Internship Report
On
Credit rating –Operation and Effectiveness

Submitted To: Mr. Fairuz Chowdhury
Lecturer
BRAC Business School
BRAC University

Submitted By: **Md. Ashraful Islam**
ID No.: 13364016
Program: MBA
Major: Finance
BRAC University

BRAC University

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17 December, 2015

Letter of Transmittal

17 December, 2015

Mr. Fairuz Chowdhury
Lecturer
BRAC Business School
BRAC University

Subject: Submission of the Internship report titled “Credit rating-operation and Effectiveness”

Dear Sir,

It is my great pleasure to submit you my internship report on “Credit rating-operation and Effectiveness**”.** I have completed my internship program in National Credit rating company Limited from 01-07-2015 to 30-11-2015 as a part of my study. I have tried myself to explain my learning and experience that I have gathered from my internship program briefly in this report.

The entire report is based on my practical experience working with National credit rating company Limited. I have put my best effort in completing the report with all the information that I have collected during my stay in National Credit rating company limited.

I have great hope that the report will meet your expectation and my academic requirement and aid you in getting a clear idea about the subject.

Sincerely yours,

……………………..
Md. Ashraful Islam
ID No.: 13364016
Program: MBA

SUPERVISOR'S CERTIFICATE

This is to certify that internship titled 'Credit rating-Operation and Effectiveness is done by Md. Ashraful Islam, ID No- 13364016, as a Partial fulfillment of the requirement of MBA program from the BRAC Business School, BRAC University.

The report has been prepared under my guidance and is a record of the bona fide work carried out successfully.

………………………………………..
Signature of the Supervisor

Mr. Fairuz Chowdhury
Lecturer
BRAC Business School
BRAC University

<u>STUDENT’S DECLARATION</u>

I do hereby declare that the work presented in this internship report titled ‘Credit rating-operation and Effectiveness’ is an original work done by me under the supervision of **Mr. Fairuz Chowdhury,** Lecturer, BRAC University.

No part of this report has been previously submitted for any academic certificate / Degree/ Diploma or qualification.

The work I have presented does not breach any existing copyright and no portion of this report is copied from any work done by anyone.

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Md. Ashraful Islam
ID No: 13364016
Program: MBA

ACKNOWLEDGEMENT

The theoretical knowledge that is gathered from the educational institution is not sufficient to be aware the subject matter rather the practical knowledge. In order to resolve the dichotomy between these two areas, I was assigned to as an intern in National Credit rating company Limited.

I, Md. Ashraful Islam, first of all would like to express my gratitude to almighty Allah for keeping me mentally and physically sound to prepare this report. Again, I would also like to express my heartiest gratitude & thanks to those people, because without their support and contribution this report would not been possible and would not get the successful compellation.

I would like to take the opportunity to express my gratitude to my internship advisor, Mr. Fairuz Chowdhury, Lecturer, BRAC University for his valuable suggestion, constant encouragement and keen interest at every stage of this study, without his supervision that would have been extremely difficult to accomplish.

Finally, I humbly appreciated the endurance & assistance of the entire individuals at national credit rating company Limited who spent their time in helping me able to complete my Internship Report.

EXECUTIVE SUMMARY

This report is written on credit rating, operation and effectiveness and functions of domestic Credit Rating Agencies a study on National Credit Ratings Limited. This report addresses definition of credit rating and its benefits, methodology followed by NCR, context of Basel II, current practices in Bangladesh and recommendation and thereon. The credit rating system emerged as a private sector institution in the middle of the 19th century. Although the concept of credit rating emerged in early twentieth century in the financial market of USA, it is still new in the developing countries like Bangladesh and no rating agency was licensed in the country till 2002, hence no rating was published .Currently there are 08 recognized external credit rating institutions are operating in Bangladesh which is more than the requirement considering the size of our economy. Established regulatory framework and regulatory body is there to monitor the activities of the credit rating companies CRAs act as corporate gatekeepers to bridge the gap of asymmetric information between lenders, investors and issuers about the creditworthiness of companies or business. Credit rating is the assessment of the credit worthiness of a particular borrower with reference to a particular debt or financial obligations. It has certain advantages like Market access, Build up market reputation, Lower cost of funding, distinguish oneself from the competition, Regulatory Requirement, Enables quicker processing of loans and enchantments and independent view of the entity's strengths and weakness. With the implementation of Basel II in the context of Pillar 1, a regulatory capital requirement for credit risk is calculated according to two alternative approaches: (I) the Standardized Approach; and (ii) the Internal Ratings-Based Approach. The Standardized Approach is generally conducted worldwide by independent Credit Rating Agency (CRA).Different methodology is followed while conducting the rating. As in Bangladesh there is quite a few number of credit rating agencies operating in Bangladesh fierce competition exist which allows rating as shopping with low price and conflict of interests. Few standards need to follow by all the credit rating company to judge a rating. Regulatory bodies should monitor the credit rating agencies activities more closely to establish an additional layer of safety and incorporate proper guidelines so that it is useful for the parties involved, borrower as well as financial institutions.

Chaper-01

- Introduction
- Credit Rating
- Origin of Credit Rating
- Background of Credit Rating Agencies in Bangladesh
- Who Can Perform Credit Rating
- Importance of credit rating

1.1 Introduction

This report is written on credit rating, operation and effectiveness and functions of Domestic Credit Rating Agencies (DCRAs), a study on National Credit Ratings Limited. This report addresses definition of credit rating and its benefits, methodology followed by NCR, context of Basel II, current practices in Bangladesh and recommendation and thereon. With the implementation of Basel II (introduced in Bangladesh by BRPD Circular No- 09, published on December 31st 2008), in the context of Pillar 1, regulatory capital requirements for credit risk is calculated according to two alternative approaches: (I) the Standardized Approach; and (ii) the Internal Ratings-Based Approach. The Standardized Approach is generally conducted worldwide by independent Credit Rating Agency (CRA) who is licensed by domestic regulators (Bangladesh Securities and Exchange Commission (BSEC) and Bangladesh Bank (BB) in Bangladesh). Recent scandals and events has reinforced the need for strict framework and regulatory awareness to various banks nationwide which furthermore extends the requirement and support of DCRAs to operate and execute credit rating efficiently. BRPD Circular No- 18 (published on December 21, 2014) issues a roadmap for implementation of Basel-III in Bangladesh and also additional BRPD Circular No- 01 (published on January 01, 2014) issues external DCRA’s to perform credit rating of Small and Medium Enterprise (SME). Therefore the need for DCRAs in a drive to develop the financial system of Bangladesh is evermore growing. Credit rating is an independent opinion on ability of a business or a government to repay its debt obligations. Hence CRAs act as corporate gatekeepers to bridge the gap of asymmetric information between lenders, investors and issuers about the creditworthiness of companies or business.

1.2 Origin of the Report

Master of Business Administration (MBA) is designed with an excellent combination of practical and theoretical aspects. After completion of MBA program specific time is preserved for internship in a particular organization. Master of Business Administration (MBA) course requires 3 months attachment with an organization followed by a report assigned by the supervisor in the organization and endorsed by the faculty .I did my internship in National credit rating company Limited. My supervisor Mr. Fairuz Chowdhury, Lecturer, BRAC University approved, authorized and supervised me to prepare this report as part of the fulfillment of internship requirement. This report titled ‘Credit rating-operation and effectiveness’ is a curriculum requirement for Master of Business Administration Degree of BRAC University.

1.3 Objectives of Study

The key objectives of the report are as follows:

- To know the about the Credit rating process and its benefits in the context of Bangladesh.
- Identify the problems and prospects of credit rating in the context of Bangladesh.
- To acquire depth knowledge about whole process of the credit rating.

1.4 Methodology of the Report

The nature of the report is descriptive. The required information was collected from my personal observation at National credit rating company Limited, conversation with colleagues and the theoretical knowledge that I have learned from MBA program. This report was based on primary and secondary data. I have collected data by the following ways:

- From the organization manuals and websites.
- Internet
- By talking with organization’s officials time to time.
- Observation method also used to prepare this report.
- Face to face conversations with the workers.

