

***Implications
of BASEL II
on Corporate
Borrowers***



FAQS ON BASEL II AND IMPLICATIONS FOR A CORPORATE BORROWER

1. What is Basel II and what are the main provisions of Basel II (from the view point of a corporate borrower)?

Basel II is a new capital adequacy framework applicable to Scheduled Commercial Banks in India as mandated by Reserve Bank of India (RBI). 'Basel Capital Accord' is in respect of Capital measurement and Capital Standards which align regulatory capital requirements more closely with underlying risks. The Accord has been accepted by over 100 countries including India.

'Capital Adequacy' is the ratio of capital funds (own funds or networth, in other words) to risk weighted assets. Under the old Basel I framework, all assets used to get a 'one-size-fits-all' treatment and were given a uniform risk weightage of 100% while the stipulated minimum capital adequacy ratio (CAR) for a Bank was 9%.

Under Basel II, while the minimum CAR is unchanged at 9%, the risk weights assigned to assets would be proportionate to the credit risk of these assets. As of March 31, 2009, all Indian Banks were to adopt Basel II. Within Basel II, various approaches have been prescribed and Indian Banks would have to adopt 'Standardized approach' for Credit risk.

Under this standardized approach, credit ratings awarded by recognized agencies (such as CARE) would be used to assign risk weights (and be a proxy of credit risk). RBI had come out with its final guidelines in this regard, in April 2007.

2. When does Basel II come into effect?

Foreign banks operating in India and Indian banks having operational presence outside India were to migrate to Basel II with effect from March 31, 2008. All other commercial banks (except Local Area Banks and Regional Rural Banks) were to migrate by not later than March 31, 2009.

RBI had also prescribed that all unrated exposures of Banks over Rs.50 crore migrating to Basel II w.e.f. March 31, 2008 would carry a 150% risk weight for the financial year 2008-09. The threshold was brought down to Rs. 10 crore w.e.f. April 1, 2009.

3. What is CARE's role in Basel II?

CARE is one of the agencies recognized under Basel II. Accordingly, CARE Ratings would entail risk weights to be applied on Bank exposures as per the table given on page 2.



4. What are CARE's rating symbols for Bank Facilities Ratings?

A) Long /Medium-term facilities

Symbols	Rating Definition
CARE AAA	Facilities with this rating are considered to be of the best credit quality, offering highest safety for timely servicing of debt obligations. Such facilities carry minimal credit risk.
CARE AA	Facilities with this rating are considered to offer high safety for timely servicing of debt obligations. Such facilities carry very low credit risk.
CARE A	Facilities with this rating are considered to offer adequate safety for timely servicing of debt obligations. Such facilities carry low credit risk.
CARE BBB	Facilities with this rating are considered to offer moderate safety for timely servicing of debt obligations. Such facilities carry moderate credit risk.
CARE BB	Facilities with this rating are considered to offer inadequate safety for timely servicing of debt obligations. Such facilities carry high credit risk.
CARE B	Facilities with this rating are considered to offer low safety for timely servicing of debt obligations and carry very high credit risk. Such facilities are susceptible to default.
CARE C	Facilities with this rating are considered to be having very high likelihood of default in the payment of interest and principal.
CARE D	Facilities with this rating are of the lowest category. They are either in default or are likely to be in default soon.

B) Short term facilities

Symbols	Rating Definitions
PR-1	Facilities with this rating would have strong capacity for timely payment of short-term debt obligations and carry lowest credit risk. Within this category, facilities with relatively better credit characteristics are assigned PR1+ rating.
PR-2	Facilities with this rating would have adequate capacity for timely payment of short-term debt obligations and carry higher credit risk as compared to facilities rated higher.
PR-3	Facilities with this rating would have moderate capacity for timely repayment of short term debt obligations at the time of rating and carry higher credit risk as compared to facilities rated higher.
PR-4	Facilities with this rating would have inadequate capacity for timely payment of short-term debt obligations and carry very high credit risk. Such facilities are susceptible to default.
PR-5	Facilities are in default or are likely to be in default on maturity.

