AN INTERNSHIP REPORT ON

`` CREDIT RATING SYSTEM BANGLADESH : GLOBAL PERSPECTIVE (A CASE STUDY ON ALPHA CREDIT RATING LIMITED)”

AN INTERNSHIP REPORT ON

`` Credit Rating System in Bangladesh : Global Perspective (A Cash Study Alpha Credit Rating Limited) "

Submitted To

Shanaz Parvin

Chairman

Department of Finance and Banking

Faculty of Business Studies

HSTU, Dinajpur.

Prepared By

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E – MBA (Major in Accounting

And Information System)

Student No. E- 130501097

Batch : 1

This report has been prepared for submission into the Department of Accounting, Faculty of Post Graduate Studies, Hajee Mohammad Danesh Science and Tecnology university, Dinajpur, as a partial requirement for fulfillment of degree of Master of Business Administration (MBA).

Faculty of Post Graduate Studies

HAJEE MOHAMMAD DANESH SCIENCE AND TECHNOLOGY UNIVERSITY

DINAJPUR

April, 2016

Letter of Transmittal

Date : April 22, 2016

To

Shanaz Parvin

Chairman

Department of Finance and Banking

Faculty of Business Studies

Hajee Mohammad Danesh Science and Technology University, Dinajpur

Subject : Submission of Interniship report

I am very glad to inform you that I have finally completed the Report successfully, which was a partial fulfillment of the requirement for the Masters of Business Administration program.

The topic of my Recharge is **`` Credit Rating System in Bangladesh : Global Perspective (A case Study on Alpha Credit Rating Limited)"**. I enjoyed much by preparing this study as well as it has increased my knowledge vary much about credit rating system in Bangladesh. I am grateful to you and my Department for giving me the opportunity to obtain practical skills as well as to learn how to cope with the practical situations, which is very much valuable for my future career.

I , myself have prepared this recharge. This recharge or any part of this report does not match with any other published recharge.

Md. Arman Ali

Student No. E- 130501097

E – MBA (Major in Accounting

And Information System)

Department of Accounting HSTU, Dinajpur.

Letter of Acceptance

Date : May,2016.

I hereby declare that the concerned report entitled `` **Credit Rating System in Bangladesh : Global Perspective (A case Study on Alpha Credit Rating Limited.)"** is prepared by Arman Ali, Student ID. E- 130501097, Session 2013

Hajee Mohammad Danesh Science and Technology University, Dinajpur – 5200, completed his Report program under my supervision and submitted for the partial fulfillment of the requirement of the degree of Master of Business Administration (E-MBA) Major in Accounting and Information System) at Hajee Mohammad Danesh Science and Technology University, Dinajpur – 5200.

I approve his full recharge with full satisfaction and wish him a bright future and every success in his life.

……………………………

Shanaz Parvin

Supervisor

Department of Finance and Banking

Faculty of Business Studies

HSTU, Dinajpur.

Student’s Declaration

I, Md. Arman Ali, ID : 130501097, a student of E – MBA program of Department of Accounting, Hajee Mohammad Danesh Science and Technology University, Dinajpur, do hereby declare that the report titled ``Credit Rating System in Bangladesh: Global Perspective (A case Study on Alpha Credit Rating Limited) “ is prepared and completed by me under the supervision and guidance of Shanaz Parvin, Lecturer, Department of Finance and Banking. This Report has not vewen previously submitted elsewhere by me for any degree, title of recognition or reward before.

I also declare that the Report is prepared fpr an academic purpose, alone.

…………………………..

Md. Arman Ali
Student No. E- 130501097
E – MBA (Major in Accounting
And Information System)
Department of Accounting
HSTU, Dinajpur.

Supervisor's Declaration

It's my pleasure to certify that Md. Arman Ali, Student ID: 130501097,
E- MBA 1st Batch, **session 2013,** has successfully completed E – MBA Internship(Recharge) Program titled on`` **Credit Rating System in Bangladesh : Global Perspective (A case Study on Alpha Credit Rating Limited.)"** under my Supervision and Guidance. This report or any part of this report does not match with any other reports to the best of my knowledge.

Therefore, he is directed to submit his Report for Evaluation. I wish him Success at every sphere of his life.

…………………………………..

Shanaz Parvin
Supervisor
Department of Finance and Banking
Faculty of Business Studies
HSTU, Dinajpur.

Co - Supervisor's Declaration

I hereby declare that the concerned report entitled **``Credit Rating System in Bangladesh : Global Perspective (A case Study on Alpha Credit Rating Limited.)"** is an original work made by Md. Arman Ali No. 130501097, E- MBA(Major in accounting), Hajee Mohammad Danesh Science and Technology University, Dinajpur completed hisReport under my supervision and submitted for the partial fulfillment of the requirement of the degree of Master of in Business Administration (MBA) (Major in accounting and information system) at Hajee Mohammad Danesh Science and Technology University, Dinajpur

……………………………

Abul Kalam

Co-Supervisor

Department of Marketing

Faculty of Business Studies

HSTU, Dinajpur.

Acknowledgement

For the very first of all I would like to express my gratefulness and harmony to the almighty Allah the supreme authority of the Universe, without whom we would be nothing. Next I would like to express my kindness to my Beloved Parent whose continuous inspiration enrages me to make a right move in my life.

My first and greatest indebtedness is to my respectable teacher and Report supervisor Shahnaz Parvin, Department of Accounting, Faculty of Business Studies, Hajee Mohammad Danesh Science and Technology University, Dinajpur for gis guidance in carrying out of my research. I would like to provide special thanks to him. I can humbly tell that without his meticulous care, valuable suggestion and instruction it would not have been possible for me to complete the report. He has continulusly and properly guided me and timely direction and sincere cooperation helped me a lot to design and organize this report. His valuable opinion on the topic enriched my knowledge to carry out research and portray the information in a logical sequence.

Secondly I am indebtedness is to my others teachers and friends for helping me to prepare this Report. Some others key web . site of Alpha Credit Rating Limited whose valuable information and kind cooperation helped me to gather more knowledge. I would like to thank from the deep of my heart to those people who are related with making of this report and make it a success. May almighty Allah bless all of them

Executive Summary

Credit rating evaluates the credit worthiness of a debtor, especially an individual, a business or a government. It is an evaluation made by a credit rating agency of the debtor's ability to pay back the debt and the likelihood of default. Over the year 2012 and 2013, the number of credit rating agencies (CRA) has increased by several folds, from only two in 2009 to eight 2013. As a result, the competition among the CRAs for market share has become severe. As credit rating is very sensitive to quality, this increase competition may lead to deteriorated or inflation ratings by the CRAs to retain its clients and keep the cash – flow unharmed.

There are several types of credit rating practiced all around the glove. Credit rating types based on the subject matter of rating includes issue rating, issuer rating, and sovereign rating. Credit rating types based on the tenure can be divided into short-term rating, and long term rating. Other types of credit rating include structure finance rating, mutual fund scheme rating, Corporate Governance and Stakeholder Value Addition Rating, Micro Finance Capacity Rating, and project finance rating. However, many of these types are not practiced in Bangladesh yet.

Credit rating plays a vital role in developing the financial markets, regulating the financial markets, estimating risk premium, enhanced transparency in the credit and fixed income securities market, and standardization of credit evaluation process. However, there are also some drawbacks of the credit rating. These drawbacks include that credit rating can be biased, in absence of proper knowledge management by the credit rating companies changing the concerned analyst of a rating assignment may lead to discrepancies, and credit ratings cannot be treated as a standalone measure to invest. The history of credit rating in Bangladesh is very new. The first credit rating law was enforced in 1996, followed by establishment of CRISL. Subsequently, CRAB also started its operation two years later. In 2012, Bangladesh Securities and Exchange Commission permitted two more credit rating agencies. By 2012, there were eight credit rating agencies operating in Bangladesh. This is number is significantly high compared to the number of credit rating agencies operating all over the world.

According the common business model followed by the credit rating agencies in Bangladesh, the main source of business is the commercial banks implementing the BASEL II guidelines. Other source of business is the client/issuer itself. This model of business is problematic in itself as the awareness of the credit rating is still at primitive stage and both the banks and

clients want to inflate the credit rating for self – serving bias. However, this can be detrimental to the capital market, the money market, and the overall economy. Moreover, because of severe competition among the credit rating agencies, there is always a probability of rating shopping by the clients.

Banks play a vital role in the business model of the credit rating agencies. From the bank's perspective, credit rating is important both when bank is borrower and when bank is lender. Another important part of the business model of credit ratings is the corporate houses of Bangladesh.