Sources of Information

In order to make the report more meaningful, two sources of data have been collected.

Primary Source of Data:

- Observation of working procedure while working in National Credit rating Limited.
- Practical work exposures from the different desk of the department.
- Relevant file and document study as provided by the concerned officers.

Secondary Sources of Data:

- Printed materials like brochures, and instruction manuals.
- Various journals were used as sources of relevant secondary data.
- Other secondary sources were books and articles on the related factors in the conceptual framework of the report.
- Different publications and journals regarding credit rating operation and practices.

1.5 Limitations of Study

Although efforts are made to make the report as comprehensive as possible, nevertheless, the following limitations have been identified for the preparation of the report.

- There is a lack of sufficient secondary data.
- Management is reluctant to provide necessary data.
- Lack of in-depth knowledge and analytical ability for writing such report.
- The allocated time is not sufficient for me to gather knowledge and to make the study a complete and fruitful one.

1.6 Credit Rating

Credit rating is the assessment of the credit worthiness of a particular borrower with reference to a particular debt or financial obligations. Ability to pay debt is known as 'creditworthiness'. Credit Rating usually appears in form of alphabetical letter grades such AAA, A+, BBB etc. Usually a credit rating grade is inversely proportional to default risk which means higher the grade lower the risk. A credit rating can be assigned to any institution that intends to borrow money, any individual, government, proprietorship business, partnership business, company or a government institution may opt for credit rating for the purpose of borrowing funds. These are known as entity ratings.

1.7 Origin of Credit Rating

The credit rating system emerged as a private sector institution in the middle of the 19th century. The precursors of bond rating agencies were the mercantile credit agencies, which rated merchants' ability to pay their financial obligations. In 1841, in the wake of the financial crisis of 1837, Louis Tappan established the first mercantile credit agency in New York. Robert Dun subsequently acquired the agency and published its first ratings guide in 1859. A similar mercantile rating agency was formed in 1849 by John Bradstreet, who published a ratings book in 1857.

In 1941 Poor Publishing merged with Standard Statistics to form the S&P. In 1960 S&P acquired a stake in Fitch Investors Service rating agency operations. The ratings symbols that are today used worldwide that were developed by Fitch were incorporated into the S&P ratings. In 1966 McGraw Hill an American publishing house bought out S&P and still today they own the company.

The ratings developed by Moody in early 1900s, were later applied to industrial companies and in the 1970s they began rating commercial paper and euro bonds. Since 1962 Moody's has been a subsidiary of the Dun and Bradstreet Corporation (D&B). The most significant new entry in the United States since that time has been the Chicago-based Duff and Phelps, which began to provide bond ratings for a wide range of companies in 1982. Another major ratings provider–McCarthy, Crisanti, and Maffei–was founded in 1975 and acquired by Xerox Financial Services before its fixed income rating and research service was merged into Duff and Phelps in 1991.

In the beginning the CRAs sold their information to investors, rather than charging issuers as is the case today. Some issuers were skeptical in the beginning and regarded the CRAs as intruding, but in the end they were forced to provide the agencies with information because absence of information would affect their rating. In these initial stages the ratings provided by CRAs were financed through the sale of publications. Following the invention of the photocopier however and ease at which these publications were copied, CRAs started to charge the issuers.

Since the beginning of the 1980s, the role and importance of rating agencies has increased. As it stands today they hold a central role in the international system of capital allocation.

1.8 Background of Credit Rating Agencies in Bangladesh

Although the concept of credit rating emerged in early twentieth century in the financial market of USA, it is still new in the developing countries like Bangladesh. Long after a century of its emergence, Securities and Exchange Commission (SEC) of Bangladesh promulgated rules regarding the operation of rating agencies in 1996. No rating agency was licensed in the country till 2002, hence no rating was published. It was the South-east Bank Limited to be rated for the first time in Bangladesh by premier credit rating agency CRISL, in November 2002.

Credit rating industry in Bangladesh started its journey with the mandatory requirement of having credit rating for all public debt type instruments, right offer issues and shares issued at a premium before the same were offered to the public. In the year of 2002, Credit Rating Information & Service Limited (CRISL) started its operation as the first registered credit rating agency of Bangladesh. The second rating agency, Credit Rating Agency of Bangladesh Limited (CRAB) went to operation on 2004.

Credit Risk Grading Manual of Bangladesh Bank was circulated by Bangladesh Bank vide BRPD Circular No. 18 dated December 11, 2005 on Implementation of Credit Risk Grading Manual which is primarily in use for assessing the credit risk grading before a bank lend to its borrowing clients. By that time CRISL rating reports were appearing to be very useful for the users specially CRISL rating report on the then Al Baraka Bank convinced the Bangladesh Bank of the need of credit rating and it took the initiative to make mandatory for all banks to have credit rating before it goes for public offering. The banking regulator further decided to make it mandatory for all banks to submit credit rating reports to the regulator within six months after the finalization of accounts. Following the example of the central bank, the insurance regulator also came up with the requirement to make rating mandatory for all general insurance companies every year and for the life insurance companies bi-annually. The Dhaka Stock Exchange, while issuing the direct listing regulations, made the credit rating mandatory before a company apply for direct listing. The above regulations created an enabling environment for credit rating in the country's capital and financial markets. The concept of client rating by the rating agencies to support capital adequacy of the banks came up in view of the need for implementation of Basel II capital adequacy framework by Bangladesh Bank. Bangladesh Security and Exchange Commission (BSEC) allow only a mere 2% default rate of the credit rating agencies. There are certain penalties in case default rate of more than 2% including cancellation of license of the defaulter rating agency as the highest penalty.

Other credit rating companies namely National Credit Ratings Ltd and Emerging Credit Rating Ltd started their journey on 2010. Lastly, new four credit rating companies have come to operation on 2012, which are ARGUS Credit Rating Services Limited, Alpha Credit Rating Limited, The Bangladesh Rating Agency Limited and WASO Credit Rating Company (BD) Limited. A list of credit rating companies operating in Bangladesh can be found in the following table.

According to Association of Credit Rating Agencies of Asia, Bangladesh has the highest number of credit rating companies. India, one of the largest economies of Asia has only two credit rating companies. On the other hand China, another largest economy is continuing its economic growth with a single credit rating company. Below are the Names and Dates of issuance of Registration Certificates of CRAs‟ in Bangladesh.

1.9 Who Can Perform Credit Rating?

Credit Rating Agencies performs credit rating assignments of various entities and debt instruments. In Bangladesh they are known as External Credit Assessment Institution (ECAI). Rating agencies falls into two categories: (I) Recognized and (ii) Non -recognized. The former are recognized by supervisors in each country for regulatory purposes.

<u>Recognized following eight local credit rating agencies:</u>

- **Credit Rating Information and Services:** Credit Rating Information and Services was the first rating agency in Bangladesh, established in 1995 at the initiative of SECB. It was a joint venture between the Duff and Phelps Credit Rating Company (DCR) of Chicago and Rating Agency Malaysia (RAM) along with the Investment Corporation of Bangladesh and Prime Commercial Bank of Pakistan. While SECB took its time over issuing the license, DCR withdrew from the joint venture. After a long hiatus, CRISL was licensed by SECB in April 2002, taking into consideration its joint venture with Rating Agency Malaysia, Malaysia and DCR-VIS Credit Rating Company of Pakistan. Credit Rating Information and Services, with the support of its joint venture partners, has developed its own rating methodologies and database on various economic sectors to emerge as a reliable rating agency of the country. Credit Rating Information and Services is a founding member and signatory to the memorandum of the Association of Credit Rating Agencies in Asia (ACRAA).

- **Credit Rating Agency of Bangladesh:** Credit Rating Agency of Bangladesh was established in 2003 and received license from SECB in 2004. The agency has technical collaboration with ICRA, India, a subsidiary of Moody’s Investors Service, United States. Immediately after recognition, it became a member of ACRAA, which organized many seminars and best practice dialogues that also assisted CRAB in devising rating methodologies and developing technical staff. With individuals with distinguished service in high positions of public and private institutions on its rating committee, the agency brought into the rating system exemplary standards of integrity and external independent professional judgment of quality and reliability. A clear division of responsibility across the promoter-directors, rating committee members, and the professional staff members is maintained.

