

# CARE'S 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**

**1. Instrument Structure:** Coupon linked to equity index

**2. 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 ultimately 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.

## **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.

**HEAD OFFICE - MUMBAI**  
**CREDIT ANALYSIS & RESEARCH LTD**

4th Floor, Godrej Coliseum,  
Somaiya Hospital Road,  
Off Eastern Express Highway,  
Sion (East), **Mumbai** - 400 022.  
Tel: +91-022- 6754 3456  
email:care@careratings.com  
Website:www.careratings.com

| <u>Regional Offices</u>  | <u>Branch Offices</u>   |
|--|---|
| Unit No. O-509/C, Spencer Plaza, 5th Floor, No. 769, Anna Salai,<br><b>Chennai</b> 600 002<br>Tel: (044) 2849 7812/2849 0811                                 | 401, Ashoka Scintilla<br>3-6-520, Himayat Nagar<br><b>Hyderabad</b> - 500 029<br>Tel.: (040) – 40102030/31, 91600 04563   |
| 3rd floor, B-47, Inner Circle,<br>Near Plaza Cinema,<br>Connaught Place,<br>New Delhi - 110 001.<br>Tel: +91- 011- 2331 8701/ 2371 6199<br>Cell: 98117 45677 | Unit No. 8, I floor,<br>Commander's Place<br>No. 6, Raja Ram Mohan Roy Road,<br>Richmond Circle,<br><b>Bangalore</b> - 560 025.<br>Tel.: (080) - 2211 7140/41, 9886024430 |
| 3rd Floor, Prasad Chambers<br>(Shagun Mall Building),<br>10A, Shakespeare Sarani,<br><b>Kolkata</b> - 700 071<br>Tel: (033)- 2283 1800/ 1803/ 2280 8472      |   |
| 32 TITANIUM<br>Praladnagar Corporate Road,<br>Satellite,<br><b>Ahmedabad</b> - 380 015.<br>Tel.: (079) 4026 5656   |   |

### **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