



Rating Methodology – Government Support Entities

INTRODUCTION

CRISL defines credit rating is a measure of assessing relative risk of default and the severity of default associated with particular securities issue, issuer and/or other financial assets. It is a symbolic indication of current opinion of the relative capability of timely servicing of the debts and obligations as per the terms of contract. It is an independent, impartial best judged professional OPINION on the ABILITY and WILLINGNESS of a borrower to discharge its debt obligation when due, in case of a debt instrument and assessment of net worth, external liability and earning prospects in case of a Corporate Entity.

DEFINITION OF DEFAULT

CRISL adopted the international definition of default as being adopted by global rating agencies. Under the above definition, Default is:

- A) A missed installment (Principal and or Interest) which has not been discharged / paid as per schedule or within the grace period allowed by the regulators/ creditors.
- B) Failure to honour the corporate guarantee obligations as per contract or within the allowed grace period;
- C) The legal insolvency or bankruptcy of the issuer/ entity
- D) A distress exchange in which the bondholders/ creditors are offered a substitute instrument with inferior terms and conditions
- E) Restructuring of a financial obligation substantially disadvantageous to the creditors;

SCOPE AND LIMITATIONS OF CRISL RATINGS

CRISL ratings are in local currency and therefore, it does not take into consideration the sovereign risks and foreign currency risk of Bangladesh Government. CRISL, being a domestic rating agency of Bangladesh considers the government of Bangladesh as the highest pay master and all government guaranteed securities/ guarantees are considered as AAA.

TIME HORIZON

CRISL ratings are forward looking and sustainable throughout normal business cycle. CRISL issues normally two types of ratings – Long term and short term. Short term rating carries the validity of six

months while the long term rating is valid for one year. The change in economic scenario, complexities and change in government policy may have an impact on the ratings assigned over a period of time. CRISL updates the rating periodically with the cooperation of the clients. In case the client is not willing to cooperate, CRISL withdraws the rating after due notice to the client. Therefore, CRISL ratings are to be read with the time.

RATING DEFINITION

CRISL follows standard definition of ratings in line with the global rating agencies. It follows a ten notch scale with AAA being the highest and D, the lowest rating reflecting default in discharging its liabilities in time. With the addition of plus (+) and minus (-) signs before the scale, the 10 notches scale reflects 26 positions. These plus and minus signs indicates the position of each rating in the scale.

DEFINING GOVERNMENT SUPPORT ENTITIES (GSE)

Government-support entities include enterprises in which the government has full or majority ownership, operational involvement, full or partial control or Government financial supports. Examples of such entities are Sector Corporations, Public Sector Enterprises (PSE), Utility companies/ enterprises, Gas and Mineral exploration companies/ enterprises, Power Transmission and Distribution Companies, State Owned Banks (SCB) and other enterprises / manufacturing and service organizations that are set up in support of Government policies etc. The role of government globally has been changing in managing the enterprises under its control. Governments are relying on market mechanisms to address the inefficiencies of the public sector. There is a growing tendency globally and also in Bangladesh to expose the GSEs to private sector or corporatize them in line with market demand. During recent days a good number of GSEs have off-loaded its shares either through IPO or through direct listing with the bourses. Some of the enterprises / banks have been converted to public limited companies to make the operation more dynamic, transparent and accountable. Since these entities are enjoying support from the government in terms of business or finance and these entities are set up in line with the national importance, CRISL considers it necessary to rate them differently. CRISL offers two different long term ratings to the above entities- First, rating with due consideration to the above government supports and Secondly a stand alone rating to reflect its actual

operational position in CRISL rating scale so that its fundamentals are not shaded with the Government support ratings. The above have been factored in CRISL rating framework while offering ratings to the GSEs.

STAND-ALONE RATINGS

CRISL stand-alone ratings to GSEs means rating of the GSE has been done on the basis of its own fundamentals, that is, on its commercial or economic prudence. CRISL applies the methodology designed for each sector where the enterprise belongs. The above framework covers fundamentals such as Industrial Risk, Business Risk, Market Risk, Operational Risk, Financial Risk, covering various qualitative and quantitative factors of the GSE. While conducting stand-alone rating, CRISL keeps the factors relating to Government support in business, finance and others in abeyance. CRISL analysts consider peer average, industry average etc to place the entity into its stand alone position.

For many government-supported entities, however, the determination of a stand-alone rating is not so clear-cut because of the intricacy of the government's involvement in many aspects of the entity's operations. This can include access to preferential funding, a monopoly position, favorable contracts and sympathetic regulatory regimes, all of which are difficult-to-isolate forms of support that enhance both operational and financial performance. Conversely, price ceilings, risky investment project mandates and directives to provide loss generating goods and services represent forms of government intervention that constrains operational and financial performance. In these cases, assuming a sudden and complete stripping away of all forms of government influence may be neither practical nor informative. As such, the one assumption made in determining the stand-alone rating is that the government will not specifically intervene to maintain the solvency or liquidity of the public entity, or in other words that the government will not bail out the enterprise in a crisis. In short, CRISL applies the criteria for the type of entity being rated on the basis of that entity's existing business profile and financial position, including whatever government support or intervention the entity typically enjoys in the normal course of business, but excluding credit for any extraordinary government assistance that might be expected in the event of a crisis.

