

CARE's FUND CREDIT QUALITY RATING CRITERIA

Introduction

CARE's fund credit quality ratings are opinions on the overall credit quality of specific Debt Mutual Fund schemes. The ratings capture the fund's overall exposure to default risk.

The need for Fund credit quality ratings

Mutual funds have of late gained considerable prominence in India. A large variety of mutual fund schemes with different investment styles and objectives are now available in the Indian Market. Fund managers today have a variety of options to construct their portfolios from plain vanilla bonds to more complex derivatives. In this context, CARE's fund credit quality ratings, seek to enhance the understanding of fund credit risks to investors. Fund ratings would provide an independent opinion on fund's credit quality to enable investors to evaluate such fund schemes. Investors can then examine the fund risk vis-à-vis their risk appetite. Fund managers would use such ratings for communicating their target level of credit risk of their schemes to investors to enable them to make informed decisions.

Rating Methodology

CARE's fund credit quality ratings are based on evaluation of the fund's investment strategy and portfolio credit risk. It also involves evaluation of credit quality of individual assets, diversification of portfolio, management quality and operational policies. CARE uses the concept of credit scores, assigned to individual securities, as per credit scoring matrix developed by CARE.

CARE's credit scoring matrix

In CARE's credit scoring matrix, a credit score is assigned to each rating category. The score is essentially a function of the credit quality/rating of the security and its residual maturity. CARE's credit scores are arrived at using historical data on defaults adjusted for data limitations. Credit score is lower for higher rating categories and vice versa. The credit score of a rating category is weighted by the proportion of exposure to that rating category. The aggregate of such scores (i.e. the fund credit score) reflects the credit quality rating of the fund. In order to retain the rating, the fund credit score has to be maintained within the benchmark fund score of the rating category.

Qualitative factors

Qualitative factors also play an important role in arriving at the final rating. The qualitative factors examined by CARE are:

Management Quality

CARE assesses the asset management company (AMC) in terms of organization setup, qualifications and experience of senior management team. The AMC's track record in fund management is also examined. CARE also examines the credentials of AMC sponsors and the board of trustees.

Operations & Risk Management Systems

CARE examines MIS (management information systems) and risk management systems in various operational areas. Systems for regular monitoring of the portfolio as well as transactions with custodian and registrars are examined. The accounting systems, disclosure levels and the regulatory compliance record of the AMC as well as systems to ensure such compliance are also studied. The quality of trading and back office systems, control systems for segregation of trading and back office operations is also examined.

Ongoing Review, Monitoring/Surveillance & Withdrawal of Rating

CARE reviews the rated mutual fund scheme on an ongoing basis to support its published rating opinions. As such, monthly reports of the fund are examined. In addition, detailed annual review of the fund is also undertaken. While the fund has to maintain the fund credit score with the benchmark fund scores, in a particular month, if the fund credit score breaches the benchmark, CARE provides one month to the AMC to realign the score. If the fund credit score is not corrected in that period, CARE would consider revising the rating opinion. CARE would withdraw the rating of a mutual fund on request by the AMC with a notice period of one year.

What fund ratings are not?

CARE's fund quality rating is not a recommendation to purchase, sell, or hold a security/fund. It neither comments on the current market price, suitability for a particular investor nor on the prospective performance of the fund with respect to appreciation, volatility of net asset value (NAV), or yield of the fund. The ratings do not address the fund's ability to meet the payment obligations to the investors.

Rating Symbols and Definition

| Symbols | Rating Definition |
|----------------------|---|
| CARE AAAf | Indicates highest credit quality rating by CARE to a fund and carries credit risk similar to instruments having minimal credit risk . |
| CARE AAf | The high credit quality fund rating carries credit risk similar to instruments carrying very low credit risk . |
| CARE Af | The adequate credit quality fund rating carries credit risk similar to instruments carrying low credit risk . |
| CARE BBBf | The moderate credit quality fund rating carries credit risk similar to instruments carrying moderate credit risk . |
| CARE BBf | The inadequate credit quality fund rating carries credit risk similar to instruments carrying high credit risk . |
| CARE Bf | The low safety fund rating carries credit risk similar to instruments carrying very high credit risk . |
| CARE Cf | This is the lowest credit quality rating for funds. The fund carries credit risk similar to instruments carrying extremely high credit |

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.

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CARE's ratings are opinions on credit quality and are not recommendations to sanction, renew, disburse or recall the concerned bank facilities or 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 entities whose bank facilities/instruments are rated by CARE have paid a credit rating fee, based on the amount and type of bank facilities/instruments.