Finally, it was suggested that proper monitoring and supervision should be carried out by both Bangladesh Bank and Bangladesh Securities and Exchange Commission for a more effective credit rating system. Further, a dedicated body to supervise the CRAs can also be formed. Another recommendation is that the government can also reduce the competition by segregating or defining target markets for the CRAs.

Dedicated

To

My Beloved

Parents

and

Honorable

Teachers

Table of Contents

Chapter One

Introduction

1.1 Background of the Research

This research is prepared as a requirement for completing the Masters in Business Administration (MBA) program of Department of Accounting, Hajee Mohammad Danesh Science and Technology University. Honorable teacher, Shahnaz Parvin Supervised during the preparation this report on `` Credit Rating system in Bangladesh : Global perspective (A case study on Alpha Credit Rating Limited).” Credit rating evaluates the credit worthiness of a debtor, especially an individual, a business or a country. It is an evaluation made by a credit rating agency of the debtor’s ability to pay back the debt and the likelihood of default. The history of credit rating is almost 100 years old which started with three companies Standard and Poor’s Moody’s Investor Service and Fitch Ratings. Credit rating in Bangladesh is relatively new with the Credit Rating Companies Rules got approval in 1996. However, in 2011 Bangladesh Securities and Exchange Commission (BSEC) awarded license to two new companies. Additionally, in the subsequent year (2012) BSEC awarded 4 (four) more companies with the license to rate companies. So there are eight rating companies currently operating in Bangladesh. This has lid to tighter competition among the players and declining rating fees. Recently an association has been founded by the all credit rating companies named Association of Credit Rating Agencies of Bangladesh (ACRAB) . Now ACRAB has provided a new fixed fee structure for the credit agencies, which has emulated internal competition of the companies. Now all rating agencies are providing deep concern on quality in credit rating. By the definition of credit rating, it should reflect the credit worthiness of the debtor, taking into consideration both the capacity and the willingness of te4h borrower. However, the effectiveness of the ratings within Bangladesh has been questioned.

As a participant in internship program, I was place at Alpha Credit Rating Limited, Dhaka. This report will focus in Credit Rating System in Bangladesh: Global Perspective (A case Study on Alpha Credit Rating Limited). The reason behind choosing this company was the availability of data and cooperation from their end.

1.2 Statement of the Title

I was very much interested about the credit rating system of Credit Rating Agencies in our country. In order to know the activities related with credit rating of Credit Rating Agencies and documents required to maintain this system, I chose the topic as `` **Credit Rating System in Bangladesh : Global Perspective (A case Study on Alpha Credit Rating Limited).”**

1.3 Objectives of the study

The research is going to serve two particular objectives, which are –

- To describe the current scenario of credit rating in Bangladesh from global perspective.
- To know credit rating system of selected rating agency.

1.4 Methodology

The nature of this report is descriptive. So instead of doing any survey, observation method is used to complete this qualitative research. I have tried to collect all such information that will reflect the actual situation of the company for any report. I have collected various types of primary and secondary data while I was performing my job. I have collected various data from various sources by face to face interview with the employees working in different departments of company, personal investigation, circulars sent by Head office and maintaining daily diary which contains all the activities that has been observed in the company.

1.5 Research Design

In this research, I have tried to find out overall credit rating system in Bangladesh. I have prepared this report based on Alpha Credit Rating Agencies. In addition I also try to depict the current scenario of the credit rating industry from that research, which involves Descriptive Research.

1.6 Sources of Data

The report is based on both primary and secondary sources of information. Interviewing the managers and officers of the company, talking to the customers the primary data have been collected. Furthermore, different publications of the company's reports and the company's websites have been used for the purpose of collecting secondary data.

1.6.1 Primary Sources of Data

(a) Guidelines, Opinions and suggestions of company's officials.

1.6.2 Secondary Sources of Data

(a) Various published document.
(b) Website.

1.7 Method of Data Collection

For the purpose of the study, two methods of data collection have been used:

(a) Observation method.
(b) Interview method.

1.8 Limitation of the study

This research and report has some limitations, which are as follows:

(a) This report is prepared only from secondary data. If any user or decision maker wants to take any important decisions from this report, then the decisions may not be accurate.
(b) The management of the company appears me as an intern not as employee. For this reason they have lack of confidence to me.

(c) The officers were quite busy with their regular activities. For this reasons it was also a little problem to collect detail information from them.

(d) In some cases, they could not be able to supply me any information for the reason that they have no printed documents of supply chain activities.

(e) Office secrecy was one of the most important problems. Disclosing of some information was restricted.

(f) Company’s policies do not permit of disclosing some sensitive information and data for obvious reason that poses as an obstacle to evaluate my **<u>research report.</u>**

(g) In case of secondary data collection, there was very little secondary information. There were few support books, reports, journals, etc. moreover, the branch office had very little of this information. That’s why bulk of it had to be collected from the head office.

(h) I have lack of knowledge about how to prepare an excellent **<u>research report.</u>**

Chapter Two

Literature Review

Credit ratings aim to measure the credit worthiness of an entity, e.g. a corporation, or issue. They represent an opinion of a rating agency that evaluates the fundamental credit strength of an issuer and his ability to fully and punctually meet his debt obligations. Credit ratings are produced by professional rating agencies and in most of the countries it requires establishment of regulatory guidelines that permits and monitors the credit rating agencies. For example, in the USA, agencies must be approved as Nationally Recognized Statistical Rating Organizations (NRSRO) by the Securities and Exchange Commission (SEC) (Hill, 2014). In Bangladesh, credit rating agencies has to be approved by Bangladesh Securities and Exchange Commission (BSEC). Subsequently, for the CRAs to rate issues and issuers under the BASEL II guideline has to be approved by Bangladesh Bank (BB) as External Credit Assessment Institution (ECAI). In an economic sense, rating agencies function as financial intermediaries, the existence of which would not be justifiable under the hypothesis of efficient markets (Ramakrishnan and Thakor, 1984).

According to the BASEL II, any person, any organization or any client of any recognized bank in Bangladesh want to enjoy loan facilities from his conducting bank, then the person or client must be need a credit rating from a registered credit rating agencies to enjoy the loan facilities. Credit Tating Agencies make the rating report by analyzing the financial statement and other qualitative information of the business. A credit report focuses long term and short term rating about a business and the business outlook.

Rating are placed on a discrete ordinal scale, where for example under the S and P scale an AAA (the so called `triple A’) rating is the highest credit rating assigned to issuers with the highest credit –quality and a D rating is the lowest credit rating assigned to bonds or firms in default. Moreover, CRAs stress that rating are just opinions. These opinions, which stem from fundamental credit analysis, are used to classify credit risk. In keeping with their status as opinions, rating are determined by a rating committee.

The credit rating will be an ongoing process i.e. credit rating should be updated on a continuous basis from year to year, within six months from the date of close of each financial year. The rating report completed in all respects be submitted to Bangladesh Bank and made

Chapter Three

Credit Rating: Global Perspective

3.1 Definition of Credit Rating

A credit rating evaluates the credit worthiness of a debtor, especially a business (company) or a government. It is an evaluation made by a credit rating agency of the debtor's ability to pay bank the debt the likelihood a default. Credit ratings are determined by credit rating agencies. The credit rating represents the credit rating agency's evaluation of qualitative and quantitative information for a company or government; including non-public information obtained by the credit rating agencies analysts. Credit ratings are not based on mathematical formulas. Instead, credit rating agencies use their judgment and experience in determining what public and private information should be considered in giving a rating to a particular company or government. The credit rating is used by individuals and entities that purchase the bonds issued by companies and governments to determine the likelihood that the government will pay its bond obligations. A poor credit rating indicates a credit rating agency's opinion that the company or government has high risk of defaulting, based on the agency's analysis of the entity's history and analysis of long-term economic prospects.

3.2 Types of Credit Rating

3.2.1 Classification based on Subject-matter of Rating

Based on the subject matter, credit ratings are divided into two categories. They are:

Issue Rating: An issue credit rating is an opinion of the credit worthiness of an obligor with respect to a specific financial obligation, a specific class of financial obligations, or a specific financial program. It takes into consideration the credit worthiness of guarantors, insurers, or other forms of credit enhancement on the obligation and takes into account the currency in which the obligation is denominated. Most of the rating agencies claim that the issue credit rating is not a recommendation to purchases, sell, or hold a financial obligation. Similarly, it also does not comment as to market price or suitability for a particular investor.