RATING BASED ON GOVERNMENT-SUPPORT

In order to rate a GSE with Government support, CRISL classifies the GSEs into three broad categories on the basis of the ownership, relationship and support as follows:

1. HIGH INTEGRATION WITH THE GOVERNMENT

The rating of the GSEs under this category is generally equated with that of the Government when

the entity is a government department, Ministry, or an agency, which is integrated with the Government in such as away that it is difficult to change, or engages in activities that cannot readily be undertaken on a commercial basis. Government support does not result solely from the entity's policy role or importance, but rather from its place in the processes of government. The debt of these entities may or may not receive explicit guarantees from the government. Changes in government policy could mean that entities in this category will migrate to other categories over time. Examples of entities currently falling into this category include:

- Government Ministries;
- Government Departments
- Regulatory bodies;
- Sector Corporations;
- State Owned Commercial Banks;
- Public educational institutions receiving direct Government funds for its operation
- National Flag carriers such as Bangladesh Biman, Shipping Corporations
- Port Authorities
- Municipal Corporations

2. PUBLIC POLICY-BASED INSTITUTIONS

This category differs from the first in that it encompasses a broader variety of entities for which government support is based on a defined public policy role. Support is both as a matter of policy and law, but is more subject to change and so is less robust than for entities in the first category. This support may be expressed, in part, through statutory or ultimate—rather than timely—guarantees. Government support is not simply a matter of a positive attitude and supportive disposition. CRISL must be convinced that the government could and would intervene to avoid default by the enterprise. Some public sector entities that historically were viewed as critical instruments of government policy may no longer fall into this category because of the changing stance of the government toward them, reflecting a decline in willingness to provide support, rather than limited ability. CRISL considers the following factors while placing a GSE under this category:

- The track record of support for government entities.
- The formal policy regarding support and CRISL's evaluation of the policy.
- The mechanisms that are in place for diagnosing and responding to financial distress. Whether the government has financial assets available that can be readily mobilized to assist the entity.
- The financial and political self-interest of the government in keeping the public entity solvent.

- The likelihood of access to the debt markets by the government or its other business entities being compromised in the event of a particular entity defaulting.
- The importance of continued, unimpeded access to debt markets for the government. The stability of policy-making procedures and the administrative and political culture.
- The core public functions, if any, carried out by the public entity.
- The entity's economic and political importance, visibility, and sensitivity; its ranking in terms of order of importance to the government versus other public sector entities; and its public policy role compared with similar entities in other countries.
- The likelihood of private sector entities providing the same products or services on a commercial basis.
- The government's policy and track record regarding privatization. Whether the government assumes liabilities or recapitalizes companies upon privatization.

3. OTHER ENTERPRISES

The third category includes an array of government-owned enterprises that lack a defined public policy mission. The rating of entities in this third group is generally within one or two category above the stand-alone rating. The debt of these entities does not benefit from either full-faith-and-credit or ultimate guarantees. In these cases, government credit enhancement reflects two broad sets of circumstances. First, it encompasses situations where government support is possible, but without much certainty. Second, this category encompasses situations where the government does not hold itself out as the ultimate guarantor, but where it acts in a "supportive" manner and as such reduces the business risks faced by the entity. Specific characteristics of entities in this category include:

A. Probable Support

Government officials have asserted support and pledged to assure avoidance of default. However, CRISL may have doubts about institutional stability, administrative process, or the ability to diagnose and promptly respond to financial distress, there is a situation of unacceptable ambiguity, where the government has a track record of avoiding default by its enterprises, but its official or stated position is one of nonsupport. Ambiguities of this kind point to an analytical approach that puts very little or no weight on the government relationship, but that essentially focuses on the enterprise's own credit attributes.

B. Supportive Government

The government indicates its support for an entity demonstrated through favorable policies, which may be substantiated by a variety of measures including

- The clear allocation of responsibility for government support and intervention. The definition of responsibilities for government officials, departments, or ministers. The rigor and regularity with which the government monitors the financial position of these entities.

Quite clearly, these issues are not always clear-cut and will be balanced out within the context of the direction of government policy and indeed the underlying credit strength of the enterprise itself in reaching a final rating conclusion.

A rating committee, notwithstanding the current government policy, might take account of privatization risk over the next three to five years when considering its rating decision. The ultimate rating decision might take into consideration the time horizon of privatization risk, the likelihood of a reversal in current policy, and the standalone rating.

restrictions on competition, pricing policies, preferential access to credit, favorable business transactions, access to profitable business opportunities, willingness to subscribe equity, or other relevant measures. The government may provide assistance through favorable industry policies, including taxation breaks or policies, duties on competing imports, provision of infrastructure, or helpful directives to other public sector entities.

C. Government Guarantees

Some government-supported issuers have outstanding obligations benefiting from a timely, full-faith-and-credit government guarantee. These guaranteed obligations are always rated the same as the government's rating. However, the issuer credit rating will not necessarily be the same, despite the current level of support indicated by the guarantee. To determine an issuer credit rating (and thus the rating assigned to unguaranteed debt), the entity is classified into one of the above-mentioned categories.

Issuer ratings for government-supported entities enjoying a statutory or ultimate, rather than a timely guarantee, are also rated in accordance with the methodology outlined above. As already suggested, these entities are generally placed in the first or second categories of government-supported issuers.