- **National Credit Ratings:** National Credit Ratings (NCRL), a public limited company, started its operation with paid-up capital of 10.00 million taka (Tk) and got a license from SECB and subsequent ECAI status from Bangladesh Bank in 2010 with a technical collaboration agreement with the Pakistan Credit Rating Agency (PACRA), Pakistan. NCRL is a member of ACRAA.

- **Emerging Credit Rating:** Emerging Credit Rating (ECRL) was incorporated in 2009 with technical collaboration of Malaysian Rating Corporation (MARC). It obtained a credit rating license from SECB and subsequent ECAI recognition from Bangladesh Bank in 2010. ECRL is a member of ACRAA.

- **ARGUS Credit Rating Services:** ARGUS Credit Rating Services (ACRSL) is a joint venture between Singapore-based DP Information Group (experts in credit and equity research) and local sponsors with experience in capital markets. It was licensed by the SECB in 2011 and accredited with Bangladesh Bank as an ECAI in 2012.

- **Alpha Credit Rating:** Alpha Credit Rating (ACRL) was incorporated in 2011 by a few distinguished and renowned professionals of Bangladesh with technical support from Istanbul International Rating Services (Turk Rating), a Turkish credit rating agency. It was licensed by SECB and granted ECAI status by Bangladesh Bank in 2012. Regulatory Framework and Role of Domestic Credit Rating Agencies in Bangladesh

- **WASO Credit Rating Company (BD).** WASO Credit Rating Company (BD) (WCRCL) started operations on 15 February 2012 with technical collaboration with Financial Intelligence Services (FISL), Hong Kong, China. It was given a license by SECB on 2 February 2012 and accreditation by Bangladesh Bank as an ECAI in October 2012.

- **Argus Credit Rating Services Ltd. (ARGUS):** Argus started its journey in 2011 as a joint venture between Singapore based credit rating company DP Information Group (DP) and local sponsors. The company has one office in Dhaka.

- **The Bangladesh Rating Agency Ltd. (BDRAL):** BDRAL is a subsidiary of Dun & Bradstreet South Asia Middle East Ltd .It obtained license in 2012 and for only to do the SME Rating. The company has one office in Dhaka.

Apart from these Credit Rating Agencies the Bangladeshi Regulatory Authorities also recognizes the following international credit rating agencies mainly for sovereign rating.

- **Standard & poor's (S&P):** S&P is considered one of the Big 3 Credit Rating Agencies, which also include Moody's Investor Service and The Fitch Ratings. It has 26 offices around the world. Standard & Poor's Ratings Services publishes more than a million credit ratings on debt issued by sovereign, municipal, corporate and financial sector entities.

- **The Fitch Ratings:** The firm was founded by John Knowles Fitch on December 24, 1913 in New York City as the Fitch Publishing Company. It merged with London-based IBCA Limited in December 1997. In 2000 Fitch acquired both Chicago-based Duff & Phelps Credit Rating Co.

- **Moody's Investor Service (Moody's):** Moody's was founded by John Moody in 1909 to produce manuals of statistics related to stocks and bonds and bond ratings. In 1975, the company was identified as a Nationally Recognized Statistical Rating Organization (NRSRO) by the U.S. Securities and Exchange Commission. Following several decades of ownership by Dun & Bradstreet, Moody's Investors Service became a separate company in 2000 Moody's Corporation was established as a holding company.

1.10 Importance of credit rating

The motives act behind the entities' paying fees to secure a credit rating depends on the surrounding regulatory environment and form of financial market. There are several reasons of getting a rating. The reasons are different in different markets and economies. The motives of getting a rating in Bangladesh are not identical as USA or UK. However, there are some common reasons for which the entities all over the world are spending money to get rating from the rating agencies. The identical reasons are enumerated here with the context of Bangladesh:

1.10.1 Market access:

Any company that wishes to enter capital markets and issue debt in capital market is obliged to obtain a credit rating. Rating conveys the entity's ability and willingness to the market participants regarding repayment of its borrowed money or equity capital. In Bangladesh, as per Credit Rating Companies Rules 1996, all the companies are required to be rated before issuing its debt or floating its equity share at premium in the market.

1.10.2 Build up market reputation:

New companies that seek to build a reputation in the international and local financial markets demand credit ratings to increase the exposure of their brand name. This brand exposure is important when companies for example initiate foreign direct investments. An entity with a higher rating is considered as a reputable organization. For example Delta Brac Housing – DBH has been awarded as an "AAA" rated company of the country that excels the company's reputation that was reflected through the share price the company at DSE and CSE.

1.10.3 Lower cost of funding:

A less known company can lower their cost of borrowing if they obtain a higher investment grade rating. Banks or financial institutions consider rating as an indication of an entity's performance measurement yardstick. Entities with a higher rating are sanctioned loan at a lower interest rate whereas a lower graded entity is charged at a higher interest rate. So, it is going to be a common practice of the country to require an entity to be rated itself before applying for a loan to the banks or financial institutions.

1.10.4 Distinguish oneself from the competition:

In sectors that are characterized by a limited number of competing companies such as the banking or insurance industry, a credit rating is a tool to distinguish them from the competition. Our banking sector is an example of this practice. In 2006, only Standard Chartered Bank was rated "AAA" by CRISL that makes the bank unique. But in 2007, both Standard Chartered Band and HSBC operation of Bangladesh has been awarded the highest rating "AAA" by CRISL and CRAB respectively that creates some competitive advantage for both the banks.

1.14.5 Regulatory Requirement:

All over the world entities are rated for the regulatory bindings by the securities commissions and other authorities. In Bangladesh, SEC, Bangladesh Bank and Department of Insurance are the three regulators who issued regulations, circulars and notifications for the entities for rating. Our banks and insurances are now rated once in a year for these requirements of the regulatory authorities

1.10.6 A bank could insist on rating the loan facility before sanction/renewal of loan facilities as it would help the bank to save on capital and provide it with additional inputs to decide on the terms of the loan

Benefits for Bankers:

- Offers an independent and unbiased opinion on credit risk associated with loans extended by the bank.
- Provides risk based pricing of bank facilities.
- Inculcates financial discipline in borrowers.
- An independent view of the borrowers' strengths and weakness through a detailed rating report.
- Provides a dynamic health check of portfolio.

Benefits for bankers:

- Enables risk based pricing lower borrowing costs for competent entities

- Enhances visibility in the investment community
- Enables quicker processing of loans and enchantments
- Provides an independent view of the entity's strengths and weakness through a detailed rating report.

Chapter 02

- Regulatory framework for domestic credit rating agencies in Bangladesh
- Credit rating and standardized approach to credit risk in BASEL II
- Capital Adequacy Ratio
- Risk Based Capital Adequacy
- Calculation of Risk Weighted Assets (RWA)
- Effects of loan rating

2.1 Regulatory framework for domestic credit rating agencies in Bangladesh

Domestic CRAs in Bangladesh are operating within a regulatory framework put in place and monitored closely by the SECB. The framework is defined by a set of rulings that came into play at various points in time.

Bangladesh Securities and Exchange Commission (BSEC) has been one of the prime regulators for CRA, along with the authority to issue license and quarterly monitoring of CRA‟s, it also oversees the compliance requirement and rules laid down by Credit Rating Companies Rules 1996.

2.1.1 Credit Rating Companies Rules 1996

The Credit Rating Companies Rules issued by SECB in 1996 created the umbrella of provisions under which the business of credit rating companies in Bangladesh is regulated, monitored, and controlled. The CRC Rules 1996 provided in Section 3, "Requirement of Credit rating: No issue of debt security or public issue of shares (including right share) at a premium shall be made by an issuer unless the issue is rated by a credit rating company and declaration of such rating is given in the prospectus or Right share offer document. This made it mandatory for

- All bonds, either public issues or private placements;
- Issue of shares (equity) at premium in the capital market and
- Any right offer of shares at premium to be rated.