Issue credit ratings can be either long-term in or short-term. Short-term ratings are generally assigned to those obligations considered short-term in the relevant market. In the Bangladesh, for example, that means obligations with an original maturity of less than or equal to 365 days. Short—term ratings are also used to indicate the credit worthiness of an obligor with respect to put features on long-term obligations. The result is a dual rating, in which the short-term rating addresses the put feature, in addition to the usual long-term rating.

Issuer Rating: Issuer Ratings also provide an opinion on the general credit worthiness of the rated entities in relation to their senior unsecured obligations. Before investors decide whether to invest into a debt security from a company or foreign country, they must determine whether the prospective entity will be able to meet its obligations. A ratings company can help you do this. Providing independent objective assessments of the credit worthiness of companies and countries, a credit ratings company helps investors decide how risky it is to invest money in certain country and /or security.

Sovereign Rating: The credit rating of a country or sovereign entity. Sovereign credit ratings give investors insight into the level of risk associated with investing in a particular country and also include political risks. At the request of the country, a credit rating agency will evaluate the; country's economic and political environment to determine a representative credit rating. Obtaining a good sovereign credit rating is usually essential for developing countries in order to access funding I international bond markets. Another common reason for obtaining sovereign credit ratings, other than issuing bonds in external debt markets, is to attract foreign direct investment. To give investors confidence n investing in their country many countries seek ratings from credit rating agencies like Standard and Poor's, Moody's and Fitch to provide financial transparency and demonstrate their credit standing.

3.2.2 Classification based on the Tenure

The credit ratings are classified into two categories based on the tenure. They are:

Short-term rating: A short-term rating is a probability factor of an individual going into default within a year. This is in contrast to long-term rating which is evaluated over a long timeframe. In the past institutional investors preferred to consider long-term ratings. Now a days, short-term ratings are commonly used.

First, the Basel II agreement requires banks to report their one-year probability if they applied internal – ratings – based approach for capital requirements. Second, many institutional investors can easily manage their credit/bond portfolios with derivatives on monthly or quarterly basis.

Therefore, some rating agencies simply report short-term ratings.

Long-term rating: A long-term rating is probability factor of an individual/issuer/issue going into default in the long run. This is in contrast to short-term rating, which is evaluated within one year of tenure. In the past institutional investors preferred to consider long-term ratings. Now a days, short-term ratings are commonly used.

3.2.3 Other types of Credit Rating

Structured Finance Rating: Structured Finance Rating inducted under this category will be asset backed securitization, mortgage backed securitization, future flow transaction etc. Structured Finance ratings are opinions on the likelihood of the concerned structured instrument servicing its debt obligations in accordance with the terms. An SFR, which is generally different from the corporate credit rating of the originator, is based on the risk assessment of the individual components of the structured instrument:

- Assessment of issuer and/or originator/servicer
- Legal issues and documentation
- Originations, underwriting criteria and portfolio servicing
- Historical portfolio performance
- Portfolio characteristics and concentrations
- Obligor characteristics and concentrations
- Loan and lease features
- Manufacture/vendor concentration
- Derivation of credit enhancement
- Cash flow analysis

Mutual Funds Schemes Rating: Mutual Funds Schemes rating is designed to provide investors, intermediaries and Fund Sponsors/Asset Management Companies with an Independent opinion on the performance record and risks associated with various Mutual Fund Schemes. Funds ratings incorporate various qualitative and quantitative factors affecting a fund's portfolio. Such analyses focus on the resilience of portfolio companies to economic change, assessing asset quality, portfolio diversification and performance, and liquidity management.

Corporate Governance and Stakeholder Value Addition Rating: Such rating assesses the level to which an organization accepts and follows the codes and guidelines of corporate governance practices. It is evaluated from the system of distribution of rights and responsibilities among different participants in the organization such as the board, management, shareholders and other financial stakeholders, and the rules and procedures lay down and followed for making decisions on corporate affairs.

Micro Finance Capacity Rating: Micro Finance Capacity Assessment rating is intended as a service to lenders by providing informed opinion on the credit worthiness of the MFIs; this would facilitate flow of funds to MFIs by providing detailed information and analysis on the programs and performance of the organization. The rating would also provide suggestions for improvements in MFIs' performance strength facilitating the ability of more efficient utilization of funds.

Project Finance: Credit rating of Project Finance provides opinion on the types of risks associated with the project and the relative ability of the project its sponsors/executing agency to service the financial obligations. These rating are useful for the project sponsors in raising funds, and for the lenders in designing and pricing their funds.

3.3 The Importance of Credit Rating Agencies:

Credit rating agencies provide investors and debtors with important information regarding the credit worthiness of an individual, corporation, agency or even a sovereign government. The credit rating agencies help measure the quantitative and qualitative risks of these entities and allow investors to make wiser decisions by benefiting from the skills of professional risk assessment carried out by these agencies. The quantitative risk analysis carried out by credit rating agencies include comparison of certain financial rations with chosen benchmarks and the qualitative analysis focuses on the management character, legal, political and economic environment in a jurisdiction.

3.3.1 Development of Financial Markets

Credit rating agencies help provide risk measure for various entities and make it easier for financial market participants to assess and understand the credit risk of the parties involved in the investing process. Individuals can get a credit score in order to be eligible for easy access to credit cards and other loans. Institutions can borrow money easily from banks without having to go through lengthy evaluations from each individual lender separately. Also corporations and governments can issue debt in the form of corporate bonds and treasuries to attract investors based on the credit ratings.

3.3.2 Credit Rating Agencies Help Regulate Financial Markets

The credit ratings provided by popular rating agencies including Moody's Standard and Poor's and Fitch, have become a benchmark for regulation of financial markets. Legal policies require certain institutions to hold investment graded bonds. Bonds are classified to be Investment graded based on their ratings by these agencies, any corporate bond with a rating higher than BBB considered to be investment graded bond.

3.3.3 Estimation of Risk Premiums

The credit ratings provided by these agencies are used by various banks and financial institutions in determining the risk premium they will charge on loans and corporate bonds. A poor credit rating implies a higher risk premium with an increase in the interest rate charged to corporations and individuals with a poor credit rating. Issuers with a good credit rating are able to raise funds at a lower interest rate

3.3.4 Enhanced Transparency in the Credit Markets

The credit rating agencies provide improved efficiency in the credit markets and allow for more transparency in dealings. The ratings help monitor the credit soundness of various borrowers through set of well-defined rules.

3.3.5 Standardization of the Evaluation Process

Most credit agencies use their own methodology for determining credit ratings, but since only a handful of popular credit rating providers exist, this adds a great deal of standardization in the rating process. The credit ratings of different borrowers can be easily compared using ratings provided by a credit rating company and the applications can be easily sorted.

3.4 Limitations of Credit Rating

Some limitations of credit rating are-

- Rating could be biased depending on the relationship between the credit rating agency and rated company. The ``Big Three" global credit rating agencies- U.S.-based Standard and Poor's Moody's and Fitch Ratings- have been under intense scrutiny since the 2017-2009 global financial crises. They were initially criticized for their favorable pre crisis ratings of insolvent financial institutions like Lehman Brothers, as well as risky mortgage-related securities that contributed to the collapse of the U.S economy.
- Credit rating requires a fine knowledge about the rated company. Analyst needs to know about the company, its operation properly which is time consuming and requires a very good effort. Several meeting and conversations over phone are done to ensure that. Once a company is rated by a financial analyst of a credit rating agency and after that if that financial analyst switches his/her job, new analyst faces a lot of troubles while performing surveillance of the company.
- As ratings are designed exclusively for the purpose of grading obligations according to their credit quality, they should not be used alone as a basis for investment operations. For example, they have no value in forecasting the direction of future trends of market price. Market price movements in bonds are influenced not only by the credit quality of individual issues but also by changes in money rates and general economic trends, as well as by the length of maturity, etc.

3.5 History of Credit Rating

The three renowned rating companies of today's world are Fitch Ratings, Moody's and Standard and Poor(S and P). The history of credit rating is similar to the history of forming and adopting credit rating services by these companies.

John Knowles Fitch founded the Fitch Publishing Company in 1913. Fitch published financial statistics for use in the investment industry via ``The Fitch Stock and Bond Manual" and `` The Fitch Bond Book". In 1924, Fitch introduced the AAA through D rating system that has become the basis for ratings throughout the industry. With plans to become a full – service global rating agency, in the late 1990s Fitch merged with IBCA of London, subsidiary of Fimalac, S.A., a French holding company. Fitch also acquired market competitors Thomson Bank Watch and Duff and Phelps Credit Ratings Co. Beginning in 2004, Fitch Ratings began to develop operating subsidiaries specializing in enterprise risk management, data services and finance industry training with the acquisition of Canadian company, Algorithmic, and the creation of Fitch Solutions and Fitch Training.

