

## Rating Criteria for Debt Mutual Funds schemes

### Introduction

Debt mutual fund schemes of fund houses cater to a select set of investors - corporate investors (looking to manage their liquidity/treasury), financial institutions (treasury/liquidity management) and retail investors who have a lower risk appetite.

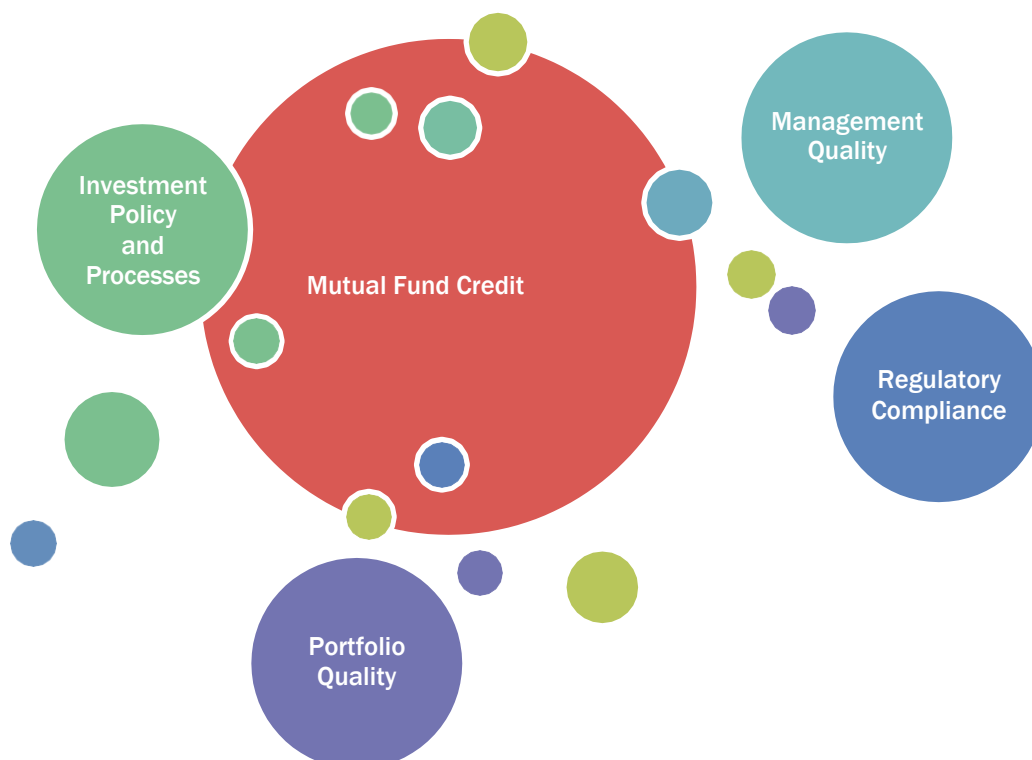
As such, these funds invest in debt markets via listed/unlisted debt securities, the maturities of which could vary with the investment strategy and policy of the fund house.

The rating assigned by Brickwork Ratings (BWR) for such schemes reflects the credit quality of the scheme considering the underlying portfolio and investment policies and processes.

Fund ratings assigned by Brickwork Ratings are for both long-term and short-term funds. However, Capital Protection Oriented Funds, which are very similar to Collateralized Debt Obligations involving a pool of corporate debt exposures and hence 'SO' rating symbol will be used. The ratings would be on the regular rating scale for debt instruments and not on the mutual fund rating scale.

### Rating Criteria - Mutual Fund Credit Rating

The criteria used by Brickwork Ratings in assigning ratings to mutual fund schemes are as shown:



## Approach & Methodology

### 1. Management Quality

BWR assesses the quality of the management teams at two levels:

- a. **Management quality at the AMC / Trustee company level:** this reflects the overall experience and track record of the Board of Directors and Trustees, the governance standards of the AMC and the experience of the fund house in managing such schemes. The management quality of the AMC will also reflect in its investment strategies and policies and processes.
- b. **Management quality of the investment team:** this reflects the overall experience and track record of the investment team managing the fund. In cases where the team may be inexperienced in such schemes, their overall experience as well as the experience at the top management at the AMC will be considered while analyzing this criterion.

