

**CARES RATING METHODOLOGY FOR RATING OF
MARKET LINKED NOTES*
(*INCLUDES EQUITY LINKED NOTES)**

Introduction

A Market-Linked Note (MLN) is a debt instrument that differs from a standard fixed-income security in the sense that the coupon on the instrument is linked to a variable market indicator such as equity index, commodity price such as gold etc. A MLN is generally a principal-protected instrument designed to return 100% of the original investment at maturity. While a portion of the capital may be invested by the issuer in debt instruments to bring in the feature of capital protection, the return may be linked to an external market indicator such as equity index to capture the market upside. However, issuers may also issue non principal protected instruments wherein both the principal as well as coupon are linked to performance of external market indices.

Definition

CARE's credit quality ratings of Market Linked Notes are *opinions on the credit quality of the issuer of the MLNs.*

What MLN Ratings are not?

CARE's rating on the Market Linked Notes would only be an expression of its opinion on the credit risk associated with the issuer concerned. The rating would not address the risks associated with variability in returns or erosion of principal resulting from adverse movements in the variable(s) concerned. It would be essentially be an opinion on the willingness and ability of the issuer to meet the obligation under the MLN issuance.

CARE assumes that the issuer would be clearly stating the terms of the MLN in the information memorandum/offer document and fully expects the investors to understand the nature and terms of the MLNs. Thus the market risk sensitiveness of the instrument is expected to be apparent to the investors who are expected to take an informed decision.

CARE would not as a matter of policy rate self referencing products, i.e. where the linkage lies with the performance of the issuer's own Equity shares.

Example of an Equity Linked Note Credit Rating assessment

- **Instrument Structure:** Coupon linked to equity index
- **Rating assessment:**

Investment bank X, with an 'A+' senior debt/issuer rating, issues ELN under its umbrella rating program. The note's interest payments are linked to the NIFTY. CARE would now rate the note 'A+', reflecting the investment bank's credit risk to pay interest and principal, but not reflecting the potential volatility of the interest payments.

The issue rating on a Market Linked Note thus reflects the credit risk inherent in the issuer's promise to pay, but not the potential volatility of payments due to market risk.

CARE's Rating Methodology

Since the rating of the Market Linked Notes is finally a rating of the credit-worthiness of the issuer, the rating methodology would be dependent on the issuer. CARE has defined different rating methodologies suited to different issuers of financial instruments.

Rating Process

The MLN rating is mandate driven. Once the mandate is received by CARE, request for information is sent to the client. Based on the analysis of information and inputs received after meeting with the client, CARE arrives at the rating.

Rating Scale

A special qualifier is appended to the credit rating to indicate the extraordinary risks, particularly market risks, that are not covered in the credit rating. MLNs with the same credit rating and comparable credit risk may thus have substantially different market risk, depending on their terms.



CARE'S MARKET LINKED NOTES SCALE*

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

The 'mr' symbol attached to the rating indicates that payments on the rated instrument have significant risks other than credit risk. As instrument 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.

(- The same scale would be used for other instruments which would be market linked)*

Disclaimer

CARE's opinion on market linked instruments is an assessment of the underlying credit risk of the instrument and does not address the market risks arising on account of linkage of returns or principal amount of the instrument to external market variables. CARE's ratings are opinions on credit quality and are not recommendations to buy, sell or hold any security. CARE has based its ratings on information obtained from sources believed by it to be accurate and reliable. CARE does not, however, guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. Most issuers of securities rated by CARE have paid a credit rating fee, based on the amount and type of securities issued.

Ongoing Review, Monitoring / Surveillance and Withdrawal of Rating

CARE would review relevant information on the company being rated on an ongoing basis. CARE would rely on information obtained from the issuer and/or from publicly available sources.