John Moody and Company first published ``Moody's Analyses of Railroad Investments", which added analytical information about the value of securities. Expanding this idea led to the 1914 creation of Moody's Investors Service, Which in the following 10 years, would provide ratings for nearly all of the government bond markets at the time. By the 1970s, Moody's began rating commercial paper and bank deposits, becoming the full-scale rating agency. Moody's ratings represent the opinion of Moody's Investors Service as to the relative credit worthiness of securities. As such, they should be used in conjunction with the descriptions and statistics appearing in Moody's publications. Reference should be made to these statements for information regarding the issuer. Moody's ratings are not commercial credit ratings. In no case is defiler receivership to be imputed unless expressly stated.

Henry Varnum Poor first published the ``History of Railroads and Canals in the United States" in 1860, the forerunner of securities analysis and reporting to be developed over the next century. Standard Statistics formed in 1906, which published corporate bond, sovereign debt and municipal bond ratings Standard Statistics merged with Poor's Publishing in 1941 to form Standard and Poor's Corporation, creditworthiness of securities. As such, they should be used in conjunction with the descriptions and statistics appearing in Moody's publications. Reference should be made to these statements for information regarding the issuer. Moody's ratings are not commercial credit ratings. In no case is defiler receivership to be imputed unless expressly stated.

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3.6 Overview on International Credit Rating Agencies

Credit scores for individuals are assigned by credit bureaus (US; UK: credit reference agencies). Credit ratings for corporations and sovereign debt are assigned by credit rating agencies.

In the United States, the main credit bureaus are Experian, Equifax, and Trans Union. A relatively new credit bureau in the US is Innovis. In the United Kingdom, the min credit reference agencies for individuals are Experian , Equifax, and Callcredit In Canada, the main credit bureaus for individuals are Equifax, TransUnion and Northen Credit Bureaus/Experian. In India, the main credit bureaus are CRISIL, ICRA and Credit Registration Office (CRO). The credit rating agency for individuals in India is CIBIL (Credit Information Bureau (India) Limited).

The largest credit rating agencies (which tend to operate worldwide) are Moody's Standard and Poor's and Fitch Ratings.

3.6.1 Moody's

Moody's is the oldest agency in the credit rating industry and published the first rating in the history. Moody's history dates back to 1900 when John Moody founded the company. In 1909 Moody's published their first ratings when they rated loans and American railway companies. These were classified according to the same rating scale still in use today. Since

1962 Moody's has been a subsidiary of the Dun and Bradstreet Corporation (D and B). Moody's Investors Service is among the world's most respected and widely utilized sources for credit ratings, research and risk analysis for broad scope of debt securities. It has 17 offices worldwide and provides ratings on a 100 sovereign nations' debt.

3.6.2 Standard and Poor's

Standard and Poor's (S and P) is a company with a history that dates back to 1860 when Henry Varnum Poor opened a publishing house that produced manuals of railway companies. It was not until 1923 that S and P stared to publish ratings and these were limited to loans of industrial companies. In 1941 Poor Publishing merged with Standard Statistics to form the S and P. in 1960 S and P acquired a stake in Fitch Investors Service rating agency operations. In 1966 McGraw Hill an American publishing house bought out S and P and still today they own the company. Standard and Poor is not a public company.

Standard and Poor's is a leading provider of financial market intelligence. The world's foremost source of credit ratings, indices, investment research, risk evaluation and data, Standard and Poor's provides financial decision-makers with the intelligence they need to feel confident about their decisions.

3.6.3 Fitch

The third major rating agency, Fitch Ratings provides ratings and research to almost 100 countries. Similar to the other agencies, Fitch Ratings covers a wide range of debt securities offered by corporations, financial institutions, municipal government, insurance companies and sovereign nations. At present they have ratings on 100 sovereign nations. It has further been expanding by opening offices in Central Europe and by joint ventures and equity stakes in Asian rating agencies.

Fitch Rating was founded as the Fitch Publishing Company on December 24, 1913 by John Knowles Fitch. Located in the heart of the Financial District in New York City, the Fitch

Publishing Company began as publisher of financial statistics. In 1924, the Fitch PublishingCompany introduced the now familiar ``AAA” to ``D” ratings scale to meet the growing demand for independent analysis of financial securities. Fitch Ratings was one of the three ratings agencies first recognized as a nationally recognized statistical rating organization (NRSRO) by the Securities and

Exchanges Commission in 1975. In 1997, Fitch Ratings merged with IBCA limited, headquartered in London, significantly increasing Fitch Ratings’ worldwide presence and coverage. Fitch is dual-headquartered in New York and London, operating offices and joint ventures in more than 50 locations and covering entities in over 100 countries.

3.7 Rating Grades

Each rating agency has developed its own system of rating sovereign and corporate borrowers. Fitch Ratings developed a rating system in 1942 that was adopted by Standard and Poor’s. Moody’s grading is slightly different. Moody’s sometimes argues that their gratings embed a conceptually superior approach that directly considers not only the likelihood of default but also the severity of loss in the event of default.

Exhibit 1 : Rating Notches of Moody’s , S and P, and Fitch

Description	Moody’s	S and P	Fitch
Maximum Safety	Aaa	AAA	AAA
High Grade	Aa	AA	AA
Higher Medium Grade	A	A	A
Lower Medium Grade	Baa	BBB	BBB
Speculative	Ba	BB	BB
Highly Speculative	B	B	B
Substantially Risky	Caa	CCC	CCC
May be in Default	Ca	CC	CC
Extremely Speculative	C	C	C

Default	D	D	D

3.8 Rating Methodology

Rating methodology used by the major credit rating agencies is more or less the same. The rating methodology involves an analysis of all the factors affecting the creditworthiness of an issuer company e.g. business, financial and industry characteristics, operational efficiency, management quality, competitive position of the issuer and commitment to new projects etc. A detailed analysis of the past financial statements is made to assess the performance and to estimate the future earnings. The company's ability to service the debt obligations over the tenure of the instrument being rated is also evaluated.

In fact, it is the relative comfort level of the issuer to service obligations that determine the rating. While assessing the instrument, the following are the main factors that are analyzed into detail by the credit rating agencies.

1. Business Risk Analysis
2. Financial Analysis
3. Management Evaluation
4. Geographical Analysis
5. Regulatory and Competitive Environment
6. Fundamental Analysis

These are explained as under:

1. Business Risk Analysis

Business risk analysis aims at analyzing the industry risk, market position of the company, operating efficiency and legal position of the company. This includes an analysis of industry risk, market position of the company, operating efficiency of the company and legal position of the company.

a. Industry risk: The rating agencies evaluates the industry risk by taking into consideration various factors like strength of the industry prospect, nature and basis of competition, demand and supply position, structure of industry, pattern of business cycle etc. Industries compete with each other on the basis of price, product quality, distribution capabilities etc. industries with stable growth in demand and flexibility in the timing of capital outlays are in a stronger position and therefore enjoy better credit rating.

b. Market position of the company: Rating agencies evaluate the market standing of a company taking into account:

i. Percentage of market share
ii. Marketing infrastructure
iii. Competitive advantages
iv. Selling and distribution channel
v. Diversity of products
vi. Customers base
vii. Research and development projects undertaken to indentify obsolete products
viii. Quality Improvement programs etc

c. **Operating efficiency:** Favorable locational advantages, management and lafor relationships, cost structure, availability of raw-material, labor, compliance to pollution control programs, level of capital employed and technological advantages etc. affect the operating efficiency of every issuer company and hence the credit rating.

d. **Legal position:** Legal position of debt instrument is assessed by letter of offer containing terms of issue, trustees and their responsibilities, mode of payment if interest and principal in time, provision for protection against fraud etc.

e. **Size of business:** The size of business of a company is a relevant factor in the rating decision. Smaller companies are more prone to risk due to business cycle changes as compared to larger companies. Smaller companies operations are limited in terms of product geographical area and number of customers. Whereas large companies enjoy the benefits of diversification owing to wide range of products customers spread over larger geographical area. Thus, business analysis covers all the important factors

f. related to the business operations over an issuer company under credit assessment.

