



Ratings of Entities based on Government Support

Executive Summary

The rating of entities related to the Government (state or central) either as Public Sector Undertakings (PSUs) that have a majority ownership with the Government of India (GoI)/ State government, or those not directly held by the Government but having a majority shareholding with PSUs is done based on the assessment carried out by Brickwork Ratings (BWR), of the strategic importance to the government, linkages to other public sector entities and the probability and extent of support that the government could provide to them in the event of a difficulty. These entities are either wholly owned by the government or have a certain share of capital stock owned by the government. The extent of government ownership and control, economic and social imperatives to extend support, strategic importance and political sensitivity are evaluated, to determine the rating.

The standalone rating of the entity is first arrived at, and subsequently, the rating is notched up depending on the extent and likelihood of support expected to be received from the government. These linkages can be broadly classified based on economic and strategic importance, social or legal linkages, the impact of their default on the government, explicit support in the form of guarantees and letters of comfort or undertakings extended to some extent (which will be rated under the credit enhancement methodology); the linkages often help the entity in various ways in the form of implicit support during a distress situation or whenever need arises, explicit support such as through a common management, loans extended, equity contribution and committed financial support.

Scope of Criteria:

The document provides a brief analysis of the attributes considered by BWR while arriving at the rating of an entity based on government support. The criteria factor all the aspects in which the government extends support to the related entity in times of distress, depending on the policy role played by the entity and implications of the entity's default on the government. The scope of this document is to capture risks associated with entities' creditworthiness while arriving at the rating of entities to which the government has extended implicit/explicit support. The impact of these risks on the standalone credit profile of an entity/PSU is assessed, and based on the evaluated government support, the rating is notched up or down based on the extended support or linkage with the government that is highlighted, which helps ascertain the debt servicing capability as against the cash flow generation and ability of the government to support the entity in a distress situation.

Risk Assessment and Rating Methodology:

BWR factors in the financial, economic and strategic linkages with the government and extent of support an entity may get from the government in times of financial difficulty. The extent of notch-up to the standalone rating is broadly determined by the following parameters:

Parameters considered while assessing government support

BWR may assess the standalone rating of the Government-Related Entity (GRE) based on the assessment of its strategic and economic importance, the government's social obligation to support the entity, government policy and the impact of its default on the government. The various factors considered are as follows:

- a) **National Importance:** Government-supported entities engaged in activities of national and economic strategic importance such as regulation, defence equipment, agricultural support towards lending and rural infrastructure development, and in which private sector participation is likely to be limited, are generally notched-up higher.
- b) **Economic and Strategic Importance:** BWR also considers the economic importance of the entity/PSUs within the sector. Entities whose operations contribute towards GDP growth and employ a large proportion of the population also get a higher level of support from the government. The government's policy on disinvestment also shows its intention to retain control and the entity's strategic importance to the economy.
- c) **Spill-over Effect:** Assessment is also done on whether the default of the entity would have only a localised impact or a domino effect with spill-over onto other entities in the sector or the government. The political/social implications of default are also factored in while arriving at the rating. Furthermore, the same can be assessed based on the demonstrated track record of the government towards extending support to the entities/PSUs in the past and shows their willingness to extend support in case need arises.
- d) **Investor Confidence:** Investors gain more confidence in cases wherein there is a guarantee or Letter of Comfort (LOC) from the government for a GRE's debt. A guarantee is considered better than a LOC. A central government guarantee or LOC is considered better than a state government guarantee or LOC (which will be rated under the credit enhancement methodology).
- e) **Political/Social Implications of Default:** The political/social implications of default are also factored in while arriving at the rating. If the area of operations of the government to fulfil a social role is wide or it has a higher degree of unionisation, and the government has a higher amount of foreign currency debt, an event of default could result in political and/or nationwide credit implications. In such cases, a higher level of government support is expected. With regard to entities wherein there is a state government guarantee, the rating is influenced by the state finances, political stability and general economic situation of the state.
- f) **Public Perception of Support:** In cases wherein, there is significant public perception of support by the government to the entity, there is a moral/social obligation by the government to extend distress support, and this is duly factored in the assignment of rating.
- g) BWR may consider the implicit guarantees of governments in assigning ratings. Such decisions will depend on the general economy, finances of the state, past borrowings track record and entities' strategic importance, among others.
- h) It may, however, be noted that for some entities, the standalone rating could be higher than the government's rating.

Notching-up Criteria:

BWR considers the key factors described above while assigning the rating of GREs/PSUs. The notching-up can be upto the concerned government's (state government/ GoI) standalone rating, based on the economic state of the government and government finances/fiscal position. Generally, the entity is assessed on a standalone basis and subsequently Rating is notched up based on implicit or expected support from the Government. Here, Government support does not factor in the committed financial support in the form of, say, corporate guarantees (which will be rated under the credit enhancement methodology), but implicit support that would (expectedly) come in during a distressed situation or whenever the need arises.

Conclusion:

BWR assesses the probability and extent of government support through a detailed analysis of the aforementioned parameters. A higher level of support is expected to be extended by the government to entities whose operations are of national and strategic importance and affect the well-being of the government, as well as the economy, directly. Significant emphasis is also laid on entities that fulfil social roles and responsibilities and have political implications in the event of a default.