In line with the regulation, 93 issues were enlisted with the stock exchanges through initial public offerings (IPOs) between 2004 and 2013. Credit Rating Agency of Bangladesh (CRAB) rated 49 issues, CRISL rated 36 issues, and the remaining 8 issues did not have any ratings. Five the trend shows that an average of 8–10 issues would come under purview of rating in a bid to comply with the regulation.

2.1.2 Banking Regulation and Policy Department Bangladesh Bank

(Circular Number 05, Dated 29 May 2004 and Circular Number 06, Dated 13 March 2011)

Bangladesh Bank's Banking Regulation and Policy Department (BRPD) issued a circular on 29 May 2004 to all unlisted banking companies to get them rated before they proceeded for IPO. The banks that were waiting to go public at that time did opt for the rating exercise before proceeding. Six banks namely, BRAC Bank, Jamuna Bank, Trust Bank, the Premier Bank, Shahjalal Islami Bank, and First Security Islami Bank, were listed in the exchange through IPO. Three of these were rated by CRAB and the rest by CRISL. In 2013, Bangladesh Bank granted eight more banking licenses. Rating agencies forecast that in the near future these eight banks may also be brought under the purview of annual rating.

The Insurance Development and Regulatory Authority (IDRA) is the primary regulator of insurance companies in Bangladesh. Nevertheless, another circular issued by Bangladesh Bank, BRPD 06 dated 13 March 2011, made it mandatory for general insurance companies to get themselves rated. Through the circular, all banks were instructed to consider the rating of general insurance companies instead of the relationship-based enlistment of eligible insurance companies to provide insurance/cover note to the bank clients.

2.1.3 Insurance Development and Regulatory Authority (IDRA):

The Insurance Development and Regulatory Authority (IDRA) is the primary regulator of insurance companies in Bangladesh. Nevertheless, another circular issued by Bangladesh Bank, BRPD 06 dated 13 March 2011, made it mandatory for general insurance companies to get themselves rated. Through the circular, all banks were instructed to consider the rating of general insurance companies instead of the relationship-based enlistment of eligible insurance companies to provide insurance/cover note to the bank clients.

For credit rating assessment of insurance companies, the respective regulatory authority is Insurance Development and Regulatory Authority Bangladesh (IDRA). To perform credit assessment, credit rating companies can be recognized as a Credit Rating Institution by IDRA. Circular of Chief Controller of Insurance No. 21/21/98-376 dated 27 March 2007 requires all general insurance companies to get credit rating assessment once a year and all life insurance companies to get credit rating assessment every two years. Further to that, a circular issued by Banking Regulation and Policy Department (BRPD) No. 06, dated March 13, 2011 also made it mandatory for general insurance companies to get credit rating assessment.

2.2 Credit rating and standardized approach to credit risk in BASEL II

Basel II is an international business standard that requires financial institutions to maintain enough cash reserves to cover risks incurred by operations. The Basel accords are a series of recommendations on banking laws and regulations issued by the Basel Committee on Banking Supervision (BSBS).

The financial sector of Bangladesh is now considered to be the most regulated sector compared to other sectors. Currently 56 banks are now in operation in a small economy like Bangladesh. Consequently, the financial institutions have been facing tough competition in grabbing market share.

Bank for International Settlement (BIS) has issued Basel-II Capital Accord, which is in the process of implementation globally. Under this framework, capital adequacy will be determined in either in

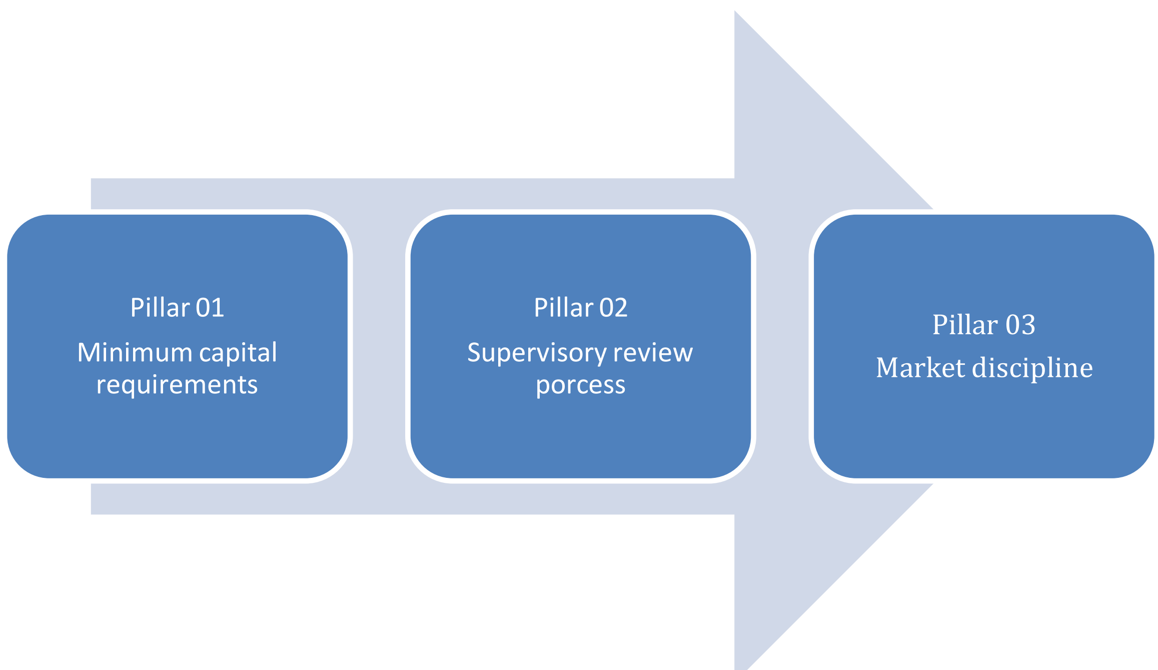
- Standardized Approach (The standardized approach uses external ratings such as those provided by ECAI to determine risk-weights for capital charges) or

- Internal Rating Based Approach: IRB allows banks to develop their own internal ratings for risk-weighting purposes subject to the meeting of specific criteria and supervisory approval.

Most of the developed and developing countries even our neighboring countries have already taken initiatives to implement Basel-II since the beginning of 2007. Realizing the importance, Bangladesh Bank has already declared time framework for the parallel run of Basel-II exercise along with BASEL I from the beginning of the year 2009. CRAs' role has expanded with financial globalization and has received an additional boost from Basel II which incorporates the ratings of CRAs into the rules for setting weights for credit risk.

Bangladesh Bank (BB) is the central bank of Bangladesh and governs all the active performing commercial banks in the country. Considering the persistent complexity and diversity in the banking industry and to make the bank's capital more risk sensitive and shock absorbent, Bangladesh Bank has introduced Risk Based Capital Adequacy guideline relating to the Basel II Accord. In compliance to international standards Bangladesh Bank has made the guidelines statutory for all scheduled banks in Bangladesh from January 01, 2010. Basel II attempts to integrate Basel capital standards with national regulations, by setting the lowest capital requirements of financial institutions with the goal of ensuring organization or Institution liquidity.

These guidelines are structured on following three aspects:



- **Pillar 1:**

Pillar 1 of the Basel II Accord requires banks to maintain sufficient levels of regulatory capital to meet risks clustered around three areas; credit, market and operational risk. It provides details of how banks must calculate their minimum capital requirements. It suggests various approaches for calculating capital for credit, market, and operational risk.

Capital for Credit Risk

- Standardized Approach
- Internal Ratings Based (IRB) Foundation Approach
- Internal Ratings Based (IRB) Advanced Approach

Capital for Market Risk

- Standardized Approach (Maturity Method)
- Standardized Approach (Duration Method)
- Internal Models Method

Capital for Operational Risk

- Basic Indicator Approach
- Standardized Approach
- Advanced Measurement Approach

- **Pillar 2: Supervisory Review Process**

- Supporting Pillar 1: Dimensions of risks not considered (e.g. large exposures and credit concentrations)
- Risks not taken into account (e.g. interest rate risk in the banking book, business and strategic risk)
- Factors external to the bank (e.g. business cycles)
- Ensuring compliance with Pillar 1 requirements – both quantitative and qualitative
- Fostering improvements in risk management and in supervision.

