Credit rating -the concept and objective of credit rating:

Definition of 'Credit Rating'

Definition: Credit rating is an analysis of the credit risks associated with a financial instrument or a financial entity. It is a rating given to a particular entity based on the credentials and the extent to which the financial statements of the entity are sound, in terms of borrowing and lending that has been done in the past.

Description: Usually, is in the form of a detailed report based on the financial history of borrowing or lending and credit worthiness of the entity or the person obtained from the statements of its assets and liabilities with an aim to determine their ability to meet the debt obligations. It helps in assessment of the solvency of the particular entity. These ratings based on detailed analysis are published by various credit rating agencies like Standard & Poor's, Moody's Investors Service, and ICRA.

Benefits of Credit Rating to Investors:

Helps in Investment Decision : Credit rating gives an idea to the investors about the credibility of the issuer company, and the risk factor attached to a particular instrument. So the investors can decide whether to invest in such companies or not. Higher the rating, the more will be the willingness to invest in these instruments and vise-versa.

Benefits of Rating Reviews : The rating agency regularly reviews the rating given to a particular instrument. So, the present investors can decide whether to keep the instrument or to sell it. For e.g. if the instrument is downgraded, then the investor may decide to sell it and if the rating is maintained or upgraded, he may decide to keep the instrument until the next rating or maturity.

Assurance of Safety : High credit rating gives assurance to the investors about the safety of the instrument and minimum risk of bankruptcy. The companies which get a high rating for their instruments, will try to maintain healthy financial discipline. This will protect them from bankruptcy. So the investors will be safe.

Easy Understandability of Investment Proposal : The rating agencies gives rating symbols to the instrument, which can be easily understood by investors. This helps them to understand the investment proposal of an issuer company. For e.g. AAA (Triple A), given by CRISIL for debentures ensures highest safety, whereas debentures rated D are in default or expect to default on maturity.

Choice of Instruments : Credit rating enables an investor to select a particular instrument from many alternatives available. This choice depends upon the safety or risk of the instrument.

Saves Investor's Time and Effort : Credit ratings enable an investor to his save time and effort in analyzing the financial strength of an issuer company. This is because the investor can depend on the rating done by professional rating agency, in order to take an investment decision. He need not waste his time and effort to collect and analyse the financial information about the credit standing of the issuer company.

Benefits of Credit Rating to Company:

Improves Corporate Image : Credit rating helps to improve the corporate image of a company. High credit rating creates confidence and trust in the minds of the investors about the company. Therefore, the company enjoys a good corporate image in the market.

Lowers Cost of Borrowing : Companies that have high credit rating for their debt instruments will get funds at lower costs from the market. High rating will enable the company to offer low interest rates on fixed deposits, debentures and other debt securities. The investors will accept low interest rates because they prefer low risk instruments. A company with high rating for its instruments can reduce the cost of public issue to raise funds, because it need not spend heavily on advertising for attracting investors.

Wider Audience for Borrowing : A company with high rating for its instruments can get a wider audience for borrowing. It can approach financial institutions, banks, investing companies. This is because the credit ratings are easily understood not only by the financial institutions and banks, but also by the general public.

Good for Non-Popular Companies : Credit rating is beneficial to the non-popular companies, such as closely-held companies. If the credit rating is good, the public will invest in these companies, even if they do not know these companies.

Act as a Marketing Tool : Credit rating not only helps to develop a good image of the company among the investors, but also among the customers, dealers, suppliers, etc. High credit rating can act as a marketing tool to develop confidence in the minds of customers, dealer, suppliers, etc.

Helps in Growth and Expansion : Credit rating enables a company to grow and expand. This is because better credit rating will enable a company to get finance easily for growth and expansion.

Various credit rating agencies in India and International credit rating agencies:

1. Credit Rating Information Services of India Limited (CRISIL)

CRISIL is one of the oldest credit rating agencies in India. It was launched in the country in 1987 following which the company went public in 1993. Headquartered in Mumbai, CRISIL ventured into infrastructure rating in 2016 and completed 30 years in 2017. CRISIL acquired 8.9% stake in CARE credit rating agency in 2017. It launched India's first index to benchmark performance of investments of foreign portfolio investors (FPI) in the fixed-income market, in the rupee as well as dollar version in 2018. The company's portfolio includes, mutual funds ranking, Unit Linked Insurance Plans (ULIP) rankings, CRISIL coalition index and so on.

2. ICRA Limited

ICRA Limited is a public limited company that was set up in 1991 in Gurugram. The company was formerly known as Investment Information and Credit Rating Agency of India Limited. Before going public in April 2007, ICRA was a joint venture between Moody's and several Indian financial and banking service organisations. The ICRA Group currently has four subsidiaries - Consulting and Analytics, Data Services and KPO, ICRA Lanka and ICRA Nepal. At present, Moody's Investors Service, the international Credit Rating Agency, is ICRA's largest shareholder. ICRA's product portfolio includes rating for - corporate debt, financial rating, structured finance, infrastructure, insurance, mutual funds, project and public finance, SME, market linked debentures and so on.

