

Criteria for Notching up Stand Alone Ratings of Companies based on Parent Support

CRISIL evolved its comprehensive notch-up criteria for parent-supported ratings in mid-1999. CRISIL notches-up ratings for parent support on the hypothesis that an entity's creditworthiness is not only dependent on its own business and financial strengths but also on its lineage and the relationship that it enjoys with its parent. To capture the benefits that flow to a company from a credit perspective, CRISIL employs a comprehensive framework, which measures parent support available on an ongoing basis as well in times of distress. This is objectively assessed through a set of economic and moral factors that primarily takes into account the extent of integration between the parent and the subsidiary and accordingly, the subsidiary's stand-alone rating is notched up.

■ General principles for notching up stand alone ratings

CRISIL considers notching up a subsidiary company's rating only in cases where the parent does not explicitly guarantee the debt. In case the parent guarantees the debt that is rated, then the rating for this debt is directly equated with the parent's rating.

CRISIL's analysis of parental support is determined by various factors including the strategic importance of the subsidiary to the parent, the extent of the parent's shareholding in the subsidiary and the economic incentive for the parent to support the subsidiary. Factors that can create a moral obligation on the parent with regard to the subsidiary's liabilities are the extent of management control of the subsidiary, shared name, the management's stated posture and the domiciliary status of the parent and the subsidiary. CRISIL also takes into account the corporate status of the parent company (whether closely held or listed) while assessing the possibility of support forthcoming from the parent to its subsidiary.

Based on the extent of integration assessed, CRISIL notches up the stand-alone rating. The extent of notching up also depends on the parent's financial capacity as represented by its rating. Moreover, the subsidiary is notched up for parent support only if the parent's credit quality is stronger than the subsidiary. While CRISIL would notch up a subsidiary for parent support, it would also factor in the likely impact of the support while assessing the parent's credit quality.

■ Determining factors for notching up

The extent of integration between a parent and its subsidiary is assessed by analysing various parameters. These can be broadly classified into factors that constitute the economic rationale for the parent to support its subsidiary and aspects that constitute a moral obligation on the parent to extend support to its subsidiary.

Some of the important parameters under each of these categories are:

Economic rationale

Strategic importance of subsidiary to the parent: The criticality of the subsidiary to the parent is assessed on the basis of factors like the commonality of business between the two entities, whether the subsidiary is a critical supplier or if it operates in a major market with growth potential. The strategic importance is also reflected in the extent of the parent company's investments in the subsidiary.

Size of investments in other related entities in India: If an MNC or a large domestic parent company has invested in a number of Indian subsidiaries, which have business synergies with the company being rated, then the strategic importance increases compared to a parent company that has a single subsidiary. The quantum of investments in other subsidiaries vis-à-vis the parent's total investments can also be taken as a parameter for determining the subsidiary's strategic importance to the parent.

Extent of parent holding (current and prospective): A higher holding by the parent reflects a higher level of commitment to the subsidiary. CRISIL exercises caution in cases where the parent's holding is lower than 50% and/or the parent is not the dominant shareholder in the rated entity.

Economic incentive to parent (current and prospective): If a subsidiary is not profitable, beyond a point, the parent company's shareholders will not be willing to extend financial support. Therefore, economic incentive is a powerful reason for the parent to support its subsidiary. The subsidiary's past and future return on capital employed and return on net worth would be indicators of this parameter.

In the case of a subsidiary company that is a green field project, the timeframe set for the subsidiary to break-even and to start contributing towards the investments made by the parent as well as the expectations on the return on investment, would be important parameters that would be evaluated.

Moral obligations

Extent of management control: This is determined by the extent of the parent's interaction in the subsidiary's management process and decisions, commonality in

board members and the like. It is a critical input for assessing the parent's moral obligation to support the subsidiary.

Shared name: A shared name between the parent and subsidiary creates a moral obligation on the parent to bail out the subsidiary in times of financial stress. This aspect is duly captured as part of this framework.

Domiciliary status: A parent that is domiciled in the same country as its subsidiary will face greater market pressure to support the subsidiary. Such market pressures could come from common lenders, labour unions, governments and the like. Also, if the parent were domiciled in the same country, it would be easier for it to transfer money to bail out the subsidiary.

Management's stated posture: CRISIL evaluates the parent's stated posture regarding its support to the subsidiary. Any assurances from the parent, letters of comfort, keep-well agreements, letters of awareness, guarantees and the like for the subsidiary's other debt obligations reflect the level of commitment and is positively factored in by CRISIL.

Parent's corporate status

If the parent is a public limited company listed on the stock exchange, the propensity to support the subsidiary will be higher as a default on the subsidiary's debt obligations may impact the parent's plans to raise funds from the market. Even an unlisted public limited company (deemed public company) has a larger number of stakeholders and hence, has a higher obligation to support the subsidiary than a privately held parent company.

In conclusion, apart from the above factors, CRISIL also examines the parent company's track record of supporting its subsidiaries. CRISIL will not notch up a subsidiary for parent support if the parent's track record in supporting its subsidiaries is unsatisfactory.