As facility characteristics or debt management capability could cover a wide range of possible attributes whereas rating is expressed only in limited number of symbols, CARE assigns '+' or '-' signs to be shown after the assigned rating (wherever necessary) to indicate the relative position within the band covered by the rating symbol

5. What would be the risk weights applicable to various ratings of CARE?

Long Term Ratings:

CARE Rating	AAA	AA+, AA and AA-	A+, A and A-	BBB+, BBB and BBB-	BB+ and below
Risk Weight (%)	20	30	50	100	150

Short Term Ratings:

CARE Rating	PR1+	PR1,	PR2+, PR2,	PR3+, PR3	PR4 & PR5
Risk Weight (%)	20	30	50	100	150



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For example, if the entire loan assets (say Rs. 100 crore) of a Bank were to carry a 'AAA' rating, the risk weighted assets would be Rs. 20 crore and the required Capital to achieve the minimum CAR of 9% would be only Rs. 1.8 crore instead of Rs. 9 crore as per Basel I guidelines which prescribes uniform 100% risk weight for all assets of Rs. 100 crore. In effect, the Bank would achieve a 'capital relief' of Rs. 7.2 crore in case it gets its exposure rated.

6. How much time does CARE take to assign ratings?

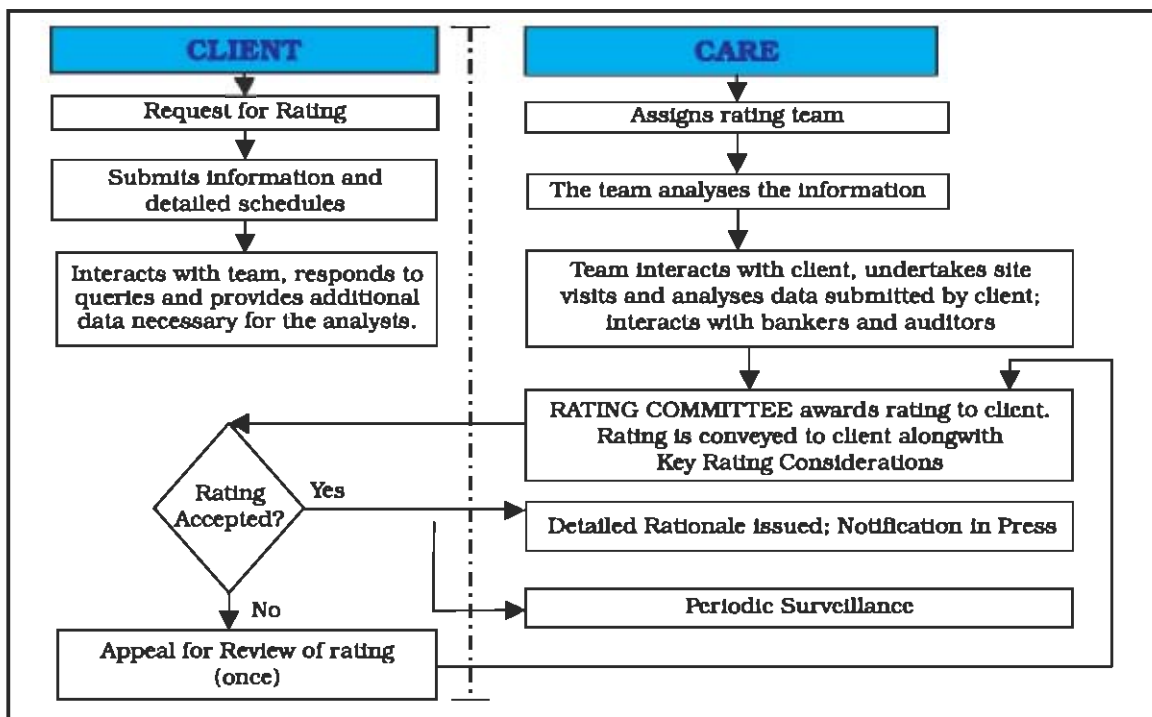
The rating process takes about three weeks after submission of initial information. The time taken critically depends on speed of information flow from clients.

