



Criteria Rating Modifiers

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Summary

This criterion explains PACRA’s rating modifiers, which provide additional information regarding the likelihood of change in direction of underlying ratings. It is important to note that rating modifiers are not necessarily precursors to rating changes. In cases where actual developments deviate from PACRA’s expectations, rating changes may not follow those indicated by the rating modifiers. Likewise, rating changes may occur without the rating modifier indicating the same in certain cases.

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0. Introduction

- Rating modifiers indicate potential change in direction of underlying ratings based on through-the-cycle approach
- Two types of modifiers: Rating Outlook and Rating Watch

A sound financial ecosystem is critical for functioning of any economy. It is defined by interaction of providers of funds (savers), users of funds (borrowers), financial institutions (intermediaries), and regulators (oversight). This system ensures smooth flow of funds between savers and borrowers; wherein, financial institutions provide platform for their interaction. Regulatory oversight safeguards the sanctity of this system. Like all systems, financial system has its own set of challenges. The most prominent being “Risk”; the risk that some participant may not be able to meet its commitments. All participants do their best to manage this risk to maximize their return. This is not possible unless we have independent information on the risk. Here comes expertise of rating agencies, providing independent opinion on credit risk. Flow of funds is only possible when the provider of funds has confidence that user of funds will be able to return these in a timely manner and as committed. Ratings help build this confidence. A higher rating means higher likelihood of timely repayment compared to a low rating. Our ratings are forward-looking and reflect our expectations for future financial and operating performance. However, historical results are helpful in understanding patterns and trends of a company’s performance as well as for peer comparisons.

0.1 Ratings reflect forward-looking opinion on creditworthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

0.2 Rating modifiers are refinements about a rating opinion that PACRA may use. Rating modifiers address the likelihood of change in direction of underlying ratings. These are annexed after assigning the rating from the rating scale. A rating modifier, however, does not mean a rating change is inevitable and rating changes may occur without the rating modifier indicating the same.

0.3 Rating modifiers are based on a through-the-cycle approach, rather than on a point-in-time basis. Thus, they are not applicable to opinions based on actual or past performance. As a result, rating modifiers accompany all PACRA opinions with the exception of Fund Performance Rankings.

0.4 PACRA has two types of rating modifiers – Rating Outlook (Outlook) and Rating Watch (RW).

1. Rating Outlook

- **Rating Outlook:** View on the future direction of rating incorporating impact of changing financial / economic trends

1.1 Rating outlook indicates the likely direction of a rating over the intermediate term in response to changing trends in economic and/or fundamental business/financial conditions. It is not necessarily always a precursor to a rating change.

1.2 PACRA updates all its ratings on a biannual basis. Hence, the biannual review would also update the latest status of the outlook. Rating outlook indicates the likely direction of a change in the rating upon the translation of the rating outlook:

- **Positive:** Indicates the likelihood that a rating may be upgraded;
- **Negative:** Indicates the likelihood that a rating may be downgraded;
- **Stable:** Indicates that a rating is not likely to change;
- **Developing:** “developing” outlook is used for situations in which there are conflicting elements or future events that are significant in nature but are unclear with regards to their potential impact on the rating.

1.3 The following points should be considered while interpreting an outlook:

- An outlook merely indicates PACRA’s view that the rating could be changed if the scenario upon which the rating is based does not transpire and future developments are in line with PACRA expectations. Rating outlook is unique to each rating opinion. A very highly rated entity may have a negative outlook associated with the assigned rating, while an entity with a low rating may have a positive outlook. Thus, the outlook must always be considered relative to the underlying rating, rather than in isolation.
- An outlook reflects PACRA’s view regarding the trends and risks affecting the intermediate rating prospects. As such, it isn’t necessary for companies within a given industry peer group to have the same outlooks. However, this could be the case if a material event affects the entire industry.
- If an outlook translates into a rating change and an outlook is then assigned to the changed rating, such an outlook is a new outlook yet to be translated.
- It is extremely rare for a rating to be downgraded and assigned a positive outlook, or upgraded and assigned a negative outlook, though it may occur.

1.4 A rating outlook – ‘Positive’, ‘Negative’ or ‘Developing’ – does not imply that any potential change would be only one notch; it could be one notch or several notches, depending on the situation. Also, there might be no change in the rating. PACRA may simply revert the outlook to ‘Stable’ if original fundamentals are restored or reached again.

2. Rating Watch

- **Rating Watch:**
Indicates possible rating change depending upon materialization of uncertain underlying events

2.1 Rating watch alerts the users to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event, the rating implications of which remain unclear/undetermined. Examples of such likely events include, but are not limited to, the following:

- Change in ownership by way of merger/demerger/acquisition,
- Operating development,
- Major economic or financial event
- Recapitalization,
- Regulatory action.

2.2 Rating watch is assigned if the rating impact of above-mentioned events cannot be accurately assessed at a given time and additional information is necessary to fully ascertain this. Alternatively, a rating watch is also assigned in cases where the rating implications of an event are clear, however, a specific triggering event (shareholder approval or regulatory approval) is awaited to enable a decisive rating action.

2.3 Rating watch does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. PACRA will generally publish updates to identify, as and when required, its most current assessment of the situation.

2.4 Rating watch does not imply that any potential change would be only one notch; it could be one notch or several notches, depending on the situation. Also, there might be no change in the rating. PACRA may simply remove the rating from “Rating Watch” if original fundamentals are restored or reached again, or update the rating with the appropriate action at the time of resolution of the key events triggering the rating watch.

<p>OUTLOOK (STABLE, POSITIVE, NEGATIVE, DEVELOPING)</p>	<p>RATING WATCH</p>
<p>Indicates the potential direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. ‘Stable’ outlook means a rating is not likely to change. ‘Positive’ means it may be raised. ‘Negative’ means it may be lowered. Where the trends have conflicting elements, the outlook may be described as ‘Developing’.</p>	<p>Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.</p>