 2013, India has 5 SEBI registered & RBI approved Credit Rating Agencies - CRISIL, ICRA, CARE, Fitch India Rating and Brickwork. These rating agencies rate variety of financial products like corporate bonds, commercial papers, insurance, mutual funds, SME, SSI, IPO, Corporate Governance, Structured Products, Micro Finance, Infrastructure products etc. In India, apart from the major 5 Credit Rating Agencies, SME Rating Agency of India Limited - SMERA and Micro-Credit Rating International Ltd - MCRIL are two specialized Credit Rating Agencies established for Small & Medium Enterprises and Micro Credit respectively. In India, rating agencies are governed by multiple regulators e.g. SEBI has regulations regarding use of Credit Rating Agencies to rate Capital Markets Instrument, RBI for Banks, IRDA for Insurance companies, PFRDA for pension funds etc. In 1999, Securities and Exchange Board of India SEBI was one of the first regulators to introduce regulations relating to Credit Rating Agencies - SEBI (Credit Rating Agencies) Regulations, 1999. The regulation provided detailed requirements for registration of rating agency. In the view of global financial crises, the SEBI modified regulations relating to Credit Rating Agencies in 2010. To bring more transparency in the system, SEBI made various disclosures and audit compulsory for all Indian Credit Rating Agencies. Due to implementation of Basel second in Indian Banks, the business of Rating Agencies has flourished. For instance on September 30th 2012 CRISIL rated 10,542 firms in comparison of 783 firms four years ago.

3. Role of Credit Rating Agencies

Credit rating industry has assumed a significant position in the financial market Operations during the last two decades. This has been reflected in the proliferation of credit rating services in a variety of fields. Initially, credit rating was restricted to debt instruments such as bonds debentures and fixed deposits. Over time, rating services spread their wings across the domain of instrument rating and now it covers issuers as well. Besides, certain special types of rating products such as sovereign rating, corporate governance ratings, and ratings of states have been devised by CRAs. Healthcare rating, educational institution rating, real estate rating and social rating are some of the instances of organization rating. Thus, there is hardly any sector where rating agencies have not marked their presence. Among the numerous rating products, only a handful is mandated by our financial market regulators. Initial Public Offer, mutual fund, plantation, debentures, bonds, SMEs and few other instruments are to be compulsorily rated. Barring these, most of the ratings are requested voluntarily. Mandated ratings earn CRAs the largest chunk Of revenue from ratings. The non-mandated rating products, which are mostly customized, account for relatively less amount of revenue for the CRAs.

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 'in formed' 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 organization 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 fifteen sources of information on the credit quality of the assessed.

4. Following are the Major Credit Rating Agencies in India

Credit Rating Information Services of India Limited (CRISIL)

The Credit Rating Information Services of India Limited 'CRISIL', the first rating agency in India, was promoted in 1987 by Industrial Credit and Investment Corporation of India Limited ICICI and Unit Trust of India UTI. Other shareholders include ADB, LIC, SBI, HDFC, General Insurance Corporation of India and its subsidiaries, Standard Chartered Bank, Banque IndoSuez, Sakura Bank, Bank of Tokyo, Hong Kong and Shanghai Banking Corporation, Citibank, Grindlays Bank, Duetsche Bank, Society Generale, Banque National de Paris, Bank of India, Bank of Baroda, UCO Bank, Canara Bank, Central Bank of India, Allahabad Bank, Indian Overseas Bank, Vysya Bank Ltd. and Bank of Madura Ltd. The main businesses of CRISIL are ratings and risk assessment, research and advisory. CRISIL is a pioneer in credit rating and the only credit rating agency in the country to operate on the basis of sectoral specialization. CRISIL provides rating and risk assessment services to manufacturing companies, banks, Non - banking financial companies, financial institutions, housing finance companies, municipal bodies and companies in infrastructure sector. It rates long-term instruments such as debentures, bonds, preference shares, structured obligations, fixed deposits, commercial papers and short-term deposits. It makes credit assessments of various entities including state governments and subsidiaries and joint ventures of multinationals. It also assigns ratings of financial strength to insurance companies. 'CRISIL' has developed several structured ratings for multinational corporations based on guarantees and letters of comfort from the parent companies as well as standby letter of credit arrangements from bankers.