7. What type of facilities which would be rated by CARE?

CARE would rate all types of fund and non fund based facilities sanctioned by Banks. This would include cash credit, working capital demand loans, Letters of credit, Bank guarantees, Bill discounting, Project Loans, loans for general corporate purposes etc., to name a few.

8. What is the rating process followed by CARE?

The rating process commences with the Request for rating received from the client. The rating process is pictorially given below:



The client has the right to accept or not accept every rating assigned by CARE. Only accepted ratings are kept under surveillance and made known in the public domain.

Only ratings which are accepted by the clients, kept under surveillance and published in the periodic bulletins of a Rating Agency are eligible to be risk weighted under Basel II. Further, the ratings so awarded should have been reviewed in the past 15 months for Banks to take cognizance of the rating for risk weighting. CARE Ratings are regularly disseminated to the media by way of press releases, a bi-monthly Rating Reckoner and daily updates in its website www.careratings.com



9. What are the rating methodologies adopted by CARE?

For detailed rating methodologies for various sectors please visit www.careratings.com

10. What are the advantages for a Bank for getting its loans rated and as a Bank borrower, what can I expect from Banks in return for getting my loans rated?

As said earlier, Banks earn capital relief by getting the exposures rated, provided the ratings obtained are Triple B and above. There are two implications of this

- a) Banks save cost of borrowing an equivalent capital from the market
- b) Banks can leverage this additional capital they get (out of having the portfolio rated) and earn margins on such lending. Theoretically, this is an infinite process – as banks can further leverage on the margins earned and earn further margins and so on.

11. What are the other relevant provisions of Basel II?

- Only solicited ratings are allowed to be risk weighted. That is, ratings have to be sought by the client (bank's borrower). For getting a rating from CARE, the client is required to sign a 'Letter of Request' which inter-alia, binds the client to give periodic information in order to enable CARE keep the rating current.
- To be eligible for risk weighting purposes, the rating should be in force and confirmed from the monthly bulletin of the rating agency. The rating agency should have reviewed the rating at least once during the previous 15 months.
- Rating is applicable to all fund and non fund based facilities of the borrower. The risk weighting would vary based on the individual facility's credit rating.
- For assets in the bank's portfolio that have contractual maturity less than or equal to one year, short term ratings accorded by the credit rating agencies would be relevant. For other assets with a contractual maturity of more than one year, long term ratings would be relevant.
- Cash credit exposures would require a long term facility rating.
- In case one or more exposures of a borrower is rated, the rating can be mapped to another exposure of the same borrower provided the unrated claim has a lesser maturity and is senior to the rated claim. However, unrated short term claims would carry risk weight at one level higher than their rated counterpart.
- Banks can reduce risk weights of those claims which have credit risk mitigants. Eligible mitigants include cash collaterals, Gold, Central or State Govt securities, liquid debt securities having investment grade rating, listed equities and mutual funds, etc.

For further information, kindly refer to the RBI guidelines on the above.

12. Has CARE tied up with any Bank for Basel II ratings?

CARE has entered into Memoranda of Understanding (MOU) with many Scheduled Commercial Banks in India for Basel II ratings. The MOU inter-alia envisages concessional rates of rating fee for the borrowers of these banks.

13. Has CARE commenced doing facility ratings for Basel II?

Yes. Please visit the press releases section on www.careratings.com for the list of Basel II ratings.

14. Whom do I contact for obtaining a rating from CARE?

CARE is headquartered in Mumbai, with Offices all over India. The office addresses and contact numbers are mentioned on the back cover.



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