- **Pillar: 03 :Market Discipline**

This guides the framework of public disclosure on the position of a bank's risk profiles, capital adequacy, and risk management system. Market discipline is based on enhanced disclosure of risk. Under Basel II, banks may use their own internal models but the price of this is transparency. Information to be disclosed includes:

- Available capital in the group, capital structure, detailed capital requirements for Credit risk
- Breakdown of asset classification and provisioning
- Breakdown of portfolios according to risk buckets and risk components
- Credit risk mitigation (CRM) methods and exposure covered by CRM

2.3 Capital Adequacy Ratio:

Assessment of Capital Adequacy is carried out in conjunction with the capital Adequacy reporting to the Bangladesh Bank and listed approaches were pursued to calculate Minimum Capital Requirement:

Under the standardized approach of the Risk Based Capital Adequacy Framework (Basel II), credit rating is determined on the basis of the risk profile assessed by the ECAIs recognized by Bangladesh Bank. All scheduled banks have been asked to nominate a recognized ECAI for their own credit rating as well as that of their counterparty. In this perspective, a set of guidelines regarding the recognition of eligible ECAIs was issued and forwarded to the scheduled banks. The Bangladesh Bank circular says, “External Credit Assessment Institutions duly recognized by Bangladesh Bank will be engaged in credit risk assessment under the standardized approach of the Risk Based Capital Adequacy Framework (Basel II).On the basis of that assessment, risk weight will be mapped with the credit rating category and the risk weighted assets will be determined for calculating the capital requirement of banks against credit risk. The criteria of ECAI recognition and mapping process of risk weight has been developed in line with the International Convergence of Capital Measurement and Capital Standards (Basel II) issued by the Basel Committee on Banking Supervision (BCBS) in June 2006.” The recognition criteria have been listed below.

Capital adequacy provides regulators with a means of establishing whether banks and other financial institutions have sufficient capital to keep them out of difficulty. Regulators use a Capital Adequacy Ratio (CAR), a ratio of a bank’s capital to its assets, to assess risk.

CAR = (Bank’s Capital)/ (Risk Weighted Assets)
= (Tier I Capital + Tier II Capital)/ (Risk Weighted Assets)

2.4 Risk Based Capital Adequacy:

Bangladesh Bank did not make any certain amount of Capital target. A bank should weight its assets according to its risk exposure and thus maintain sufficient capital to protect itself through any shock. The assets should be weighted with risk factors and calculate total Risk Weighted Asset (RWA). Banks are to calculate Risk Weighted Asset (RWA) on the basis of risk weight mapping circulated by BB against the credit rating assessment made by listed External Credit Rating Agencies (NCR, CRISL, CRAB, and ECRA)

2.4.1Calculation of Risk Weighted Assets (RWA):

Risk must be taken into consideration while calculating the capital needed to meet BB requirements. BB provides a list of assets and necessary weights based on their respective risk. The basic RWA calculation is as below:

Example: If Bank finance a company BDT 35.00 million which is secured by the company's fixed assets, and obtains a credit rating grade of A will have a RWA of BDT 17.50 million

- Calculation of RWA for Rated Company

BDT 35.00 million x RW mapping against **A**= BDT? Million
BDT 35.00 million x 50% = BDT 17.50 million
Therefore, the Provisioning of Capital is 10% of RWA
= RWA x 10%
= BDT 17.50 million x 10%
= BDT 1.75 million

- Calculation of RWA for **Un-Rated** Company

BDT 35.00 million x RW = BDT? Million
BDT 35.00 million x 125% = BDT 43.75 million
Therefore, the Provisioning of Capital is 10% of RWA
= RWA x 10%
= BDT 43.75 million x 10%
= BDT 4.37 million

Additional capital that can be lend by bank is (4.37-1.75) million= BDT 2.63 million

2.5Effects of loan rating

If an bank has high quality assets for example if the majority of its assets are in the AAA,AA and A categories it will save capital because of low credit risk The Illustration is given below:

Basel II(Corporate Rating)						
Rating	Capital required	RW for Unrated weights	RW for rated weights	Capital required		Capital release
				Rated exposure	Unrated exposure	Rated exposure
AAA,AA	10%	125%	20%	2%	12.5%	10.5%
A	10%	125%	50%	5%	12.5%	7.5%
BBB,BB	10%	125%	100%	10%	12.5%	2.5%
B and below	10%	125%	150%	15%	12.5%	-2.5%
SME Rating (Medium Enterprise)						
NSME-1	10%	100%	20%	2%	10%	8%
NSME-2	10%	100%	40%	4%	10%	6%
NSME-3	10%	100%	60%	6%	10%	4%
NSME-4	10%	100%	80%	8%	10%	2%
NSME-5	10%	100%	120%	12%	10%	-2%
NSME-6	10%	100%	150%	15%	10%	-5%

Long term Rating category							
BB rating grade	Equivalent notch of CRISL	Equivalent notch of CRAB	Equivalent notch of NCRL	Equivalent notch of ECRL	Equivalent notch of ACRL	Equivalent notch of WASO	Risk weight
1	AAA	AAA	AAA	AAA	AAA	AAA	20%
	AA+, AA, AA-	AA1, AA2, AA3	AA+, AA, AA-	AA+, AA, AA-	AA+, AA, AA-	AA1, AA2, AA3	
2	A+, A, A-	A1, A2, A3	A+, A, A-	A+, A, A-	A+, A, A-	A1, A2, A3	50%
3	BBB+, BBB, BBB-	BBB1, BBB2, BBB3	BBB+, BBB, BBB	BBB+, BBB, BBB-	BBB+, BBB, BBB-	BBB1, BBB2, BBB3	100%
	BB+,BB, BB-	BB1,BB2, BB3	BB+,BB, BB-	BB+,BB, BB-	BB+,BB, BB-	BB1,BB2, BB3	
4	B+, B, B-, CCC+, CCC, CCC-, CC+, CC, CCB1	B1, B2, B3, CCC1, CCC2, CCC3, CC1, CC2, CC3	B+, B, B-,	B+, B, B-,	B+, B, B-, CC+, CC, CC-	B1, B2, B3, CCC	150%
5	C+, C, C-, D	C, D	C+, C, C-, D	C, D	C+, C, C-, D	CC1, CC2, CC3, C+, C, C-, D	
Short term rating category							
S 1	ST-1	ST-1	N-1	ECRL-1	ST-1	P-1	20%
S 2	ST-2	ST-2	N-2	ECRL-2	ST-2	P -2	50%
S 3	ST-3	ST-3	N-3	ECRL -3	ST-3	P -3	
S 4	ST-4	ST-4	N-4	ECRL -4	ST-4	P -4	100%
S 5	ST-5	ST-5	N-5	ECRL -5	ST-5	P -5	150%
S 6	ST-6	ST-6	N-6	ECRL -6	ST-6	P -6	

Chapter 03
Company Overview

- National Credit Ratings Limited
- Mission
- Values
  Technical Collaboration
- Services NCR Provides
- Rating Process
- Rating Scales and Definition
- Short Term Credit Ratings
- Rating Methodology

3.1 National Credit Ratings Limited

National credit ratings limited is a full service rating company that offers a wide range of services incorporated as a public limited company NCR stated its business with a paid up capital of TK10 million. The Securities and Exchange Commission granted the license to NCR in June 2010 under the credit rating company's rules 1996 the company is recognized by the Bangladesh Bank as an External Credit Assessment Institution.

