

Frequently Asked Questions on Credit Rating Agencies (“CRAs”)

Disclaimer: These FAQs are prepared with a view to guide market participants on SEBI (Credit Rating Agencies) Regulations, 1999 (“CRA Regulations”). For full particulars of laws governing the Credit Rating Agencies (CRAs), please refer to the Acts/Regulations/Guidelines/Circulars etc. appearing under the Legal Framework Section of SEBI website i.e. www.sebi.gov.in. Any queries about the CRA Regulations can be addressed to the Department of Debt and Hybrid Securities, SEBI.

1. What is a Credit Rating Agency (CRA)?

SEBI (Credit Rating Agencies) Regulations, 1999 define a "credit rating agency" as a body corporate which is engaged in, or proposes to be engaged in, the business of rating of securities that are listed or proposed to be listed on a stock exchange recognized by the SEBI.

2. What is a credit rating?

A credit rating represents the rating agency's opinion on the likelihood of a rated debt obligation being repaid in full and on time. Credit rating is therefore an assessment of the probability of default on payment of interest and principal on a debt instrument.

3. What does a credit rating NOT convey?

Credit ratings are not a recommendation to buy, hold or sell a debt instrument. Further, a credit rating merely provides an additional input to the investor and the investor is required to make her or his own independent and objective analysis before arriving at an investment decision. Moreover, specific credit rating opinions are not intended to measure many of the other factors that fixed-income investors must consider in relation to risk - such as liquidity risk, pre-payment risk, interest rate risk, risk of secondary market loss, or exchange loss risk.

4. How does a CRA differ from a credit bureau?

A credit rating agency provides an opinion relating to future debt repayments by borrowers. A credit bureau provides information on past debt repayments by borrowers.

5. Who regulates CRAs?

Credit ratings of securities that are listed, or proposed to be listed, on a recognized stock exchange, and other credit ratings that are required under various SEBI Regulations or circulars thereunder are regulated by SEBI. CRAs also undertake rating of financial instruments under the respective guidelines of other financial sector regulator or authority such as the Reserve Bank of India (RBI). Illustratively, RBI accredits CRAs for credit ratings of bank loans / facilities, authorizes CRAs for independent credit evaluation of resolution plans and approves CRAs for rating of public deposits raised by NBFCs.

6. Whether the issuer company is rated or the instrument?

Credit ratings are typically assigned to a security or an instrument. However, in certain cases, a credit rating may be assigned to an issuer company. In public releases of credit ratings by CRAs, CRAs make a distinction between issuer ratings or corporate credit ratings and instrument ratings or issue ratings.

7. What are the common factors that are taken into account while awarding the credit rating?

Ratings are based on a comprehensive evaluation of the strengths and weaknesses of the company fundamentals including financials along with an in-depth study of the industry as well as macro-economic, regulatory and political environment.

Each credit rating agency may have its own set of criteria and different weight age for each component for assigning the ratings. Some of the common factors that may be taken into consideration for credit rating are Issuer Company's operational efficiency, financials, competence and effectiveness of management, past record of debt servicing, etc.

8. How is a credit rating denoted?

SEBI circular dated June 15, 2011 captioned, “Standardisation of Rating Symbols and Definitions” has standardized common rating symbols and their definitions. For instance, rating symbols and definitions for long term debt securities (i.e. those with original maturity exceeding one year) have been standardized as under:

Rating symbols should have CRA’s first name as prefix

AAA - Instruments with this rating are considered to have the highest degree of safety regarding timely servicing of financial obligations. Such instruments carry lowest credit risk.

AA - Instruments with this rating are considered to have high degree of safety regarding timely servicing of financial obligations. Such instruments carry very low credit risk.

A - Instruments with this rating are considered to have adequate degree of safety regarding timely servicing of financial obligations. Such instruments carry low credit risk.

BBB - Instruments with this rating are considered to have moderate degree of safety regarding timely servicing of financial obligations. Such instruments carry moderate credit risk.

BB - Instruments with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations.

B - Instruments with this rating are considered to have high risk of default regarding timely servicing of financial obligations.

C - Instruments with this rating are considered to have very high risk of default regarding timely servicing of financial obligations.

D - Instruments with this rating are in default or are expected to be in default soon.

Modifiers {"+" (plus) / "-"(minus)} can be used with the rating symbols for the categories AA to C. The modifiers reflect the comparative standing within the category.

Plus and minus symbols are used to indicate finer distinctions within a rating category. The minus symbol associated with ratings has no negative connotations. In fact, ratings in a higher rating category such as “AA-“ are stronger than ratings in a lower rating category such as ‘A+‘.

9. Who pays for the credit rating?

In India, the debt issuing entity pays for the credit rating. The practice is termed as “issuer-pays” model.