BWR will also consider the experience of other key personnel in the organization while assessing the overall management quality. Governance standards at the AMC will be evaluated considering the disclosures made as well as policies and processes in place.

### 2. Investment Policies and Processes

BWR considers the investment policies and processes that are in place at the AMC/investment strategies for the schemes. Internal documentation as well as detailed discussions allow BWR to understand how aligned the investment process is with regard to the stated investment objective of the scheme. The following parameters are considered for the same:

- a. **Investment Policies** – such as rating requirements, due diligence requirements, documentation maintained for investments etc.
- b. **Organizational Structure** – role of the front and back offices, presence of a mid-office, reporting lines and structures that allow for management of conflicts of interest.
- c. **Relationship with parties such as the Custodian, Brokers etc.**
- d. **Operational policies and procedures** – these are usually analyzed with the investment policy and organizational structure.
- e. **Risk Management Policies and Systems in place as well as internal and external audits.**

### 3. Portfolio Quality

The quality of the portfolio managed in the scheme is studied at a consolidated level.

- a. **Credit Quality:** The credit quality of the underlying portfolio is understood asset-wise. Thus, each instrument invested in is considered to determine the credit rating.
  1. Where the instrument invested in by the Fund has an outstanding BWR rating, the rating is considered as is during the portfolio assessment.
  2. Where the instrument invested in by the Fund has outstanding ratings assigned by other rating agencies, BWR may use the rating as is or may adjust for the same based on its analysis.
  3. For the unrated portion of the portfolio, BWR may assess the credit quality separately for each unrated instrument.

4. Cash and cash equivalents are treated at the highest rated category, allowing for counterparty credit risk of the bank in which the same is maintained.
  5. Treasury bills & Central Government Securities would be treated as highest credit quality.
- a. **Average Maturity:** BWR assesses the weighted average maturity of the portfolio (for principal alone). This allows for BWR to arrive at an overall credit quality assessment based on an internal matrix that maps the credit rating of each asset to a score (based on Probability of Defaults mapped) per maturity bucket.
  - b. **Credit Score:** The overall credit score of the portfolio is then calculated based the weighted average maturity and the credit quality. BWR will also subject the portfolio to certain stress tests on the credit quality to consider portfolio performance in case of movements of the instruments from one rating to the other.
  - c. **Diversification:** Diversification refers to both sector wise as well as asset-wise. The more the number of instruments (determined by the counterparties rather than just the number), the better the diversification in the portfolio.
  - d. **Liquidity:** Liquidity management plays an important role in ascertaining the quality of the portfolio. Redemption patterns are understood to ensure that the cash and cash equivalents as well as the credit facilities availed from banks will allow for adequate liquidity.

#### 4. Regulatory Compliance

BWR also considers the processes in place at the fund house to ensure compliance with regulatory requirements. Compliance allows for reducing risk due to a loss from regulatory proceedings as well as reputational loss.

Adherence to compliance, on-going and past regulatory discussions as well as any pending/past litigation are discussed with the AMC.

#### Periodic Monitoring of the Portfolio

BWR reviews and monitors ratings assigned on an on-going basis. In cases where the portfolio changes/maturity changes, the credit quality is evaluated and discussed with the investment team at the AMC.

In case of changes in the management, policies and processes etc. BWR will consider the effect of the same on the rating assigned and may revise the ratings assigned.

The Rating Symbols and Definitions for Long Term / Short Term Debt Mutual Fund Schemes would be as per SEBI Circulars and Guidelines.

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#### 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 referenceto criteria needs to be perceived in broad terms, only as an aid to a rating decision*