Market Guide
In collaboration with SEC

Credit Rating : rating products offered by credit rating agencies

(Part 04)

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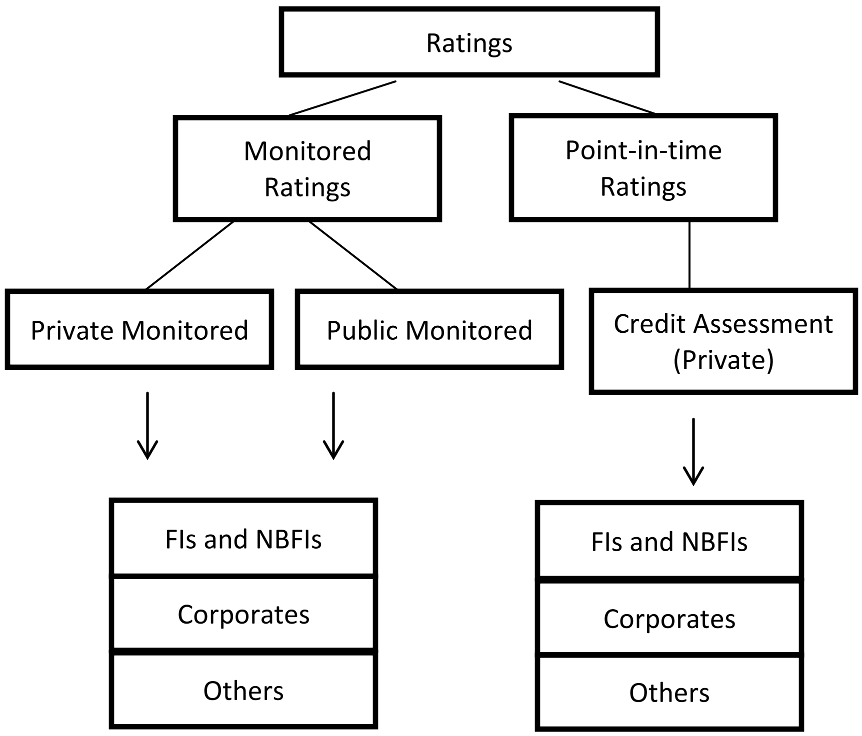
During the last three weeks the article series focused on the credit rating industry. It discussed the definition of credit rating, types of ratings, overview on the industry, rating methodology, rating scales, rating reports, possible conflicts of interest and how they are managed etc. Moving on, today's article will elaborate on the rating products offered by credit rating agencies.

Rating products are offered to the client in terms of the core business of rating i.e. monitored ratings and point-in-time ratings. The issuer / obligor has the right to decide which rating product they require (monitored or point-in-time), but the type of rating issued (i.e. stand-alone rating, support rating etc.) is decided by the rating agency based on the analysis carried out. Generally the approach which gives the higher rating is what is considered for the final rating. If an entity's support rating is stronger than a stand-alone rating, then the support rating is what is issued as the final rating. Readers could obtain a clear understanding on this classification by referring to Chart 1.



What is a monitored rating?

The definition of 'monitored' is to 'maintain a regular surveillance over'. Hence a rating agency that provides a 'monitored rating' service would monitor the issuer / obligor on an on-going basis.

The analysts assigned to each issuer / obligor will initiate a rating review whenever they become aware of any business, financial, operational or other information that they believe may reasonably be expected to result in a rating action, consistent with the relevant criteria and methodologies. As an example, an operational or fiscal deterioration, an acquisition, a divestiture, or the announcement of a major share repurchase may trigger an immediate rating review. The review process is regarded as a continuous one (on-going). Ratings are also subject to formal periodic rating reviews, which is usually on an annual basis.

These ratings are beneficial for the creditors, investors in bonds and / or trade creditors as there is an on-going surveillance of issuers / obligors.

What is a point-in-time rating?

The definition of 'point-in-time' is 'at a particular time'. Hence such ratings are given at a specific / particular time. They will not be under regular surveillance.

Point in time ratings are rare and therefore not monitored on an on-going basis. The point-in-time nature of these ratings is clearly disclosed in the rating commentary. Generally a point-in-time rating would be carried out as credit assessment, which is typically a private rating (i.e. the rating outcome would not be disclosed to the public).

What is a credit assessment?

In certain circumstances, unrated entities may request a credit assessment. A credit assessment provides an indication of the likely rating that an entity may receive if it were to request a full rating. The assessment is a rating-level opinion carried out by analysts from the same group that would assign a full rating and can consider all materials that the requesting entity (i.e. the obligor / issuer) is prepared to provide for the assessment process.

Credit assessments are provided on a confidential basis, hence it is a private rating. While credit assessments may be similar to ratings in many ways, they are not formal ratings and should not be employed by rating users (investors) without consideration of any limitations that they may have or any conditions attached to their use.

What is a private rating?

