



Ratings of Entities based on Government Support

Executive Summary

Brickwork Ratings (BWR) assigns ratings to Government-Related Entities (GREs) that are either directly majority-owned by the Government of India (GoI) or a state government, or those indirectly owned by the government with a majority shareholding by Public Sector Units (PSUs). In evaluating these entities, BWR assesses their creditworthiness by considering factors such as financial health, market position, and their strategic importance to the government. The resulting rating reflects the entity's ability to meet its debt obligations, providing insights into its financial stability and associated risk level.

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. While considering the government support for GRE, the following factors are considered - government ownership and control, Economic and social importance, Strategic importance and political sensitivity.

Government support can be broadly classified as:

- Implicit support based on economic and strategic importance, social or legal linkages, the impact of entity's default on the government. This implicit support often helps the entity in various ways during a distress situation or whenever need arises.
- Explicit support exists in the form of guarantees and letters of comfort or undertakings extended. The entities with the explicit agreement are rated using the credit enhancement methodology (outlined in the CE rating Criteria on BWR website).

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 the probable 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 support. The impact of these risks on the standalone credit profile of GRE/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.

Notching-up Criteria:

BWR considers the key factors described below while assigning the rating of GREs/PSUs. The notching- up can be up-to the concerned government's (state government/ GoI) standalone rating.

- The entity is assessed on a standalone basis and subsequently rating is notched up based on implicit or expected support from the government. The implicit support would (expectedly) come in during a distressed situation or whenever the need arises.
- The explicit support in the form committed financial support via guarantees/deeds/or any other explicit agreement will be rated under the credit enhancement methodology.
- Refer to the section below for the extend of the Notch-up based on the Implicit Support.

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 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:** GREs engaged in activities of national and strategic importance tend to receive higher support due to the critical nature of their operations .The entities engaged in activities such as regulation, defense equipment, agricultural support towards lending and rural infrastructure development are generally notched-up higher These entities typically operate in sectors where private sector participation is limited, and the government plays a crucial role in ensuring their stability and success.
- b) **Economic and Strategic Importance:** BWR also considers the economic importance of the entity/PSUs within the sector. Entities whose operations contribute significantly towards GDP growth and employ a large proportion of the population also get a higher level of support from the government.
- c) **Spill-over Effect/Domino 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) **Political/Social Implications of Default:** The political/social implications of default are also factored in while arriving at the rating. The area of operations of the government to fulfil a social role is wide, the entities that have a higher degree of unionisation, 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. Regarding 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.
- e) **Moral Obligation/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.
- BWR may consider the implicit guarantees of governments in assigning ratings. Such decisions will depend on the general economy, finances of the state, past track record and entities' strategic importance, among others.
- f) **Explicit support for Investor Confidence:** Investors gain more confidence in cases wherein there is an explicit support in the form of 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 (the explicit support will be rated under the credit enhancement methodology)
- g) It is to be note that in the absence of an official rating for a State Government, the shadow rating is assigned based on the criteria outlined for such ratings (refer to the 'Criteria for State Government' section on BWR website for further details)

Extent of Notch-Up:

- **Low Policy Level Importance and Low Default Implications:** This indicates a low likelihood of receiving support from the government. In such cases, BWR may choose not to notch up, or may notch up by only one level, the standalone rating of such entities.
- **Low Policy Level Importance and High Default Implications:** This suggests a medium likelihood of government support. The extent of the notch-up will be determined based on the severity of default implications. BWR will assess the difference between the standalone rating and the government rating to determine the appropriate notch-up.
- **High Policy Level Importance and Low Default Implications:** This also represents a medium likelihood of government support. Similar to the previous case, the notch-up extent will be determined based on policies impacted, and BWR will evaluate the notch-difference between the standalone rating and the government rating to decide the appropriate notch-up.
- **High Policy Level Importance and High Default Implications:** This indicates a high likelihood of government support, as failure to provide such support would significantly impact policies envisaged by the government. In this scenario, BWR will notch up the rating to the government's rating level.

Conclusion:

BWR evaluates the likelihood and extent of government support by conducting a thorough analysis of the aforementioned parameters. Entities that are of national and strategic importance, and whose operations directly impact the government's well-being as well as the economy, are expected to receive a higher level of support. Special consideration is also given to entities that play a crucial social role and whose default could have significant political ramifications

The previous version of this document can be found in

<https://www.brickworkratings.com/download/Criteria-GovernmentSupport-Sep2021.pdf>

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