Investment Information and Credit Rating Agency of India Limited (ICRA)

ICRA- Limited (formerly known as Investment Information and Credit Rating Agency of India Ltd) was set up in 1991 by leading financial/ investment institutions, commercial banks and financial services companies. As on March 31, 2011,

international credit rating agency Moody's Investors Service holds twenty nine percentage in the company. Besides ratings, ICRA also offers consulting services, IT-based services, information services, and outsourcing services. One of the leading credit rating companies in India ICRA is one of the leading Credit Rating Agencies in the country. It has been in the ratings business for more than two decades. The company rates rupee-denominated debt instruments issued by manufacturing companies, commercial banks, non-banking finance companies, financial institutions, public sector undertakings and municipalities, among others. ICRA also rates structured obligations and sector-specific debt obligations such as instruments issued by power, telecom and infrastructure companies. ICRA also offers grading services for initial public offers IPOs, microfinance institutions MFIs, construction entities, real estate developers and projects, healthcare entities and maritime training institutes.

Credit Analysis and Research Limited (CARE)

The Industrial Development Bank of India (IDBI) jointly with CANARA Bank, UTI, private sector banks and financial services companies promoted the Credit Analysis & Research Institution to offer Credit rating information and equity research services to the Indian industry and business institutions. CARE was incorporated on April 21, 1993 as a credit rating information and advisory services company. It commenced its operations on October 1993. CARE undertakes ratings of all types of debt instruments like commercial paper, fixed deposits, bonds, debentures and structural obligations, involving an independent and professional assessment of debt servicing capabilities of companies CARE has been registered with SEBI under SEBI (Credit Rating Agencies) Regulations, 1999. It assigned its first rating in November 1993. Its rating coverage extends beyond industrial companies to include

public utilities, financial institutions, infrastructural projects special purpose vehicles, state governments and municipal bodies. Apart from credit ratings, CARE prepares credit reports on specific requests from the banks or business partners, conducts sector studies and provides advisory services in the areas of financial restructuring, valuation and credit appraisal systems. The government also seeks assistance from CARE in equity valuation of a number of state-owned companies and for suggesting divestment strategies for these companies. The clientele of CARE includes some of the largest private sector manufacturing and financial services companies. The following table illustrates the ratings symbols for CARE.

Fitch Ratings India Ltd

Duffs and Phelps Credit Rating India Private Ltd was the first joint venture rating company promoted by JM Financials, Alliance Group and the international rating agency. Duffs and Phelps. Established in 1995, Duff and Phelps offered a wide range of services including rating services and advisory services. With the acquisition of Duff and Phelps Credit Rating Company in April 2000 by Fitch Ratings, Duff and Phelps Credit Rating India Private Limited became Fitch India Limited. Fitch Ratings was founded in 1913 as Fitch Publishing Company by John Knowles Fitch. In 1924, Fitch introduced a ratings scale to meet the growing demand for independent analysis of financial securities. Fitch was one of the three rating agencies that were first declared as nationally recognized statistical rating organizations by the Securities and Exchange Commission in 1975. In 1997, Fitch merged with IBCA Limited Through this merger, Fitch came to be owned by Fimalac SA, a holding company that acquired IBCA in 1992. The merger represented the first step in Fitch's plans to meet investor's need for an alternative global and complete service rating agency.

TABLE NO.1
Comparison of symbols used by Indian Credit Rating Agencies for Long-term Debt Investment

| CRISIL | ICRA | CARE | FITCH | Explanation of Rating |
|-------------|------|----------|-----------|-----------------------|
| LAAA | AAA | CARE AAA | AAA (Ind) | Highest Safety |
| LAA | AA | CARE AA | AA (Ind) | High Safety |
| LA | A | CARE A | A (Ind) | Adequate Safety |
| LB | BBB | CARE BBB | BBB (Ind) | Moderate Safety |
| Speculative | | | | |
| LBB | BB | CARE BB | BB (Ind) | Inadequate Safety |
| LB | B | CARE B | B (Ind) | Risk prone |
| LC | C | CARE C | C (Ind) | Substantial Risk |
| LD | D | CARE D | D (Ind) | Default |

5. Conclusion

Thus, Credit Rating Agencies play a pivotal role as information provider and thereby facilitate the flow of capital for businesses that need it, whether they are small private firms or larger companies. The issue of securities with good credit

rating made by the firms guarantees its subscription. In addition to this, credit ratings are used as critical inputs in determining investment portfolio by the developed countries.

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