For any entities with no publicly traded debt or where the rating is required for internal benchmarking a rating agency would provide a 'private' rating. These ratings are generally provided directly to the rated entity, which is then responsible for ensuring that any party to whom it discloses the private rating is updated when any change in the rating occurs. Private ratings undergo the same analysis and committee process as a published rating. Private ratings could be either 'monitored' or 'point-in-time'. If it is a monitored private rating, the surveillance would be carried out as normally conducted for monitored public ratings / published ratings.

Private ratings cannot be publicly disseminated. The entity can use the rating in its normal course of business but they cannot publicly disclose the rating. However in the occurrence of any of the below events, the rating agency would publicly disseminate the rating;

- If required by law

- If the rating or any portion of the rating analysis becomes publicly known
- If the entity should access the public debt markets

What is a public rating?

Public ratings are generally provided to entities that are publicly listed and have publicly traded debt. The rating agency would carry out the rating process as discussed in the previous article and would communicate the rating to the issuer / obligor and thereafter issue a press release. These press releases are communicated to the public via the rating agency's website and through media coverage. The issuer/obligor is at liberty to advertise and publicly disclose this type of rating.

How is regular surveillance carried out for monitored ratings?

Analysts perform an on-going surveillance of information received and / or requested. As explained in previous articles, analysis is forward looking, hence trends and forecasts are looked into in detail. Where a factor or trend can have an impact on the already assigned rating, the rating agency will determine an appropriate course of action to be taken, such as requesting further information from the entity in concern, analyzing the information and taking it to a rating committee to decide the outcome such as affirming the rating (no change to the existing rating), upgrading or downgrading the rating.

In the case of FIs, the periodic review may be carried out as a peer review, where a few FIs may be reviewed together.

What is a peer review?

Rating agencies may conduct the periodic reviews of banks (FIs) as a group review. A group or peer review is when relevant peers are taken to a rating committee at the same time. This allows the rating agency to review comparable FIs and ensure consistency and relativity of the ratings.

A peer review enables a credit comparison across selected peers and provides a mechanism for early detection of adverse credit trends. Further a group review approach facilitates targeted research and commentary on industry or sector developments, which enables investors to make informed decisions.

How does a group review compare with an individual review?

A group review does not mean deterioration in the rigour of the analysis, rather an enabling of accurate and meaningful credit comparisons. The analysis is therefore based on macro factors as well as specifics of each individual included in the review. Although the group review would form the core of the periodic review, each individual issuer may be subject to an individual review after a credit event.

Periodic reviews are annual and at predefined intervals. The review frequency is based on the profile, sensitivity, complexity and volatility of specific issuers and / or banking systems.

How is a peer group formed?

A peer group may be formed in many ways such as region, country, sector, rating category or using a sampling method.

What information is used to issue and / or maintain ratings?

Analysts base their research and rating on a thorough analysis of all relevant information known and believed by them to be relevant to the rating decision. This includes publicly available information, information received directly or during the analysts' interaction with the issuer, information from third parties and relevant information gathered by analysts during their interaction with other issuers.

The core information relied on in the credit rating process are the publicly available information such as interim and annual financials (typically at least three years of audited accounts). This public information represents the minimum requirements for investors to form an investment decision.

Rating committees should verify the data as sufficient and robust in relation to the rating decision.

What happens in case of insufficient information?

Where there is insufficient information to assign or maintain a rating, no rating will be assigned or maintained.

If information is limited, the rating agency may be in a position to issue a shadow rating. Shadow ratings only require an abbreviated analysis, in which a specific element of the analysis is omitted. The qualitative difference between such an abbreviated rating and a full rating is clearly described in the rating agency's communication of the final rating.

Why are ratings withdrawn?

Ratings remain the property of the rating agency, hence the rating agency has full discretion to determine if and when to withdraw any rating issued. The most common reasons for a rating withdrawal are due to insufficient information provided by a rated issuer / obligor, thereby disabling the rating agency from carrying out surveillance and lack of market interest. There are also occasions where the rated issuer / obligor may choose to withdraw the rating due to the maturity of the issuance or if they no longer require a credit rating. When a rating of an existing debt or existing entity is withdrawn, the rating agency should ideally publish appropriate commentary stating the rating, the withdrawal of the rating, the reason for withdrawal and that analytical coverage will no longer be available on the issuer / obligor.

Rating withdrawals should also be determined through a rating committee (discussed in the previous article).

What are unsolicited ratings?

A definition of 'unsolicited ratings' is 'a rating agency's assessment of a borrower's creditworthiness without any involvement of the borrower itself. In particular, the borrower does not pay for the rating assessment'.

Credit ratings issued by the global rating agencies today are typically initiated by the entities being rated. These are solicited ratings which involve payment to the rating agency. Under certain circumstances, a rating agency may also assign ratings at its own initiative (i.e. without the rated entity's request), or continue to rate an entity once an entity has ceased a mandated relationship with the agency. These are unsolicited ratings. Solicitation status is purely a commercial issue, and is not a proxy for the level or quality of information received from an issuer. The analytical and committee processes are identical for both solicited and unsolicited ratings and there is no difference in the credit judgment.

Rating agencies have in the past refused to assign ratings solicited by certain issuers, and have also withdrawn ratings solicited by certain issuers, where the threshold for information was not met.

Source: Fitch Ratings