BANK LOAN RATING METHODOLOGY

1.0 OVERVIEW AND SCOPE

This article represents National Credit Ratings' (NCR) Bank Loan Rating (BLR) Methodology for the rating of funded and non-funded credit facilities provided to an entity by Financial Institutions i.e., Banks and NBFIs. The BLR is an underlying credit rating of corresponding entity rating. The entity rating provides an overall assessment of an entity's credit quality while BLR indicates the degree of risk regarding timely servicing of specific debt obligation (principal including interest) being rated.

2.0 FRAMEWORK

Although NCRL assumes cross default for entity rating, BLR is applicable to the specific debt obligation to assess the credit risk exposure by means of probability of default and estimate of recovery prospect in the event of default. Particular credit facilities are analyzed by means of security risk along with relationship risk associated with the corresponding lender in addition to the parameters considered in case of corporate credit rating.

3.0 SECURITY RISK

Security risk analysis involves the assessment of securities provided against each particular credit facilities. Quality of security is an important factor in determining security risk. Following parameters are considered during the analysis of security risk:

- Loan to Value Ratio
- Forced Sale Value to Market Value
- Seniority Ranking (Priority claims on the assets during liquidation)
- Types of Collateral (FDR, Marketable Securities, Tangible Assets, Intangible Assets)
- Nature of Collateral
- Capitalization Rate
- Title of Mortgaged Properties
- Insurance Coverage
- Location

4.0 RECOVERY PROSPECT

NCR's approach to BLR involves assessment of qualitative aspects of loan and security which are converted into quantitative measures. While BLR indicates the likelihood of the default, NCR considers the recovery prospects in the event of the default. To assess the probability of default, NCR uses random sampling approach of defaulted concerns. Furthermore, NCRL emphasizes on the nature of regular periodical payments followed by the reschedule history and make probabilistic assessments of the likelihood of default. NCRL, considerably, weighs the recovery rate and expected loss in the event of default under the assumption of no relationship with the underlying likelihood of default. Each recovery rate is defined in terms of expected recovery range. Different circulars and notifications of Bangladesh Bank are scrutinized thoroughly and regularly to define the classification status and identify the payment behavior. Recovery prospects are ranked from R1 to R6 with R1 indicating very strong recovery prospect and R6 indicating the least recovery prospect. Ranking of recovery prospects are illustrated in the table below:

Ranking of Recovery Prospects						
Ranking	**Ranking Definition**	**Probability of Default**	**Classification Status**	**Recovery Expectation**	**Payment Behavior**	**Collateral Coverage**
R1	Very strong recovery	Lowest (< 10%)	Regular	100% of principal and interest	Within due time	More than 100% of outstanding (principal & interest)
R2	Strong recovery	Low (11%-20%)	Regular	100% of principal and interest	Delayed payment (within 3 months from the maturity date)	Sufficiently covers outstanding (100% of principal and more than 80% interest)
R3	Moderate recovery	Moderate (21% - 40%)	Overdue	100% of principal but 80% interest	Delayed payment (within 3 months from the maturity date)	Marginally covers outstanding (100% of principal amount)
R4	Weak recovery	High (41% - 60%)	Sub-Standard	100% of principal but 80% to 70% interest	Delayed payment (3 to 9 months from the maturity date)	90% of the principal amount
R5	Little recovery	Very High (61% - 80%)	Doubtful	100% of principal but 70% to 60% interest	Delayed payment (3 to 9 months from the maturity date)	80% of the principal amount
R6	Least recovery	Almost Certain (81% - 99%)	Bad/Loss Bad Loan	100% of principal but 60% to 50% interest	Delayed payment (12 months and above)	70% of the principal amount

- Based on the probability of default and recovery prospect at the time of rating declaration, the BLR can be notched up/down from the entity rating.

- Probability of default shows the likelihood of default; with low default probability, NCR assumes that the entity has less than 10% chance of default to the particular loan. To achieve R1 rating scale, NCR requires the entity's loan status to be regular with no late payment and partial amount payment of debt obligation in the past history. Further, the security arrangements must cover the loan limit and interest amount at any point in time. NCR also assumes that the lenders may be able to recover full amount (100%) of principal and interest outstanding at any given point of time.

- NCR prefers the uses of present value of loan recovery to nominal amount of it. Recovery ratings are primarily on an ordinal scale. The scales reflect relative recovery expectations and inter-relationship among classification status, timely payment and recovery expectation along with collateral coverage. It is also noted that the above-mentioned percentages are indicative of likely recovery instead of precise estimates.

5.0 Relationship Risk

To assess the willingness of the entity to repay the debt obligation, NCRL assesses the banking relationship with entity. The company fundamental analysis performed in the entity rating (corporate/trading) serves as the foundation of evaluation of the entity's ability, whereas the historical record of the banking performance, transaction behavior and relationship with the banks and NBFIs are used to evaluate the willingness of the entity to service the debt obligation. Relationship risk is assessed considering the following factors:

Compliance with terms & conditions	Pari-passu charge
Charge creation with RJSC	Notarization
Consistency of banking transactions (Timely / Late Payment)	Capacity of credit utilization
Export and/or import performance	Years of relationship
Loan takeover history	Rescheduling history
Prepayment history	Cross default
Cross collaterals	Honoring suppliers check
Banking performance of the associate concerns of the entity	

6.0 LIMITATION:

The BLR methodology bases on the assumptions for which NCRL puts best efforts to match each case or situation. While considering parameters for evaluation of each credit facilities and securities and collaterals, the BLR methodology is not exhaustive at the time of declaration; and in reality, their qualities (entity, security and collateral) may be different from those at the time of declaration. Further, NCRL only rates credit facilities in local currency, so no consideration is given to exchange rate risk and sovereign risk etc. NCRL also does not consider the impact of interest rate risk. The determination of default rates, recovery rates and loss given default depend on the historical data, but there is lack of historical data regarding defaults and foreclosure of recovery aspects of the entities. In addition to that NCRL is to depend highly on client provided credit information where there is likelihood of concealing irregular as well as regular facilities with other financial institutions availed beyond the exposed credit facilities.

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