*The previous version of this document can be found in
www.brickworkratings.com/download/Criteria-GovernmentSupport.pdf*

About Brickwork Ratings: Brickwork Ratings (BWR), a Securities and Exchange Board of India [SEBI] registered Credit Rating Agency and accredited by Reserve Bank of India [RBI], offers credit ratings of Bank Loan, Non-convertible / convertible / partially convertible debentures and other capital market instruments and bonds, Commercial Paper, perpetual bonds, asset-backed and mortgage-backed securities, partial guarantees and other structured / credit enhanced debt instruments, Security Receipts, Securitisation Products, Municipal Bonds, etc. BWR has rated over 11,400 medium and large corporates and financial institutions' instruments. BWR has also rated NGOs, Educational Institutions, Hospitals, Real Estate Developers, Urban Local Bodies and Municipal Corporations. BWR has Canara Bank, a leading public sector bank, as one of the promoters and strategic partner. BWR has its corporate office in Bengaluru and a country-wide presence with its offices in Ahmedabad, Chandigarh, Chennai, Hyderabad, Kolkata, Mumbai and New Delhi along with representatives in 150+ locations.

Disclaimer: It must be clearly understood that a Rating opinion is based on various factors/aspects which includes application of certain Rating criteria. The particular criteria applied depends on a number of factors, inter alia, sector/Industry, historical performance, cyclical trends, prevailing economic condition, group support etc. Rating opinions factor many assumptions and the application of any particular criteria or a set of criteria may be full or partial depending upon peculiarity of each case. Application of any Rating criteria should not therefore be considered as rendering finality or completeness to a Rating assessment. A reference to criteria needs to be perceived in broad terms, only as an aid to a rating decision.

Brickwork Ratings India Pvt. Ltd. (BWR), a Securities and Exchange Board of India [SEBI] registered Credit Rating Agency and accredited by the Reserve Bank of India [RBI], offers credit ratings of Bank Loan facilities, Non-convertible / convertible / partially convertible debentures and other capital market instruments and bonds, Commercial Paper, perpetual bonds, asset-backed and mortgage-backed securities, partial guarantees and other structured / credit enhanced debt instruments, Security Receipts, Securitisation Products, Municipal Bonds, etc. [hereafter referred to as "Instruments"]. BWR also rates NGOs, Educational Institutions, Hospitals, Real Estate Developers, Urban Local Bodies and Municipal Corporations.

BWR wishes to inform all persons who may come across Rating Rationales and Rating Reports provided by BWR that the ratings assigned by BWR are based on information obtained from the issuer of the instrument and other reliable sources, which in BWR's best judgement are considered reliable. The Rating Rationale / Rating Report & other rating communications are intended for the jurisdiction of India only. The reports should not be the sole or primary basis for any investment decision within the meaning of any law or regulation (including the laws and regulations applicable in Europe and also the USA).

BWR also wishes to inform that access or use of the said documents does not create a client relationship between the user and BWR.

The ratings assigned by BWR are only an expression of BWR's opinion on the entity / instrument and should not in any manner be construed as being a recommendation to either, purchase, hold or sell the instrument.

BWR also wishes to abundantly clarify that these ratings are not to be considered as an investment advice in any jurisdiction nor are they to be used as a basis for or as an alternative to independent financial advice and judgement obtained from the user's financial advisors. BWR shall not be liable to any losses incurred by the users of these Rating Rationales, Rating Reports or its contents. BWR reserves the right to vary, modify, suspend or withdraw the ratings at any time without assigning reasons for the same.

BWR's ratings reflect BWR's opinion on the day the ratings are published and are not reflective of factual circumstances that may have arisen on a later date. BWR is not obliged to update its opinion based on any public notification, in any form or format although BWR may disseminate its opinion and analysis when deemed fit.

Neither BWR nor its affiliates, third party providers, as well as the directors, officers, shareholders, employees or agents (collectively, "**BWR Party**") guarantee the accuracy, completeness or adequacy of the Ratings, and no BWR Party shall have any liability for any errors, omissions, or interruptions therein, regardless of the cause, or for the results obtained from the use of any part of the Rating Rationales or Rating Reports. Each BWR Party disclaims all express or implied warranties, including, but not limited to, any warranties of merchantability, suitability or fitness for a particular purpose or use. In no event shall any BWR Party be liable to any one for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of any part of the Rating Rationales and/or Rating Reports even if advised of the possibility of such damages. However, BWR or its associates may have other commercial transactions with the company/entity. BWR and its affiliates do not act as a fiduciary.

BWR keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of the respective activity. As a result, certain business units of BWR may have information that is not available to other BWR business units. BWR has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

BWR clarifies that it may have been paid a fee by the issuers or underwriters of the instruments, facilities, securities etc., or from obligors. BWR's public ratings and analysis are made available on its web site, www.brickworkratings.com. More detailed information may be provided for a fee. BWR's rating criteria are also generally made available without charge on BWR's website.

This disclaimer forms an integral part of the Ratings Rationales / Rating Reports or other press releases, advisories, communications issued by BWR and circulation of the ratings without this disclaimer is prohibited.

BWR is bound by the Code of Conduct for Credit Rating Agencies issued by the Securities and Exchange Board of India and is governed by the applicable regulations issued by the Securities and Exchange Board of India as amended from time to time.