II. **Financial Analysis**

Financial analysis aims at determining the financial strength of the issuer company through ratio analysis, cash flow analysis and study of the existing capital structure. This includes an analysis of four important factors namely:

(a) Accounting quality
(b) Earnings potential/profitability
(c) Cash flows analysis
(d) Financial flexibility

Financial analysis aims at determining the financial strength of the issuer company through quantitative means such as ratio analysis. Both past and current performance is evaluated to comment the future performance of a company. The areas considered are explained as follows.

a. Accounting quality: As credit rating agencies rely on the audited financial statements, the analysis of statements begins with the study of accounting quality. For the purpose, qualification of auditors, overstatement/understatement of profits, methods adopted for recognizing income, valuation of stock and charging depreciation on fixed assets are studied.
b. Earnings potential/profitability; Profits indicate company's ability to meet its fixed interest obligation in time. A business with stable earnings can withstand any adverse conditions and also generate capital resources internally. Profitability ratios like operating profit and net profit ratios to sales are calculated and compared with last 5 years figures or compared with the similar other companies carrying in same business. As a rating is a forward-looking exercise, more emphasis is laid on the future rather than the past earning capacity of the issuer.
c. Cash flow analysis: Cash flow analysis is undertaken in relation to debt and fixed and working capital requirements of the company. It indicates the usage of cash to different purposes and the extent of cash available for meeting fixed interest obligations. Cash flows analysis facilitates credit rating of a company as it better

d. indicates the issuer's debt servicing capability compared to reported earnings.
e. Financial flexibility: Existing Capital structure of a company is studied to find the debt/equity ratio, alternative means of financing used to raise funds, ability to raise funds, asset deployment potential etc. The future debt claims on the issuer's as well as the issuer's ability to raise capital is determined in order to find issuer's financial flexibility.

III. Management Evaluation

Any company's performance is significantly affected by the management goals, plans and strategies, capacity to overcome unfavorable conditions, staff's own experience and skills, planning and control system etc. Rating of debt instrument requires evaluation of the management strengths and weaknesses.

IV. Geographical Analysis

Geographical analysis is undertaken to determine the locational advantages enjoyed by the issuer company. An issuer company having its business spread over large geographical area enjoys the benefits of diversification and hence gets better credit rating. A company located in backward area may enjoy subsidies from government thus enjoying the benefit of lower cost of operation. Thus geographical analysis is undertaken to determine the locational advantages enjoyed by the issuer company.

V. Regulatory and Competitive Environment

Credit rating agencies evaluate structure and regulatory framework of the financial system in which it works. While assigning the rating symbols CRAs evaluate the impact of regulation/deregulation on the issuer company.

VI. Fundamental Analysis

Fundamental analysis includes an analysis of liquidity management, profitability and financial position, interest and tax rates sensitivity of the company. This includes an analysis of liquidity management, profitability and financial position, interest and tax rates sensitivity of the company.

1. Liquidity management involves study of capital structure, availability of liquid assets corresponding to financing commitments and maturing deposits, matching of assets and liabilities.
2. Assets quality covers factors like quality of company's credit risk management, exposure to individual borrowers and management of problem credit etc.
3. Profitability and financial position cavers aspects like past profits, funds deployment, revenues on non-fund based activities, addition to reserves.
4. Interest and tax sensitivity reflects sensitivity of company following the changes in interest rates and changes in tax law. Fundamental analysis is undertaken for rating debt instruments of financial institutions, banks and non-banking finance companies.

Chapter Four

Credit Rating in Bangladesh

4.1 Credit Rating in Bangladesh

Bangladesh credit rating industry stared its journey with the mandatory requirement of having credit rating for all public debt instruments, right offer issues and share issued at o premium before the same were offered to the public. In the year of 2002m Credit Rating Information and Service Limited (CRISL) started its operation a the first registered credit rating agency of Bangladesh. The second rating agency, Credit Rating Agency of Bangladesh Limited (CRAB) went to its operation on 2004, thus making the sustainability more difficult for two rating agencies.

Credit Risk Grading Manual of Bangladesh Bank was circulated bt Bangladesh Bank vide BRPD Circular No. 18 dated December 11, 2005 on Implementation of Credit Risk Grading Manual which is primarily in use for assessing the credit risk grading before a bank lend to its borrowing clients. By that time CRISL rating reports were appearing to be very useful for the users; specially CRISL rating report on the then Al Baraka Bank convinced the Bangladesh Bank of the need of credit rating and it took the initiative to make mandatory for all banks to have credit rating before it goes for public offering the banking regulator further decided to make it mandatory for all banks to submit credit rating reports to the regulator within six months after the finalization of accounts.

Following the example of the central bank the insurance regulator also came up with the requirement to make rating mandatory for all general insurance companies every tear and for the life insurance companies bi-annually. The Dhaka Stock Exchange while issuing the direct listing regulations made the credit rating mandatory before a company apply for direct listing. The above regulations created an enabling environment for credit rating in the country's capital and financial markets. The concept of client rating by the rating agencies to support capital adequacy of the banks came up in view of the need for implementation of Basel II capital adequacy framework by Bangladesh Bank.

According to Basel II framework BB adopted a standardized approach for credit risk in which the services of rating agencies were required under certain strict terms and conditions. Bank client rating is very sensitive issue in view of the fact that most of the private sector companies, enjoying banking facilities, are not maintaining standard financials for appropriate evaluation. Unless and until all the above factors are properly evaluated through sector wise studies, the ratings are bound to give wrong signals. Security and Exchange Commission of Bangladesh (SECB) allows 2% default rate of the credit rating agencies. There are certain penalties in case default rate of more them 2% including cancellation of license of the defaulter rating agency as the highest penalty by BSEC.

Other credit rating companies National Credit Ratings Ltd and Emerging Credit Rating Ltd started their journey on 2010. ARGUS Credit Rating Services Ltd. In on operation since 2011. Lastly, new four credit rating companies have come to operation on 2012, which are ARGUS Credit Rating Services Ltd. Alpha Credit Rating Limited, the Bangladesh Rating Agency Limited and WASO Credit Rating Company (BD) Limited. A list of credit rting companies operating in Bangladesh can be found inExhibit 2: List of CRAs.

According to Association of Credit Rating Agencies of Asia, Bangladesh has the highest number of credit rating companies. India, one of the largest economies of Asia has only two credit rating companies. On the other hand China, another largest economy is continuing its economic growth with single credit rating company. The rating industry In Bangladesh is now considered to be a parentless industry. The behavior of the regulators towards nourishing this industry does not appear to be rational. The rating agencies are still defined by the SEC rules as in investment advisory company. This has not changed over a long time. The paid-up capital still remains at Tk.5.0 million, to start a rating agency by any group of sponsors.

Exhibit 2: List of CRAS

Name of Company	Date of Issuance of Registration Certificate
Credit Rating Information and Services Ltd (CRISL)	21 August, 2002
Credit Rating Agency of Bangladesh Ltd (CRAB)	24 October, 2004
National Credit Ratings Ltd	22 June, 2010
Emerging Credit Rating Ltd	22 June, 2010

ARGUS Credit Rating Services Ltd.	21 July, 2011
WASO Credit Rating Company (BD) Limited	15 February, 2012
Alpha Credit Rating Limited	20 February, 2012
The Bangladesh Rating Agency Limited	7 March, 2012

4.2 Laws and Guidelines Regulating CRAs

Credit rating agencies (CRA) in Bangladesh has been guided by the ``Credit Rating Companies Rules, 1996" enacted by Bangladesh Securities and Exchange Commission (BSEC) through notification of SEC/Section-7/117 on 24 June 1996. The basic snapshot of the law is provided below:

1. **Requirement for credit rating:** No issue of debt security, or public issue of shares (including rights share) at a premium, shall be made by an issuer unless the issue is rated by a credit rating company and declaration about such rating is given in the offer document, prospectus or rights share offer document.
2. **Eligibility for registration:** A company proposing to commence business as a credit rating company shall be eligible for registration under these rules if it fulfils or complies with the following conditions or requirements:
    - ❖ It is incorporated as a public company under the Companies Act, 1994
    - ❖ It must have a paid-up capital of at least Tk. 5.00 million
    - ❖ It has professional competence, financial soundness ad has entered into a joint venture or technical collaboration arrangement with a reputed credit rating company,
    - ❖ It has at least two professional staff having professional or post-graduation degree in finance, accountancy, business, economics and / or law and experience for at least two years in credit rating or investment advisory activities,

3. **Cancellation or Suspension of Registration:** Where BSEC is of the opinion that a credit rating company has contravened any provision or has otherwise failed to comply with any requirement of the Ordinance or any rule or direction made or giver