3. Credit Analysis and Research limited (CARE)

Launched in 1993, CARE offers credit rating services to areas such as corporate governance, debt ratings, financial sector, bank loan ratings, issuer ratings, recovery ratings, and infrastructure ratings. Headquartered in Mumbai, CARE offers two different categories of bank loan ratings, long-term and short-term debt instruments. The company also offers ratings for Initial Public Offerings (IPOs), real estate, renewable energy service companies (RESCO), financial assessment of shipyards, Energy service companies (ESCO) grades various courses of educational institutions. CARE Ratings has also ventured into valuation services and offers valuation of equity, debt instruments, and market linked debentures. Moreover, the company has launched a new international credit rating agency 'ARC Ratings' by teaming up with four partners from South Africa Brazil, Portugal, and Malaysia. ARC Ratings has commenced operations and completed sovereign ratings of countries, including India.

4. Brickwork Ratings (BWR)

Brickwork Rating was established in 2007 and is promoted by Canara Bank. It offers ratings for bank loans, SMEs, corporate governance rating, municipal corporation, capital market instrument, and financial institutions. It also grades NGOs, tourism, IPOs, real estate investments, hospitals, IREDA, educational institutions, MFI, and MNRE. Brickwork Ratings is recognised as external credit assessment agency (ECAI) by Reserve Bank of India (RBI) to carry out credit ratings in India.

5. India Rating and Research Pvt. Ltd.

India Ratings is a wholly-owned subsidiary of the Fitch Group. It offers credit ratings for insurance companies, banks, corporate issuers, project finance, financial institutions, finance and leasing companies, managed funds, and urban local bodies. In addition to SEBI, the company is recognised by the Reserve Bank of India and National Housing Bank.

6. Small and Medium Enterprises Rating Agency of India (SMERA)

Established in 2005, SMERA is a joint initiative of SIDBI, Dun & Bradstreet India and leading banks in India. SMERA has joined hands with prominent institutions such as IIT Madras, The Bangladesh Rating Agency Limited, CAFRAL, CoinTribe, and SIES. Apart from its shareholder banks, SMERA has also entered into MoUs with over 30 Banks, Financial Institutions and Trade Associations of the country.

Frequently Asked Questions on Credit Rating Agencies

1. **What is credit rating agency?**

A credit rating agency does assessment of the financial strength of companies and other government entities. They help investors identify the companies ability to pay debts and their level of risk.

2. **What is the difference between credit ratings and credit score?**

   A credit rating is given to a company, organisation or a government body by calculating its ability to repay the debt and to predict the likelihood of default. On the other hand, a credit score is given to an individual after taking a look at his credit history and repayment behaviour.

3. **Who regulates credit rating agencies?**

   All the credit rating agencies in India are regulated by Securities and Exchanges Board of India (SEBI). The credit rating agencies are monitored and reviewed by SEBI.

4. **How is credit rating denoted?**

   Rating is denoted by a simple alphanumeric symbol, for e.g. AA+, A-, etc.

5. **How much time does it take for the rating process to be over?**

   Credit Rating is a long process and takes around 3-4 weeks to complete from the date of receipt.

Factors affecting credit rating & procedural aspects:

There is too much debt floating around in the world today, and people are greatly underestimating the importance of keeping and maintaining a strong credit rating. If we are not diligent when it comes to making our purchases and fulfilling our financial obligations, credit rating can take a substantial hit and our ability to perform a range of financial transactions in the future can be seriously affected.

Credit rating systems

The credit reporting system takes into account not only the negative information that is currently on a person's credit file but also the positive factors. So everything goes into account when determining the sort of score we have on your file.

In India, the average of credit score that lies between 622 and 1200 is considered to be pretty good. Any higher, we are on the right track, any lower and we might have a bit of work to do when it comes to getting our credit rating up to an acceptable level.

Negative credit information

There is a range of information associated with our financial history that offers insight into our creditworthiness. These are taken into account in determining our ultimate credit rating:

- Any credit applications and inquiries we have made in the last five years, and whether or not these applications have been successful or unsuccessful and why.
- Payment records from our current credit accounts. Not only does this include our credit cards, but it also includes our mobile phone, gas and electricity accounts.
- And overdue accounts or payment defaults in our history and any failure to meet payments.
- Any bankruptcies or insolvencies we are involved in as well as court judgments.
- A range of public record information, including directorships and proprietorships.