10. Does SEBI have a role in the rating exercise?

No. SEBI does not play any role in the assessment made by the rating agency. The rating is intended to be an independent, unbiased and professional opinion of the rating agency.

11. Is rating a one-time exercise?

No. To protect the interest of investors, SEBI has mandated that credit rating agency shall, during the lifetime of the securities rated by it, continuously monitor the rating of such securities and carry out periodic reviews of all published ratings. However, ratings may be withdrawn before the debt is fully repaid or extinguished under certain situations and fulfilment of conditions prescribed by SEBI.

12. What kind of responsibility or accountability will attach to a rating agency if an investor, who makes his investment decision on the basis of its rating, incurs a loss on the investment?

A credit rating is a professional opinion given after studying all available information at a particular point of time. Nevertheless, such opinions may prove wrong in the context of subsequent events. There is no contract between an investor and a rating agency. The investor is free to accept or reject the opinion of the agency.

13. From where can the credit ratings of instruments be obtained?

Credit ratings assigned by the credit rating agencies to various instruments are made available by the agencies through press releases and on their respective websites. The same are also available in the prospectus or the offer document of the issuer company and in media advertisements.

14. What does a rating downgrade indicate?

Rating is monitored throughout the life of the instrument. A downgrade in the rating indicates that the risk of default of the instrument is higher than what was earlier predicted.

15. Why do ratings change?

Rating is an opinion based on data and information available at a point in time with the rating agency and expectations made on the basis of such information by the

agency. However, data or information can change significantly over time causing the rated instruments' performance to deviate from the earlier expectations thereby affecting the future repayment abilities and thus, requiring the rating to be altered.

16. How can an investor know if a credit rating agency has changed its rating?

The credit rating agencies are required to continuously monitor the ratings assigned by them to a particular instrument. In case of any changes in the ratings so assigned, the agencies are required to disclose the same through press releases on their respective websites.

17. What are the measures taken by SEBI in strengthening credit rating?

SEBI has, from time to time, taken several steps to strengthen the process of credit rating. SEBI directives inter alia require the credit rating agencies to be transparent and disclose to the public the information which may have a material bearing on the ratings, any sources of conflicts of interest while undertaking the rating exercise, rating methodology, rationale of the ratings, etc.

18. What is "Issuer Not Cooperating (INC)"?

In case the rated entity does not cooperate with the CRA (for instance, does not provide information required for rating, non-payment of fees for conducting surveillance, etc.), that entity may be classified as Issuer Not Cooperating (INC). Majority of such non-cooperating clients are unlisted entities or borrowers. For entities classified as INC, CRAs will continue to review the ratings on an ongoing basis throughout the instrument/facility's lifetime, on the basis of best available information.

19. Where can an investor look out for more information on CRAs registered with SEBI?

For more information on CRAs, one can refer to the following:

a) SEBI website (www.sebi.gov.in)

- Regulatory framework including CRA Regulations ([link](#)), circulars issued thereunder
- List of registered CRAs ([link](#))

b) RBI website (www.rbi.org.in)

- List of RBI-accredited or eligible CRAs for risk weighting of banks' claims for capital adequacy purposes ([link](#) – Para 6.1.2)
- RBI-approved credit ratings and minimum investment grade ratings for public deposits by NBFCs ([link](#))
- Independent credit evaluation (ICE) of the residual debt by credit rating agencies (CRAs) specifically authorised by the Reserve Bank ([link](#) – Para 14)

c) Stock Exchanges and Depositories website

- Disclosures made by CRAs

d) Website of the respective CRA

- Information about the CRA
- Disclosures made by the CRA, including FAQs on ratings, disclosures on rating process and methodologies, etc.

20. How can investors redress their complaints against CRAs?

Investors should first approach the concerned CRAs with their complaint.

If the complaint remains unresolved, the investors may approach the respective regulator or authority, for instance:

- RBI – for complaints pertaining to rating of bank loans/ facilities, independent credit evaluations of residual debt or ratings of Resolution Plans (RPs), and deposits raised by NBFCs, etc.
- MCA – for complaints pertaining to ratings of public deposits raised by corporates, etc.
- SEBI – for complaints pertaining to ratings of securities that are listed or proposed to be listed on a recognized stock exchange. SEBI has a web based centralized grievance redress system called SEBI Complaint Redress System (SCORES) available at <http://scores.gov.in> where investors can lodge their complaints against CRAs.

21. Is there a need to appoint a compliance officer?

CRA Regulations require a compliance officer to be appointed by the CRA. Every CRA shall appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions etc. issued by SEBI or the Central Government. (Regulation 20A of CRA Regulations).