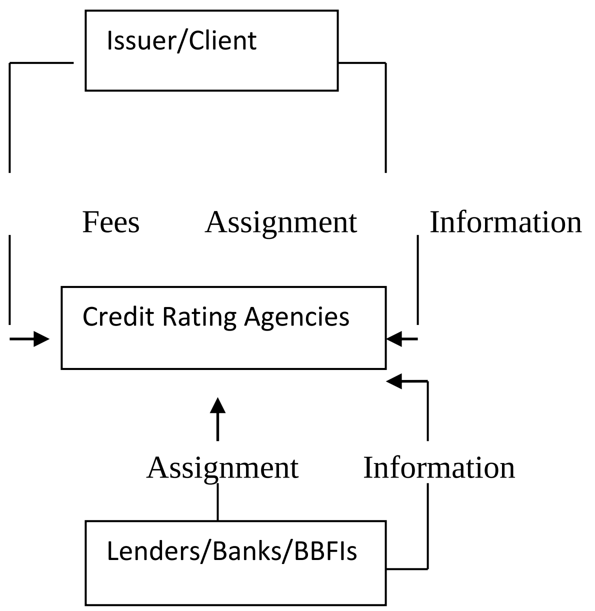
4. there under the Commission may, if it considers necessary in the public interest, so to do by order in writing, cancel or suspend the registration of the credit rating company. Provided that no such order shall be made except after giving the credit rating company an opportunity of being heard.
5. **Submission o ratings report to the Commission**: Every credit rating company shall submit to BSEC a report giving such details of credit rating for a quarter of the year in such form as may be required by the commission by order in writing, within fifteen days of the close of the quarter.

4.3 The Business Model

The business model used by the credit rating agencies in Bangladesh in primarily involves two parties apart from the CRAs. These parties are:

1. Issuers/clients of the credit rating agencies
2. The investors, usually the financial institutions including: banks, non-banking financial institutions, merchant banks, issue manager, donor organizations, and so on.

Exhibit 3 : Common business model of CRAs



Usually, the CRAs receive their rating assignments directly from the clients. The purpose of the client may vary depending on the benefits they expect to derive from getting themselves rated. However, because of implementation of BASEL II in Bangladesh, commercial banks have a great interest in getting their borrowers rated by ECAIs. So the providers of business for a CRA are both the clients and the lenders. Although assignments can be received from both ends, the fees for such assignments are usually paid by the clients.

On the other hand, the analysts of the credit rating agencies would require large amount of information regarding the business operation, financials, bank relation, and management of the issuer being rated, the information is regarding these are provided by both the peer parties. A qualitative analysis of the rating model and its impact on the effectiveness of the credit rating is reported in a later part.

4.4 Credit Rating Process:

Rating is an interactive process with a prospective approach. It involves a series of steps. The main steps are described as follows:

4.4.1 Rating Request:

Rating is CRAs are usually initiated on formal request from the prospective Issuer. An undertaking is also obtained on a Taka 150 one-judicial stamp paper before commencement of a Rating assignment; which spells out the terms an conditions of the engagement of credit rating agency.

4.4.2 Rating Team:

The Rating team usually comprises two members. The composition of the team is based on the expertise and skills required for evaluating the business of the Issuer. The team I usually led by the primary analyst with adequate knowledge of the relevant industry/instrument to be Rated.

4.4.3 Information Requirements:

Issuers are provided with a list of information requirements and broad framework for discussions. These requirements are derived from the experience of the Issuers business and broadly conform to all aspects, which have a bearing on the Rating.

4.4.4 Secondary Information:

CRA draws on the secondary sources of information including its own in – house research and information obtained through meetings with the Issuers' bankers, auditors, customers and suppliers among many other relevant market participants. CRA also has a panel of industry experts who provide guidance on specific issues to the Rating tern. The secondary sources generally provide data and trends including change in industry structure, sector outlook, global trends and government policies, etc. for the industry.

4.4.5 Management Meetings and plant visits:

Rating involves assessment of number of qualitative factors with a view to estimate the future earnings prospects of the Issuer. This requires intensive interactions with the Issuers' management specifically with a view to understanding the business plans, future outlook, competitive position and funding policies, etc.

4.4.6 Other Meetings:

The CRA's analyst team may also decide to meet the auditors (accounting pocicies followed, quality of internal control, standard of disclosures, etc.), bankers/lenders (relationship, reputation, dealings in the past in respect of timeliness of servicing obligations), lawyers (if there are major litigations pending which may have serious impact on credit quality), trade union leaders (if industrial relations is a sensitive issue), key functional executives as well as a few investors, customers and suppliers, depending upon the circumstances to get a direct feedback from different stakeholder.

4.4.7 Meeting with the Issuers' Chief Executive Officer (CEO)/ Chief Financial Officer (CFO):

This would be a very important meeting (usually, the last meeting) when the Rating team would discuss all the Issuer(in the absence of CEO/CFO, with a senior executive nominated by the Issuer for this purpose).

4.4.8 Internal Review Committee Meeting

Once the draft report is prepared by the Analyst team, it is placed before the Internal Review Committee (IRC) Meeting. The committee comprise of senior analysts. The committee reviews the draft rating report and analysis made by the analysts. Committee also reviews the due diligence, documents, meetings, site visits etc.

4.4.9 Rating Committee Meeting:

The authority for assigning Rating is vested in the Rating Committee of individual CRA. The Rating reports are sent by the analyst team in advance to the Rating Committee members. A presentation about the Issuers business and the management is made by the Rating Committee at the meeting. All the key issue are indentified and discussed at length during the meetings and all relevant issues, which influence the Rating, are considered. The differences if any arise during the discussion are taken note of. Finally, a Rating is assigned either by a consensus or by majority votes.

4.4.10 Surveillance:

It is obligatory on the part of CRAs to monitor ratings over the tenure of the rated instrument or till any amount is outstanding under program rated. The Issuer is bound by the agreement to provide information to CRAs to facilitate such monitoring. In case the Issuer do not co-operate by way of providing information, etc, for the purpose of surveillance, CRAs may on its own carry out the surveillance on best efforts basis based on the available information and possible interactions after giving the Issuer adequate notice requesting him to co-operate. The Ratings are generally reviewed every year, unless the circumstances of the case warrant an earlier review due to change in circumstances or major developments that were not anticipated/factored in the Rating decision. The Ratings may be Upgraded, Downgraded or retained after the surveillance. The CEO, at his sole discretion, may give one opportunity to the Issuer to represent his case if he is not satisfied with the rating decision after the surveillance process. However, the Issuer would not have any option of not accepting the Rating after the surveillance.

4.5 Profiles of CRAs in Bangladesh

4.5.1 Credit Rating Information and Services Ltd (CRISL)

CRISL is the first ever joint venture rating agency operating in Bangladesh since 1995. It is a joint venture of Malaysia Berhad (RAM), JCR-VIS Credit Rating Company of Pakistan, few financial institutions and a host of celebrated professionals of Bangladesh. The company got license from the Securities Exchange Commission (SEC) under Credit Rating Companies Rules 1996. CRISL is a founder member of the Association of Credit Rating Agencies in Asia (ACRAA) which is sponsored by the Asian Development Bank (ADB). CRISL is a public limited company dedicated for credit rating and related services and is being recognized by Bangladesh Bank as the External Credit Assessment Institution (ECAI) to oferits services to the banking community for banking client rating.

4.5.2 Credit Rating Agency of Bangladesh Ltd (CRAB)

CRBA was established in 2003 at the initiative of some leading personalities in private sector and institutions of the country with the commitment to contribute to the development of the capital market by providing quality ratings and comprehensive research services. CRAB was incorporated as a public limited company in 2003 and received its Certificate cor Commencement of Business in the same year. In 2004, CRAB was granted license by the Securities and Exchange Commission (SEC) of Bangladesh (under the Credit Rating Companies Rules 1996) for operating as a Credit Rating Company. In 2009 CRAB has been accredited as an External Credit Assessment Institution (ECAI) by Bangladesh Bank, to provide rating of Bank Clients under Basel II regime. CRAB has established its reputation as a reliable source of independent opinion on risks based on systematic and standardized analysis done by professionals.

4.5.3 National Credit Ratings Ltd (NCRL)

NCR is a full service rating company that offers a wide range of services. The Securities and Exchange Commission granted the license to NCR in June 2010 under the Credit Rating Companies Rules 1996. The company is recognized by the Bangladesh Bank as an External Credit Assessment Institution (ECAI). NCR has technical collaboration agreement with ``The Pakistan Credit Rating Agencies Ltd.” (PACRA), Pakistan. PACRA was set up in 1994 as the first credit rating agency in Pakistan as a joint venture between IFC of the World Bank and IBCA London (now known as Fitch Ratings). PACRA, while helping NCR in design and development of rating methodologies and programs, would support in training and development of human resources.

