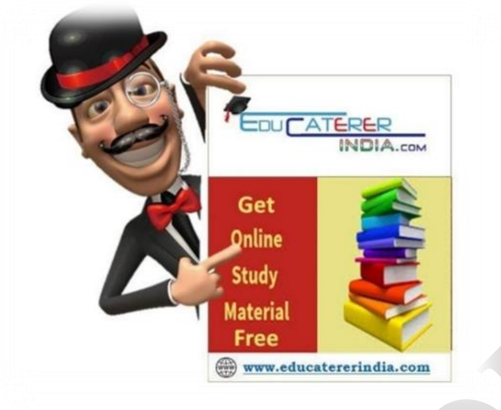
Credit Rating – Scale, Scores and Agencies



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'Credit Rating' is a very important topic from Bank interview's point. Of course, it is quite possible that questions may be asked in the written examination – but when it is an interview, knowledge about this particular area is a must in your arsenal!

1. Credit Rating

'Credit rating' the assessment of the creditworthiness of a borrower or a loan taker; creditworthiness refers to the ability of a borrower to 'service the loan', i.e., pay back the loan along with the interest.

2. How is it done?

Assessment of creditworthiness and subsequently the rating of a borrower can be made in general terms on his business as a whole to project a favourable image to the industry at large.

Or it can be undertaken at the request of the borrower specifically with respect to a particular debt or financial obligation, or for the purpose of applying for a fresh loan.

The entity which wants the credit rating done – it can be the Bank too, which before it approves a loan wants to know the creditworthiness of the prospective borrower, or the borrower itself – pays to the rating agencies for their services.

3. How are the ratings done?

- The rating agencies conduct their procedures to gauge the credit worthiness of the entity with due diligence based on latest industry standards, requirement, economic and financial climate and the entity's own past and present performances and expected/viable future plans, etc.
- The borrower/entity will always want to have the highest possible credit rating; the lender/bank will expect an average rating!

It is the job of the credit rating agency to strictly adhere to objectivity in attaching a particular rating to an entity.

4. Implications of 'rating'.

- Ratings have an impact on the interest rates charged by the lenders/Banks.
- Higher credit rating means – the borrower is highly creditworthy – that he/it is in a comfortable position with regards to his/its business operations and will generate enough turnover/adequate cash flow/income/profit from the regular business, in the foreseeable future to be able to service the loan/debt without any default. -Since a higher credit rating means lower chances of 'default', banks charge a lower rate of interest on such accounts.
- The opposite is true as well. Where the credit rating is lower – the risk of the borrower defaulting is higher – which is why the banks charge higher rate of interest!
- Thus from a borrower's point of view higher rating and lower interest is preferable! Whereas banks go for a break even on risk and return!
- Thus if you are asked in an interview – how are credit rating and interest rate related – your answer should be – they are 'inversely related'! (Like a boss! And you can also explain it in brief – higher credit rating = lower interest rate!)

5. Which are the credit rating agencies?

In India the most popular credit rating agencies are:

i. **CRISIL** – Credit Rating Information Services of India Ltd.
HQ in Mumbai/ Subsidiary of Standard and Poor's

ii. **CARE** – Credit Analysis and Research Limited
HQ in Mumbai

iii. **ICRA Ltd.** – Indian Credit Rating Agency Ltd.
HQ in Gurgaon/ An Associate of Moody's

iv. **India Ratings** – India Ratings and Research Pvt. Ltd.
HQ in Mumbai.

v. **Brickwork Ratings India Pvt. Ltd.**
HQ in Bengaluru.

vi. **SMERA – SME Ratings Ltd.** – set up for Micro, Small and Medium Enterprises.
HQ in Mumbai.

RBI allows the usage of ratings by these rating agencies for assigning Risk Weights in calculating 'Risk Weighted Assets'.
Important to also know – that in India the Credit rating agencies (CRA) are regulated by SEBI.

Internationally there are:

- Standard and Poor's (New York, USA)
- Moody's (New York, USA)
- Fitch Group (dual HQ – London and New York)

6. What are the ratings? How are they denoted?

Credit rating agencies typically assign letter grades to indicate ratings.

For Long-term loans the rating symbols are as follows:

- AAA – highest degree of safety – lowest credit risk
- AA – high degree of safety – low credit risk
- A – adequate degree of safety – low credit risk
- BBB – moderate degree of safety – moderate credit risk (the above four are 'Loan Worthy Ratings')
- BB – Moderate risk
- B – High risk
- C – Very High risk
- D – Default – they are already defaulting!

For short term loans the rating symbols are as follows:

- A1 – strong degree of safety – lowest credit risk
- A2 – strong degree of safety – low credit risk
- A3 – moderate degree of safety – credit risk higher than A1 and A2
- A4 – minimal degree of safety – high credit risk
- D – Defaulting already and expected to default