Positive credit information

In India, there is a range of positive credit information that can significantly increase our credit rating and overall perception of creditworthiness – so long as we have been in control of our finances. Some positive factors include:

- The types of credit accounts we have owned such as a credit card or home loan and the record of successfully meeting financial obligations about these accounts.
- Credit limit usages and account balance details.
- Successful repayment history which shows an overall ability to meet our financial obligations.

Ways we can increase our credit rating

It is said, that if we find ourselves with a low ranking– there are some measures we can take to improve our score significantly. These include:

- *Applying for a credit card*

As long as we are in a position to make repayments, having a credit card can increase your credit rating. Just make sure you take care of all your repayments on time, and avoid charging too much to our credit card.

- *Make appropriate applications for credit*

Submitting multiple loan applications and having them rejected can have a substantial impact on our overall credit rating, so if we need to make a loan application make sure we do your research first and make sure we are definitely in a position to do so. If we have made multiple inquiries in a short amount of time, some credit providers may look upon it negatively and this will seriously affect your rating.

- *Paying off bills, loans or credit cards*

Making sure we have met all our different financial obligations is quite important when it comes to determining our overall credit rating. If we fail to do so, it can have a negative impact on our credit rating. Something as small as a 30-day late payment can decrease your credit rating, and overdue accounts are kept on your file for up to five years, so it goes without saying – don't risk it; pay on time.

- *Keep track of our credit report and rating*

This is especially important if we have changed jobs or moved house recently, and we should be checking our credit rating at least every one to two years to ensure there are not any errors that have passed through.

The things we do that affect our credit score and how do we fix them

Applying for credit several times

This usually involves submitting loan applications to several banks, hoping that one of it will be approved. However, each time we apply for credit, it will be recorded in our credit report, which is noted as an inquiry. Credit can be a loan, mortgage or utility application. If we have made a lot of inquiries in a short amount of time, some credit providers may see this negatively and reject our application.

If we continue to apply for credit after we were refused it from a credit provider, these inquiries will significantly reduce our credit score. The Solution is that before applying, research different lenders and choose the most appropriate one to submit our credit application to.

Paying our bills, loans or credit cards late

An overdue debt and whether we have paid it on time or not will be listed on our credit report when it is 60 days or more overdue. However, a 30-day late payment may also decrease our score. Overdue accounts are kept on our file for up to 5 years.

The Solution for such circumstances is pay on time, every time. But if we really can't, make sure to at least pay off an overdue debt within 60 days of getting the first notice of payment so that it doesn't appear on our credit file. Also pay down our non-overdue debts gradually, as our credit score shows our ability to manage our credit and debt, so if we pay it completely at once, it will be deleted from the report. Hence we can pay our bills, loans and credit cards on time, by using direct debit and schedule automatic payments from the account.

When we are not paying our bills or meeting loan repayments

If we refuse to pay our phone bill even after receiving further requests from our utility provider to do so, or we don’t meet our loan repayments, we could risk having these listed as an overdue debt or defaults on our credit report, which will bring down our credit score. Defaults are kept on your file for up to 7 years.

It could be better off paying the bill and then disputing the amount after that. However, if we can’t pay our bills or meet repayments due to unexpected circumstances, speak with utilities and credit providers and to see if we can apply for a hardship variation and negotiate a repayment plan. We could also consider consolidating our personal and credit card debts into our mortgage so we can manage to pay them off each month.

Not removing errors in our credit report

If we find an error on our credit report and choose to fix it later rather than sooner, our credit score will not improve and will affect our future credit applications.

So we can tell the privacy commissioner that there is an error on our file. If we are applying for a loan, we must our lender that a correction is pending.We will need to prove that the item is not correct, such as a letter declaring that the account is not ours or that it has already been paid. We could also talk to the company who added the default on our file, claiming that we owe money to them. They could have simply mistaken us as somebody else who does owe them money.

Not keeping track of our credit report

If we have changed jobs or moved house over the years, we could end up losing track of the details in our credit report, which could adversely affect your credit rating.

Other ways to improve credit ratings

- *Get a credit card*

If we have and use a credit card, it will build our credit rating and show that we are capable of handling and managing debt. However, remember that every credit we apply for will be added to our credit report and can lower our rating. If we already have a credit card, it’s best to ask for a higher credit limit instead of applying for a new card.

- *Use different types of credit*

We can increase our credit rating if we can prove that we can manage different types of credit and also pay them all on time. For example, using a loan to purchase a car and a mortgage to buy a house.

- *Use someone else's credit*

Have someone with a good payment history add us as a credit card holder to their credit account. This way, their payment history will be included on our credit report as well, giving a perfect account. If the account is open for a long time, it will also show a long history of managing it well.

- *Keep unused accounts open*

Even if we have paid off our credit card, don't close the account. Keeping the account open without negative reports over a long period will have a positive effect on our credit rating, therefore the higher our credit rating, the higher our chances are of getting our credit application approved.