4.5.4 Emerging Credit Rating Ltd (ECRL)

Emerging Credti Rating Limited was incorporated in March 2009, with the view to providing Credit Rating Services in Bangladesh. ECRL is a licensed credit rating agency and is committed to providing Bangladesh's credit market with independent and prospective credit opinions, research and data. In addition to our core rating business, in the future we hope to branch out into providing research data and analytical tools for assessing credit risk, and publish market – leading credit opinions. The company has been built on a foundation of local market experience, which spans throughout the corporate sector of the country. The company is headquartered in Dhaka, Bangladesh, with a view to expand to other financial districts all over the nation. ECRL obtained technical support in relation to rating procedures and methodologies from MARC. ECRL obtained credit Rating Companies Rules 1996 and also received Bangladesh Bank Recognition as an External Credit Rating Institution (ECAI) in October 2010. ECRL has already started its operation and completed around 20 rating assignments.

4.5.5 ARGUS Credit Rating Services Ltd. (ACRSL)

ARGUS Credit Rating Services Ltd. (ACRSL) is the next-generation Credit Rating Agency of Bangladesh. Founded as a joint-venture between global experts in credit and equity research and local sponsors with strong capital markets track record, ACRSL received its license from the SEC in 2011.

4.5.6 WASO Credit Rating Company (BD) Limited (WCRCL)

WCRCL started its journey on 15th February, 2012 with acquiring license from Bangladesh

Securities and Exchange Commission (BSEC) and finally been recognized by Bangladesh Bank as and ECAI in October 2012. WCRCL also has the technical collaboration with Financial Intelligence Services Ltd. (FISL), Hong Kong. FISL is the Hong Kong based rating wing of World Vest Base, USA which is renowned for its unsolicited rating approach and unique rating model. Its comprehensive financial database spans over 51,000 public companies in more than 130 countries from Asia, Africa, Australia, Europe, Latin America, and North America placed it in a unique position among the global financial intelligence service provider companies.

WCRCL envisaged offering both rating and related services with a vision to establish a national risk management platform for the financial and non-financial sector.

4.5.7 Alpha Credit Rating Limited (ACRL)

ACRL was incorporated on the 24th of February 2011 a result of the initiative of a few distinguished and renowned professionals of Bangladesh and the with support and organizational assistance from SATCOM IT Ltd, Axis Resources Ltd. Equity Care Bangladesh Ltd., and TAN Equity and Investment Ltd.

4.5.8 The Bangladesh Rating Agency Limited (ACRL)

BDRAL is subsidiary of Dun and Bradstreet South Asia Middle East Ltd., is the pioneer in rating the SME sectors in Bangladesh. SMEs are the power house of the developing economy of Bangladesh and so to turn Bangladesh into ma middle-income nation, the SME sector is the only alternative which can help the country to achieve the feat. Having congruence with the mentioned pragmatic approach, BDRAL SME ratings aim to address the challenges face by bank in SME lending and took the initiative to assist the financiers to provide a comfort level for increasing the financing in the SME sector. BDRAL has launched its SME ratings in Bangladesh following a successful pilot phase carried out in the year 2009. BDRAL's rating framework considers number of financial and non-financial parameters of the enterprise and regulations and industry benchmarks. BDRAL believes that the industry in which an SME operates has a direct bearing on the overall performance of the SME and therefore rates SMEs based on industry benchmarks. BDRAL Rating is a comprehensive assessment of the enterprise taking into consideration the overall financial and non-financial performance of thesubject company vis a vis other peers in the industry in the same line of business and size criteria. The company strives for analytic excellence at all times, evaluate its rating criteria, methodologies and procedures on a regular basis, and modify or enhance them as necessary to respond to the needs of the Bangladesh's markets

4.6 Importance of Credit Rating: Bangladesh

The motives act behind the entities' paying fees to secure a credit rating depends on the surrounding regulatory environment and form of financial market. There are several reasons of getting a rating. The reasons are different in different markets and economies. The motives of getting a rating in Bangladesh are not identical as USA or UK. As same, the motives of American entities are not same as those of European or Australian entities. However, there are some common reasons for which the entities all over the world are spending money to get rating from the rating agencies. The identical reasons are enumerated here within the context of Bangladesh:

4.6.1 Market access

Any company that wishes to enter capital markets and issue debt in capital market is obliged to obtain a credit rating. Rating conveys the entity's ability and willingness to the market participants regarding repayment of its borrowed money or equity capital. In Bangladesh, as per Credit Rating Companies Rules 1996, all the companies are required to be rated before issuing its debt or floating its equity share at premium in the market.

4.6.2 Buildup market reputation

New companies that seek to build a reputation in the international financial markets demand credit ratings to increase the exposure of their brand name. This brand exposure is important when companies for example initiate foreign direct investments. An entity with a higher rating is considered as a reputable organization. Recently, Delta BRAC Housing (DBH) has been awarded as an ``AAA” rated company of the country, which excels the company’s reputation that was reflected through the share price the company at DSE and CSE.

4.6.3 Lower cost of funding

A less Known company can lower their cost of borrowing if they obtain a higher investment grade rating. Banks or financial institutions consider rating as an indication of an entity’s performance measurement yardstick. Entities with a higher are sanctioned loan at a lower interest rate whereas a lower graded entity is charged at a higher interest rate. So, it is going to be a common practice of the country to require an entity to be rated itself before applying for a loan to the banks or financial institutions.

4.6.4 Distinguish oneself from the competition

In sectors that are characterized by a limited number of competing companies such as the banking or insurance industry, a credit rating is a tool to distinguish them from the competition. Our banking sector is an example of this practice. In 2006, only Standard Chartered Bank was rated ``AAA” by CRISL that makes the bank unique. But in 2007, both Standard Chartered Band and HSBC operation of Bangladesh has been awarded the highest rating ``AAA” by CRISL and CRAB respectively that creates some competitive advantage for both the banks.

4.6.5 Regulatory Requirement

All over the world entities are rated for the regulatory bindings by the securities commissions and other authorities. In Bangladesh, SEC, Bangladesh Bank and Department of Insurance are the three regulators who issued regulations, circulars and notifications for the entities for rating. Our banks and insurances are now rated once in a year for these requirements of the regulatory authorities.

4.7 Why Credit rating is important or any organization

Bangladesh Bank (BB) issued new guidelines on capital adequacy for Banks under the implementation process of Basel II framework. The details about Basel II still next stage. Under the guidelines, Banks require to link the minimum size of their capital to the credit risk in their portfolios. That means if an person, any organization or any client of a bank wants to enjoy loan facilities from the bank, then the person or client must be need a credit rating from a registered credit rating agency to agency to enjoy the loan facilities. So far Banks were calculating required capital as proportion of the entire loan portfolio, regardless of the degree of credit risk. To determine credit risk in their loan portfolios, banks will need to use credit ratings assigned by approved External Credit Assessment Institutions (ECIAs).

4.8 What is Basel II?

4.8.1 Basel Accord

The world financial market is as extremely complex system that involves many different participants from local banks to the central banks of each nation and even the investor. Due to its importance on the global economy and our everyday lives it is vital that it is functioning properly. One tool that helps the financial markets run smoothly is a set of international

Chapter Five

Rating Policy/System of Alpha Rating

The rating mehodology incorporates quantitative factors. The rating reflects the company’s current financial strength as well as how the financial position may change in the future. In this respect, extensive research on the outlook of the sector in which the firm operatws is also an integral part of the rating methodology. Ratings are assigned by the Rating Committee. The ratings are assigned on a national scale and corporations are evaluated in respect to the financial strength of their peers in Bangladesh. Within this context, our analysis takes into consideration the fundamentals of the Bangladesh economy and the key features of the sector in which the company operates. The issuer’s evaluation will also take into account;

1. Recent economic developments,
2. The quality of economic and financial management,
3. The debt and characteristics of the sector,
4. Economic stability,
5. Political stability and effectiveness of the political system,
6. Long-trends and economic outlook.