3.2 A Snap Shot of the Company

Name of the Company	: Credit Rating Agency of Bangladesh Limited (CRAB)
Legal Form	: Technical collaboration with PACRA Limited of Pakistan.
Date of Incorporation	: 2010
Date of getting License	: 2010
Date of Commencement	: 5 April 2004.
Office Address	: 3 Bijoy Nagar (2nd and 3rd Floor)
E-mail	: ncrlbd10@yahoo.com
Telephone	: 9359878, 9348050, 9341977
Fax	: 880-2-9332769
Number of Employees	: 40
Web Site	: www.ncrbd.com

3.3 Mission

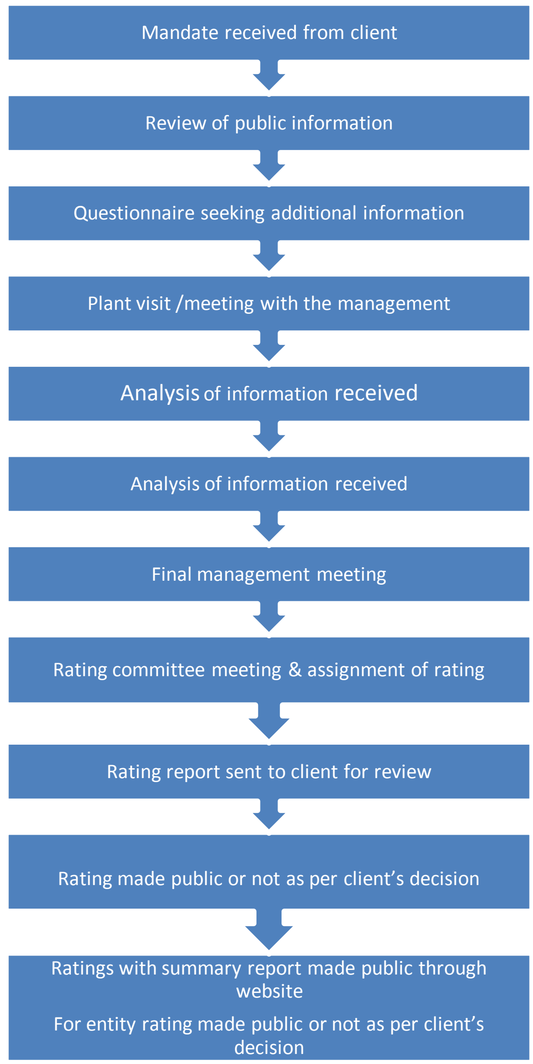
To provide high quality, independent and reliable risk profile information on industrial and commercial enterprises in the domestic market using analytical competence, professionalism and integrity.

3.4 Technical Collaboration

NCR has entered into technical collaboration agreement with "The Pakistan Credit Rating Agency Ltd" (PACRA), Pakistan. PACRA was set up in 1994 as the first credit rating agency in Pakistan as a joint venture between IFC of the World Bank and IBCA London (now known as Fitch Ratings, one of the world's leading rating agencies). PACRA is a founder member of the Association of Credit Rating Agencies in Asia (ACRAA). PACRA, while helping NCR in design and development of rating methodologies and programs, would support in training and development of human resources.

3.5 Services NCR Provides

Entity Rating
Bank Loan Rating
Financial Institution Rating
Insurance Company rating
Asset Manager Rating
Instrument Rating



3.6 Rating Process

- The rating process of NCR starts with the mandate received from client through an agreement. Then an analyst reviews the public information from a variety of sources available at NCR which include:
- Already issued rating reports in case of an update assignment, comparable clients belonging to the same sector in case of initial assignment.
- Relevant laws, regulations rules governing the sector and the website of the sector regulator.
- Financial statements of the client
- Searching information related to the owners, suppliers and customers through different mediums.

The analyst then prepares a questionnaire for additional information. The next step is plant visit/Management meeting. After getting feedback from the client, the analysis is done through xl spreadsheets. The rating starts taking shape. A written document called assessment is presented to the internal Committee and an initial assessment is done. Rating relevant issues are identified and analyzed. Then the process of management meeting begins the preparation of an agenda. MM is a critical step in the rating process when the analyst team interact with the client. The last step is the rating Committee Meeting (RCM) where the Analyst submits a ratings proposal to the RC. The RC scrutinizes the rating proposal and is responsible for the sanctity of the rating opinion. The final rating is assigned based on majority decision of the RC. Minutes of RCM are recorded.

3.7 Rating Scales and Definition

Long Term Credit Ratings
(Bank/Financial Institutions/NBFIs/Corporate/Debt Instruments)

Rating Scale	Definition
AAA	**Excellent** quality, offering **highest safety** for timely servicing of financial obligations. Such institutions carry **minimum risk**
AA+,AA,AA-	**Very strong** capacity for timely servicing of financial obligations offering **high safety**. Such institutions carry **very low risk**.
A+,A,A-	**Strong** capacity for timely servicing of financial obligations offering **adequate safety**. Such institutions carry **low credit risk**.
BBB+,BBB,BBB-	**Adequate capacity** for timely servicing of financial obligations offering **moderate safety**. The rating category denotes a moderate credit risk. However changes in circumstances or economic conditions are more likely to affect the capacity for timely servicing of financial obligations.
BB+,BB,BB-	**Inadequate safety** for timely servicing of financial obligations. Such institutions carry **high credit risk**. The entity remains more vulnerable to adverse economic changes over time.
B+,B,B-	**Low safety** for timely servicing of financial obligations.
CCC, CC, C	**Very high risk** for timely servicing of financial obligations.
D	Entities with this rating are of the lowest category. They are either in **default** or likely to be in default soon.

3.8 Short Term Credit Ratings

Rating Scale	Definition
ST-1	**Strongest capacity** for timely payment of financial commitments and carry lowest credit risk.
ST-2	**Strong capacity** for timely payment of financial commitments and carry lowest credit risk
ST-3	**Satisfactory capacity** for timely payment of financial commitments and carry very low credit risk.
ST-4	**Moderate capacity** for timely payment of financial commitments and carry Moderate credit risk
ST-5	**Uncertain capacity** for timely payment of financial commitments and carry high credit risk.
ST-6	Indicates actual or inherent payment default.

3.9 Rating Methodology

Corporate rating methodology
Financial institutions methodology
Bank loan rating methodology
Life Insurance methodology
SME rating methodology
Trading rating methodology
Insurance rating methodology

Specific methodology followed for specific rating activities to clearly identify the factors relevant for the rating purpose. However there are some common factors that followed common to decide every rating outcome. Different Rating methodology is published fully in NCR website.

The rating process of NCR starts focuses on industry in which the company operates along with an assessment of the business, financial risk, historical financial performance, financial flexibility, ability to generate cash from operations and the quality of the management of the company. Ratings are an assessment of an entity's ability and willingness to meet financial obligations in a timely manner and are intended to be comparable across industry groups.

1. Industry Risk Analysis:

NCR measures the industry risk by the strength of the industry within the economy. The analysis of industry risk focuses on the prospects of the industry and the competitive factors affecting the industry. The industry environment is assessed to determine the degree of operating risk faced by the company in a given business, investment plan of the major players in the industry, demand supply factors, price trends, changes in technology, international/domestic competitive factors in the industry, entry barriers, capital intensity, business cycles etc are key ingredients of industry risk. NCR also takes into account the strategic nature of the industry in the prevailing policy environment, role of regulation and legislation.

2. Business Risk Analysis:

Analysis of business risk involves evaluation of company's historical performances with emphasis on assessment of adequacy of cash flow to meet its operating expenses. NCR measures the company's competitive position within the industry by analyzing the historical performances. Some of the key parameters used for assessing business risk are:

2.1 Market share

The company's current market share in its major activities and the historical protection of its position and projected ability for the future are important indicators of the competitive strengths of the company. It also cover the company's past financial performances and its ability to maintain and improve them. Market leader generally has financial resources to meet the competitive pricing challenges.

2.2 Diversification

Companies operating in several industries are assessed by analyzing each major business segment separately. While diversification results in better sustainability in cash flows, NCR analyses the sustainability and adequacy of management structure in such scenario.

2.3 Size

Small size firms have limited access to funds leading to lack of financial flexibility resulting in lower protection of margins during economic downturn. Large firms, on the other hand, have ability to sustain, even during difficult times.

2.4 Seasonality and Cyclicality

Some industries are cyclical in nature with their performance varying through the economic cycle. Moreover, certain industries are seen to exhibit seasonality. NCR's rating opinion aim to be stable across seasons and economic cycles and derived by analyzing the long term fundamentals.

