BANK LOAN RATING METHODOLOGY

The Bank Loan Rating (BLR) describes the approach of NCRL for rating non-funded and funded credit facilities extended by the Financial Institutions (Banks and NBFIs). This approach illustrates the parameters to evaluate the current date liabilities of the entities with the Financial Institutions along with their terms and conditions agreed by both the parties (entity and lender), and banking performance and behavior.

BLR reflects opinion of NCRL on the ability of an entity to pay financial obligation on time as per terms of the facilities provided. BLR also associates with the measurement of risk weighted assets for calculation of capital adequacy of Financial Institutions under BASEL requirement.

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.

RELATIONSHIP BETWEEN ENTITY CREDIT RATING & BANK LOAN RATING:

The BLR is an underlying credit rating of corresponding entity rating. The entity rating provides an overall assessment of an entity's credit quality but does not indicate any specific debt obligation. Although NCRL assumes the cross default for entity rating, BLR is applicable to specific debt obligation which helps Banks and NBFIs to assess their credit risk exposure to the particular entity by means of probability of default and estimate of recovery prospects of defaulted loan. Thus BLR differentiates between the secured loans and unsecured loans along with priority of the obligation. Therefore, BLR methodology facilitates assessment of the particular credit facility by means of security risk and relationship risk associated with that particular corresponding lender and incorporates financial strength of the entity taking into account the parameters considered in case of corporate rating and trading entity rating methodology as an underlying entity rating.

SECURITIES RISK:

NCRL emphasizes on the security (collateral) analysis for the debt instruments including Bank and NBFI loan. NCRL also finds that the cash flow from operation (net operating income) is a paramount factor for assessing coverage of credit facilities along with the collaterals value. Therefore, quality of collaterals is an important factor which is determined by assessment of the following parameters:

Quality of the Collaterals:

- Capitalization Rate
- Loan to value
- Asset used for collateral (FDR, government securities, private company securities, physical property)
- Seniority of debt financing (priority claims on the assets during liquidation)
- Location
- Forced sale value
- Title of the mortgaged properties
- Hypothecation
- Pledge
- Insurance coverage
- Guarantee
- Personal net worth/group net worth/company net worth

RELATIONSHIP RISK:

To assess the willingness of the entity to repay 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 and relationship with the banks and NBFIs are used to evaluate the willingness of the entity to service the debt obligation. NCRL thus scrutinizes the banking relationship in the following aspects:

- Compliance with term & condition
- Pari-passu charge
- Charge creation with RJSC
- Notarization
- Banking transaction (credit utilization)
- Years of relationship
- Export/import performance
- Rescheduling history
- Loan takeover history
- Late payment

- Prepayment history
- Honoring suppliers check
- Cross collaterals
- Cross default
- Banking performance of the associate concerns of the entity

RATING SCALE DEFINITION:

NCR's approach to BLR involves assessment of qualitative aspects of loan and security which are converted into quantitative measures. In addition, while the BLR indicates the likelihood of the default which affects the loss given default, NCR considers the recovery prospects of the credit facilities extended by the banks and NBFIs in the event of the default. To assess the probability of default, NCR uses random sampling approach of defaulted concerns. NCR also weigh 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.

Rating Scale – Symbols & Definitions						
Rating Scale	Scale Definition	Probability of Default	Classification Status	Recovery Expectation	Timely Payment Behavior	Collateral Coverage
R1	Very strong recovery	Lowest (less than 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 (before 3 months from the maturity date)	Sufficiently covers outstanding (100% of principal and more than 80% interest)
R3	Moderate recovery	Moderate (21% - 40%)	Up to Special Mention Account	100% of principal but 80% interest	Within due time	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 months)	90% of the principal amount
R5	Little recovery	Very High (61% - 80%)	Doubtful	100% of principal but 70% to 60% interest	Delayed payment (6 months)	80% of the principal amount
R6	Least recovery	Almost Certain (81% to 99%)	Bad Loan	100% of principal but 60% to 50% interest	Delayed payment (9 months)	70% of the principal amount

- As per BLR methodology, the Bank Loan Ratings of the entity will have prefix of BLR attached to the rating symbol and will correspond to the entity's rating scale. However, based on the loan condition 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.

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