A corporate rating evaluation, whether for an industrial company of a company or a company in the service sector, will consider three main areas;

A. Busines Risk Analysis;

Business Risk analysis is segmented into two or three sub sectors; industry outlook, competitive position, and if necessary, operations analysis.

a) **Industry Outlook:** Industry evaluates the level of risk involved in participating in a particular business of businesses. Some of the factors, among potentially many others, the analyst will consider include;

1. Demand growth,
2. Pricing flexibility,
3. Capital intensity,
4. Research and development requirements,
5. Barriers to entry,
6. Regulatory framework.

b) **Competitive Position:** Competitive position looks at an organization's competitive strengths and weaknesses relative to its peers. In particular, the question is whether the firm's market position and associated business strategies allow it to favorably differentiate itself from its competitors.

c) **Operations Analysis:** Operations analysis can be a useful additional sub-sector of business Risk analysis in those cases where technical competence is an absolutely critical ingredient of success. Such situations would include those where human safety is at issue (such as fire, earthquake, terror, of even failure of the data system of breakdown in technology), and, therefore, a sudden loss of customer confidence could potentially translaate rather quickly into financial disaster.

B. Financial Risk Analysis:

Financial Risk analysis is segmented into four sub sectors:

a) **Earnings:** A record of reliable profits, even if cyclical of volatile, enables access to funding on commercial terns. Firms that have compiled such profit records have more flexibility to refund or retire outstanding debts through capital market operations, rather than being dependent on matching internally generated cash flows to debt maturities. Performance is generally evaluated by relating profits to assets, to permanent capital, and to equity. Return of assets is generally evaluated by relating profits to assets, to permanent capital, and to equity. Return of assets is computed before taxes, and measures the productivity of all assets. One other ratio used to judge the contribution of profits to the firm's credit profile is the dividend payout ratio. The dividend payout ratio considers the portion of earnings paid out as dividends on common stock.

b) **Cash Flow Generating Ability and Debt Servicing Capacity:** As cash flow is the principal source of repayment for debt obligations issued by corporations, cash flow generating ability and debt servicing capacity are closely related. Cash flow can either be from operating or from non-operating sources operating cash flow is also called funds from operating and is typically defined as pretax profits adjusted for items not involving movement of funds, principally depreciation, amortization and other non-cash items, plus interest. Non-operating cash flows are normally derived from sales of long term assets, which may include property or equipment, parts of or entire business units, of investments in affiliates.

Annual cash inflows (sources) from operating and non-operating activities are compared with annual cash outflows (uses), both on historic and projected

bases. This Sash Flow Match indicates the extent to which the organization has been reliant on external funds in

the past and is likely to be so in the future. Cash outflows considered include capital expenditures, long-term investments, dividends on common and preferred stock, income taxes, interest expense, and working capital changes.

c) **Capital Adequacy:** Capitalization and Financial Policies are often indicative of a company's risk orientation. The extent to which management decides to finance its However, very low financial leverage isn't necessarily the most appropriate strategy. After all, equity financing is usually more expensive than debt financing is reasonable. Alpharating seeks to understand the basis of management's financial policies before drawing conclusions in this section of the credit analysis.

Several ratios are computed to measure debt leverage. The universal standard leverage measure is Total Debt/Equity, which considers all on-balance sheet debt obligations, including such short-term liabilities as bank overdrafts, relative to equity. Equity includes common and irredeemable preferred shares. Short-term Debt/Total Debt, considered together with hte firm's debt maturity schedule, is evaluated to understand the extent of rollover risk. Short term debt does expose a company to refinancing risk. Its use within reasonable limits is justified by cost and asset-matching considerations. When appropriate, off-balance sheet financial liabilities such as operating leases, joint venture debt, and guarantees, are taken into account through adjustments to the standard ratios.

d) **Financial Flexibility:** financial flexibility principally incorporates the concepts of liquidity and access to alternate financial sources. Potential

e) constraints on financial flexibility, such as legal claims or potential

environmental liabilities, would also be considered in this section. a number of ratios are used to evaluate a firm's liquidity.
Traditional favorites include;

The Cash Ratio (cash and equivalents/current liabilities), the Quick Assets Ratio (cash and equivalents plus trade receivables/current liabilities), and the Current Ratio (current assets/current liabilities).

Accounts Receivable Turnover (average accounts receivable/sales x 365/1) and Inventory Turnover (cost of goods sold/average inventory x 365/1) ratios are also useful to look at to assess the level of funds tied up in these activities.

In addition, calculation of a Payables Turnover ratio (payables/cost of goods sold x 365/1) indicates whether the firm is stretching out or speeding up payment to its suppliers. Important information can be derived by tracking turnover rates over time and relative to key competitors.

C. Management/Ownership/Governance Risk Analysis:

Management/Ownership/Governance Evaluation is one of the key elements of the rating methodology sine it is management that decides what businesses to be in, what strategies should be pursued, and how these activities should be financed. Ideally, management's business goals and financial policies should be clear, consistently pursued, and realistic based on the firm's business risk. The management evaluation is also conducted with due consideration given to the actual and potential influence of significant shareholders. It is important to establish that there is a congruence of goals of such shareholders with those espoused by company management to the rating agency. If given the opportunity, Turk rating meets with significant or controlling shareholders to assess how they view the relationship. Additional governance issues that are of particular relevance include information disclosure and transparency. More specifically, the quality of a company's accounting and financial reporting practices, including timeliness and transparency, reflect the management's attitude towards risk and towards fair dealing with key constituencies including, most importantly, from Turkrating's perspective, creditors. Risk management principles and practices are also key elements of Turkrating's evaluation of management. The existence of a well-defined set of risk management principles and its strict implementation by all management staff is central to understanding the company's credit quality.

6.2 Rating scales

AlphaRating assign the following credit rating scale foe long term and short term rating scale for any business or company or organization.

Exhibit 4: Rating Scales of Alpha Credit Rating Limited

Long Term Rating Scale And Definitions

AAA	Issuers or issues rated AAA represents the strongest credit quality relative to other Bangladeshi obligors
AA	Issuers or issues rated AA represents very strong credit quality relative to other Bangladeshi obligors
A	Issuers or issues rated A represents above average credit quality relative to other Bangladeshi obligors
BBB	Issuers or issues rated BBB represents average credit quality of Bangladeshi obligors
BB	Issuers or issues rated BB represents slightly below average credit quality relative to other Bangladeshi obligors

B	Issuers or issues rated B represents weak credit quality relative to other Bangladeshi obligors
CCC	Issuers or issues rated CCC represents weak credit quality relative to other Bangladeshi obligors
CC &C	Issuers or issues rated CC and C both represents extremely weak credit quality relative to other Bangladeshi obligors. Rating of C will normally be assigned when an obligor is in technical default on certain commitments or obligations, but not yet in financial default.
D	Issuers or issues rated D have failed to meet their rated financial commitment on time or when due

Long term rating from AA to B may be modified by the inclusion of a plus (+) or minus (-) sign to indicate relative strength within the rating category.

Short term Rating Scale

AR 1	Issuers rated AR 1 have the strongest ability to meet short term financial commitments relative to other Bangladeshi obligors
AR 2	Issuers rated AR 2 have an above ability to meet short term financial commitments relative to other Bangladeshi obligors
AR 3	Issuers rated AR 3 have an average ability to meet short term financial commitments
AR 4	Issuers rated AR 4 have the strongest ability to meet short term financial commitments relative to other Bangladeshi obligors
AR 5	Issuers rated AR 5 have a well below average ability to meet short term financial commitments relative to other Bangladeshi obligors
AR 6	Issuers rated AR 6 have failed to meet short term financial commitments

Rating Outlook

Rating Outlook assesses the potential direction of the Debt Rating over the intermediate term (typically over a one to tow-year period). The Rating Outlook may either be:	
POSITIVE	Which indicates that a rating may be raised;
NEGATIVE	Which indicates that a rating may be lowered;
STABLE	Which indicates that a rating is likely to remain unchanged; or
DEVELOPING	Which indicates that a rating may be raised; lowered or remain unchanged.

Chapter Six:

Qualitative Analysis-Effectiveness of Rating

The qualitative analysis of the effectiveness is very important as it would define the restraining catalysts, which the quantitative analysis would not be able to identify. the qualitative analysis would focus on the probable discrepancies and self-serving biases.

qualitative analysis of the effectiveness of credit ratings in Bangladesh would include two different perspectives that are-

1Analysis of business model

2 Analysis of the Industry dynamics

observing the business model that was presented in previous chapter , it can be identified that client provides the fees for doing its own credit rating . This is the most vital point in the business model of the credit rating agencies . It may result in inflated credit rating as the CRAs may try to get new clients or may even try to retain the old ones . This scenario

Chapter Seven

7.1

7.2

Chapter Eight

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