2.5 Cost Structure

The cost factors and efficiency parameters of existing operations are assessed with respect to expenditure levels required to maintain its existing operating efficiencies as well as to improve its efficiency parameters in a competitive scenario. Nature of technology may also influence the cost structure.

2.6 Marketing and Distribution Arrangements

Depending on the nature of the product, NCR analyses the depth and importance of the marketing and distribution of the company.

3. Financial Risk Analysis:

Analysis of financial risk involves evaluation of past and expected future financial performance of the company with emphasis on assessment of adequacy of cash flow to meet financial obligations.

3.1 Cash Flow:

A thorough analysis of the cash flow statements reveals the ability of a company to pay its obligations. Cash flow analysis is an important tool for the assessment of financial risk. The cash flow from operations provides a company with more secure credit protection than dependence on external sources. NCR analyses cash flow from core as well as non-core operations, the stability of cash flow and its adequacy to meet debt servicing requirements.

3.2 Capital Structure

NCR analyses capital structures to determine a company's reliance on external financing. To assess the credit implications of a company's leverage, several factors are considered, including nature of its business environment and the principal fund flows from operations.

3.3 Financial Flexibility:

Financial flexibility refers to alternative sources of liquidity available to the company as and when required. Company's contingency plans under various stress scenarios are considered and examined. Access to alternate sources of funds whenever a company faces financial crunch is reviewed. Other factors that contribute to financial flexibility such as the ability to redeploy assets and revise plans for capital spending are also analyzed

4. Management and Ownership:

Evaluation of the management quality is one of the most important factors supporting a company's credit standing. An assessment of the managements plan in comparison to those of their industry peers can provide important insights into the company's ability to sustain its business. Capability of the management to perform under stress provides an added level of comfort. Track record of the management team is a good indication for evaluating the performance of the management.

4.1 Corporate Governance:

The assessment of corporate governance involves analysis of the governance data and information and review of an entity's governance practices. The independence and effectiveness of the board of directors are considered to be an essential element of a robust corporate governance framework. The board's oversight of the audit function is assessed; being an important safeguard in protecting the integrity of an entity's financial reporting. Special attention is given to the relative complexity of the shareholding/ownership structure, and/or ownership by private individuals and families, and the implications for the management behavior and financial stability of the entity are evaluated. The company's business plan, mission, policies and future strategies in relation to the general industry scenario are assessed.

4.2 Systems & Control:

Adequacy of the internal control systems to the size of business is closely examined. Existence of proper accounting records and control systems adds credence to the accounting figures. Management information system commensurate with the size and nature of business enables the management to stay tuned to the current business environment. Personnel policies laid down by the company would critically determine its ability to attract and retain human resources.

4.3 Organizational structure:

An assessment of the organizational structure would indicate the adequacy of the same in relation to the size of the company and also given an insight on the levels of authority and relationship.

4.4 Performance of Group Companies:

Interests and capabilities of the group companies belonging to the same management give important insights into the management capabilities and performance in general.

5. Security Risk & Relationship Risk:

These risk factors are from the perspective of facility ratings or Bank Loan Ratings (BLR) and are more relevant to banks for sanctioning credit facility than assigning entity ratings. We have covered these risk factors in our Bank Loan Rating Methodology.

Key Ratios:

Financial ratios are used to make an assessment of the financial performance of the company and see its relative performance with respect to its peer group within the industry.

a. **Growth ratio**:

Trends in the growth rates of the company vis-à-vis the industry reflect the company’s ability to sustain its market share, profitability and operating efficiency. The focus is drawn on growth in total income, EBIT.

b. **Coverage and Leverage Ratios**:

Coverage ratios show the relationship between debt servicing commitments and cash flow sources available for meeting those obligations. Leverage refers to the percentage of debt finance relative to an entity’s total capital. Leverage ratios help in assessing the risk arising from the use of debt finance.

Net debt to EBITDA provides perspective on an entity's debt capacity and ability to meet debt obligations falling due. Debt to Equity ratio or Gearing shows total or net debt as percentage of shareholders equity. Gearing indicates the proportional share of the risk taken by owners and lenders and gives an indication of the flexibility to raise new debt.

c. **Turnover Ratios:**

Turnover ratios also referred to as activity ratios or asset management ratios, measure how efficiently the assets are employed by the company. These ratios are based on the relationship between the level of activity, represented by sales, CGS and the level of various assets including inventories and fixed assets. Inventory turnover ratio measures the number of times a company converts its stock into sales during the year. The asset turnover ratio indicates how effectively a company utilizes its investment in assets. Fixed Assets turnover ratio is a measure of how effectively Fixed Assets (e.g. Property, plant, equipment) are being used to generate sales.

d. **Liquidity Ratios**:

Liquidity ratios such as current ratio and quick ratio are broad indicators of the liquidity position of a company. Liquidity ratios are important parameters for rating short term instruments. Cash flow statements are also important indicators of liquidity.

e. **Profitability Ratios**:

Profitability reflects the final operational result of a company. The ability of a company to earn profit determines the protection available to the company. Gross Margin, Operating Margin and Net Profit Margin are important measures of profitability of a company and are quite helpful in assessing relative profitability of companies within the same industry. Return on Equity measures the annual return on equity. Since ROE is dependent on a company's capital structure, the use of leverage can increase this ratio, assuming sufficient funds are available to service the debt. Comparing ROE across industries can be misleading, as riskier industries tend to have higher ROEs, which compensate shareholders for the inherent risk of the investment.

Chapter 04
Job part

- Summary of the Job
- Specific Responsibilities of the Job

4.1 Summary of the Job & organization

Job Title:	Research officer
Department:	Rating-Corporate
Reporting To:	Manager, Rating-Corporate
Job Posting:	National credit ratings limited Head office 3, Bijoynagar (2nd and 3rd Floor) Dhaka-1000

4.2 Specific Responsibilities of the Job:

- Communicate with clients/marketing team/bankers/Proprietor of the firm/Managing director of the company over the phone/email/arrange meeting with them for rating purpose.
- Collects information using different media.
- Visit the manufacturing plant to gain better knowledge about the concern.
- Communicate with the banker to know the loan status and outstanding date till date of declaration.
- Analysis the quantitative and qualitative parts.
- Prepare the draft report and submit it to the rating manager.
- Sending the draft report the client after the approval of rating manger.
- Make final changes after considering necessary changes from the client.
- Final submission of report to the RC members with rating proposal.
- Handover the file to the compliance officer.

Chapter 05

- Bangladesh perspective and credit rating current scenario
- Recommendation

5.1 Bangladesh perspective and credit rating current scenario

The understanding of the concept of credit rating has been improving over time in Bangladesh. By formulating CRC Rules 1996 it has added further regulatory environment. By making credit rating mandatory for all equity Offerings, SECB demonstrated its serious intent to make credit rating a sustainable proposition in the capital and financial markets of Bangladesh. Other initiatives taken by SECB and Bangladesh Bank in the context of credit ratings are enumerated below:

Initially, rating was a one-shot opinion of the ECAI regarding the creditworthiness of the rated entity without any subsequent surveillance. SECB, through a major amendment in 2009, introduced surveillance of credit rating. In addition, in order to stop rating shopping, it mandated that the issuer would enter into an agreement with rating agencies for a minimum of 3 years and the surveillance of bonds would continue throughout the life of the instrument. SECB also created an ethical code for rating agencies in line with the IOSCO Code of Conduct. Since Bangladesh is a member of the IOSCO; SECB has to ensure that international regulations are followed by rating agencies in the country.

Bangladesh Bank has introduced the Basel II Capital Adequacy Framework for all banking institutions. The standardized approach within Basel II mandates that capital adequacy of banking institutions be calculated by attributing risk weights to their assets based on credit rating of these claims by ECAIs. As a further step, the central bank has recognized seven rating agencies as ECAIs and circulated the format for mapping of the ECAI ratings against the Bangladesh Bank risk grading scale. Unrated clients attract a high risk weight of 125%, indicating that the regulatory authorities are extremely serious about getting all loans rated.

Clearly, the prospects for DCRAs are bright in Bangladesh as there is active policy and regulatory support and incentive encouraging the rating process both for borrowing as well as lending institutions. However, ensuring quality rating in a highly competitive environment is a challenge. SECB has been issuing licenses to DCRAs without factoring in the market need, size, and basis for pricing. Due to this DCRAs are facing fierce competition which puts their survivability in question. If DCRAs cannot survive in long term then the quality of its services shall also deteriorate. Bangladesh were facing severe problems as the price of performing rating assignments were drastically falling because of intense competition after emergence of new 3-4 rating agencies Bangladesh Bank has also been recognizing the newly formed rating agencies as ECAIs without undertaking any cost–benefit analysis of the increased competition, thus posing a threat to the rating industry in the country.

5.2 Recommendation

Restrictions on rating:

Not all the entities or securities should be rated by credit rating agencies. To ensure independence and objectivity in rating process, some restrictions should be imposed on rating of securities or entities related to the CRA.

Disclosure of rating and rationale by the entity:

Respective circulars for banks and insurances guide the entities to publish the rating in any two national daily within one month of completion of the rating.

Regulatory Framework for CRA

It is about 12 years to promulgate the Credit Rating Companies Rules 1996 and about 6 years to the issuance of BRPD Circulars. But it is a matter of great regret that Bangladesh Bank is yet to set up a different wing to monitor the rating status of scheduled banks and their counterparties. Bangladesh Bank should set up a monitoring cell for the rated companies or firms to supervise, review and to advice on the rating results of each rating performance.

Range of Rating Grade

The Credit Rating Companies Rules 1996 instructs the companies to be rated before floating shares to the market through IPO or right issue but didn't mention any range of rating to qualify itself for issuance. It is acceptable that the rating range primarily could be from "AAA" to "B-" for floating of shares.

Steps against Biasness

Since source of income of a rating agency is from the client whom they are rating. So there might be a chance to be biased to the client and may have chance to rate artificially higher in order to get more money. Central bank should have a monitoring cell to control this face.

Objectivity

The methodology for assigning credit assessments must be rigorous, systematic, and subject to validation based on historical experience. Moreover, assessments must be subject to ongoing review and responsive to changes in the financial condition of the concerned entity.

Independence

An ECAI should be independent and free from political, social, or economic pressure that may influence the rating. The assessment process should also be free from any such constraint that could arise in situations where the composition of the board of directors or the shareholder structure and the officials of the assessment team of the ECAIs may be seen to create a conflict of interest.

International access and transparency

The individual assessment should be available to both domestic and foreign institutions with legitimate interests, and at equivalent terms. In addition, the rating methodology used by the ECAI should be publicly available

Disclosure

An ECAI should disclose its assessment methodologies, notch or notation used, definition of the default rating category, the meaning of each rating and its time horizon, actual default rates experienced in each assessment category, and the transitions of the assessment, e.g., the likelihood of AA ratings becoming A over time.

Resources

An ECAI should have sufficient resources to carry out high-quality credit assessment. These resources should allow for substantial ongoing contact with executives at both senior and operational levels within the rated entities in order to add value to the credit assessments. Such assessment methodologies should be based on both qualitative and quantitative approaches.

Credibility

In addition to the above criteria, reliance on the credit assessment by independent parties (investors, insurers, trading partners) shall provide evidence of the credibility of the assessment of an ECAI. The credibility of an ECAI is also underpinned by the existence of effective internal control to prevent the misuse of confidential information.

Banks Should Offer Benefits to its Clients

All the financial institutions should offer some benefits to its clients such as a declined interest rate so that more and more clients are encouraged to obtain a credit rating report. As mentioned above clients in most of the time not interested to provide information which leads to a bad grade if the banks offer lower interest rates than the clients will be encouraged to provide more information which may lead to a better grade which will be mutually beneficial to the client and the bank.

Arrange Workshops and Seminars

The CRAs operating in Bangladesh should undertake more active role to educate the finance professionals of the country. The importance and benefits of credit rating needs to be clearly communicated to all the stakeholders. NCRL one of the credit rating agencies operating in Bangladesh has already started working towards this endeavor. It has held multiple seminars to promote credit rating.

ADB BEST PRACTICE HANDBOOK

Requirement of international best practice suggested by ADB handbook

ESSENTIAL BEST PRACTICES
1.**Pre-Rating Requirements** ➢ Written contract between DCRA and rate ➢ DCRA cannot promise, assure, or guarantee a particular rating outcome. ➢ Rating definitions, policy for use, and rating criteria are to be explained to the rating entity before rating services are engaged ➢ Publication of policies and processes ➢ Availability of adequate resources personnel with skills facilities such as software for information processing and regular training, and adequate financial resources for business development. ➢ Revision in organizational structure and rating process.
2.**Rating Definitions and Recognition of Default** ➢ Disclosure whether rating indicates probability of default or expected loss ➢ Preparation of concrete definition of default
3.**Policies and Processes for Rating** ➢ Consistency in application of rating policies ➢ Use of updated criteria and management meetings for ratings assignments ➢ Initial rating assignment and appeal process ➢ Publication of ratings ➢ Surveillance policy ➢ Withdrawal policy ➢ Formation of functional groups ➢ Training plan ➢ Preparation of operations manual ➢ Policies for dependence on third party ➢ Miscellaneous other activities
4.**Confidentiality Requirements** ➢ Confidentiality of ratee's information ➢ Applicability of confidentiality to all employees ➢ No access to those not involved in the rating assignment ➢ Contractual arrangement to ensure confidentiality
5.**Analytical Independence and Avoidance of Conflicts of Interest** ➢ Policies to manage conflicts of interest ➢ Policies on trading and investment declaration ➢ Formulation of other policies to ensure independence and avoidance of conflicts of interest

6.**Private, Unaccepted, and Unsolicited Ratings** ➢ Formulation and adherence to policies
7.**General Code of Conduct** ➢ Adoption of internal code ➢ Affirmation of compliance with code
8.**The International Organization of Securities Commissions (IOSCO) Code of Conduct** ➢ Adherence to the code of conduct
9.**Process Audit and Compliance Office** ➢ Institution of audit process ➢ Appointment of Compliance Officer ➢ Whistle-blower policy continued next page 26 ADB South Asia Working Paper Series No. 21 Continued from previous page
10.**Outreach Initiatives** ➢ Initiation of outreach activities
11.**Relation with Regulator and Other Domestic Rating Agencies (DCRAs)** ➢ Formulation of relevant policies and compliance
4.1 **Computation of Default Statistics** 4.1.1 Every rating agency should publish, at least annually, a default and transition study, along with the methodology used for calculating default rates. 4.1.2 In the methodology employed for calculation of the default rates, the common features designated in the handbook are recommended. 4.1.3 Transition rates should ideally be calculated and published on the basis of a 1-year observed transition
4.2 **Dedicated Advanced Functional Groups Have the following functional groups been formed:** (a). Industry focus group (b). Quality assurance group (c). Library and data management group 4.3 Conflicts of Interest between Other Businesses: Has detailed due diligence been undertaken in areas where co-mingling of diverse DCRA business lines pose conflicts of interest, and in such cases have operational firewalls been put in place and are they fully adhered to? 4.4 Are Rating Enhancers Used as Early Warning Indicators? 4.5 Are the Rating Criteria Published? 4.6 Is Market Feedback Obtained before Major Policy Changes?

Conclusion

The financial sector of Bangladesh is now considered to be the most regulated sector compared to other sectors. Currently 56 banks are now in operation in a small economy like Bangladesh. Consequently, the financial institutions have been facing tough competition in grabbing market share. Considering the latest financial collapse and turmoil in this sector CRAs' role has expanded with financial globalization and has received an additional boost from Basel II which incorporates the ratings of CRAs into the rules for setting weights for credit risk. At national level, there is a lack of initiatives to let the CRAs play their natural role. The credit rating industry of our country is yet to be matured. Government and regulatory authorities are taking initiatives to establish a platform for them. Bangladesh Bank should monitor the credit rating agencies activities more closely to establish an additional layer of safety and incorporate proper guidelines so that it is useful for the parties involved, borrower as well as financial institutions.

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