

How stable are CRISIL's Ratings?

Stability is essentially the strength to stand and endure; the ability to resist change. In the world of finance and investment, stability is critical - for decisions are made based on predictions of stability and change.

In a bid to understand the level of stability of long-term ratings, CRISIL has computed the stability and transition rates over an 11-year period (January, 1992 to January, 2003). CRISIL is the pioneer among rating agencies in India in coming out with stability and transition rates of credit ratings.

The stability of CRISIL ratings is broadly comparable with those of Standard & Poor's, one of the largest rating agencies in the world. Stability rates vary with rating levels. There is a strong correlation between stability and ratings with higher rated entities exhibiting higher stability rates than lower rated entities. Ratings in the high-investment grade remained highly stable over the period under study, while ratings in the lower investment grade and speculative grade showed greater change in rating over the same period of time.

The ratings were more turbulent between 1998 and 2000 compared to the average stability rates, followed by a period of much higher stability. The rating actions have shown a uniform trend in terms of improved stability rates in the past few years.

Rating transition rates are useful to investors and credit professionals for whom rating stability is important, as investors would like to know if their investments would maintain their ratings. Banks too can use the rating transition rates to determine and measure credit risk.

Higher rating categories continue to display strong stability in 2002

The one-year stability rate of a rating category is the percentage of ratings remaining in the same category at the end of one year. A comparison of the rating stability rates for the calendar year 2002 with the average one-year stability rates of the 11-year period till January'03 for CRISIL's long-term ratings portfolio is given below:

	<i>AAA</i>	<i>AA</i>	<i>A</i>	<i>BBB</i>	<i>Overall*</i>
2002 stability rates	96.1	90.8	75.0	75.0	87.6
Average 1-year stability rates	95.5	86.3	82.8	75.5	82.1

* All non-default category ratings

- The overall stability of ratings improved substantially in 2002 as 87.6 % of all non-default ratings (AAA to C) remained in the same rating category, compared to the 11-year average of 82.1%.

- While the stability of 'AAA' ratings in the past year was comparable to the average one-year stability rates, the stability of ratings improved substantially in the 'AA' category during 2002, as compared to the average stability.
- The ratings were less stable in the 'A' category during 2002 compared to the average stability rates.

Average one year transition rates

The average one-year transition rates are calculated based on CRISIL's 11 rating static pools from 1992 to 2002, which are shown below:

Average One year Transition Rates								
Initial Rating	Data points	AAA	AA	A	BBB	BB	B	C & below
AAA	276	95.5%	4.5%	0.0%	0.0%	0.0%	0.0%	0.0%
AA	691	2.3%	86.3%	9.5%	1.1%	0.3%	0.3%	0.2%
A	968	0.0%	3.3%	82.8%	8.4%	3.1%	0.2%	2.1%
BBB	430	0.0%	0.6%	4.5%	75.5%	11.0%	2.3%	6.2%
BB	150	0.0%	0.8%	0.0%	0.8%	59.7%	2.3%	36.4%
B	27	0.0%	0.0%	0.0%	7.7%	0.0%	53.8%	38.5%
C	47	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	100.0%

The average one-year transition matrix displays all rating movements between categories from the beginning of the year through the end of the year, as observed over the last eleven-year period.

How do you read the table?

The average one-year transition matrix shows that out of all 'A' rated companies at the beginning of the year, 82.8% have remained in the A category by the year-end, while 3.3% have been upgraded to 'AA'. At the same time 8.4% have been downgraded to BBB, 3.1% to BB and so on. Also, out of all the A rated companies at the beginning of the year, 5.4% have been downgraded to the speculative category.

These one-year rating transition rates show us that:

- The probability for AAA ratings remaining stable over a one-year period is 95.5% and the probability

for AA ratings remaining stable is 86.3%.

- One out of six ratings change in the A category. The probability of stable rating in the BBB category over one year is 75.5%.
- The speculative grade rating categories show relatively lower stability over the same one-year period.
- In the investment grade, higher rated entities have shown greater stability than the lower rated entities.
- Speculative ratings have shown a similar trend, with stability of BB ratings higher than B ratings.
- In the AAA category, 4.5% of entities were downgraded to AA in a one-year period. (In CRISIL's history, no AAA rated entity has ever been downgraded to a rating lower than AA.)

Stability of investment grade and speculative grade ratings

Year End rating		
Initial Rating	Investment	Speculative
Investment	94.3%	5.7%
Speculative	2.0%	98.0%

- On an average, only 5.7% of investment grade ratings were downgraded to the speculative category over a one-year period.
- The upgrades were smaller in number with 2.0% of the speculative grade ratings upgraded to investment category the same period.

Comparison with Standard & Poor's global ratings' one-year transition rates

The average one-year transition rates of Standard & Poor's global ratings (computed over a 21-year period till 2002) are shown in the following table:

Ratings at year end (%)								
Rating	AAA	AA	A	BBB	BB	B	CCC	D
AAA	93.1	6.2	0.5	0.1	0.1			
AA	0.6	91.1	7.5	0.6	0.1	0.1		
A	0.1	2.1	91.5	5.6	0.5	0.2		0.1
BBB		0.2	4.3	89.3	4.6	0.9	0.3	0.4
BB		0.1	0.4	5.9	83.2	7.7	1.2	1.5
B		0.1	0.3	0.4	5.2	82.5	4.8	6.7
CCC	0.1		0.3	0.6	1.6	9.8	57.0	30.6

- In terms of ratings stability, CRISIL's 11-year average stability rates are better than that of S&P for the AAA category. CRISIL's AAA ratings are also more stable in not being downgraded below AA category, while a small percent of S&P's AAA ratings were downgraded to A / BBB in a one-year period.
- However, in other investment grade (AA, A and BBB) categories, CRISIL's rating stability is lower. The speculative (BB and B) category ratings of CRISIL also exhibited significantly lower average stability rates compared to S&P.
- Around 6.4% of S&P's 'BB' rated entities and 0.8% of its 'B' rated entities were upgraded to investment grade over a one-year transition period, while only 1.6% of CRISIL's rating were upgraded to investment grade in BB category. Contrarily, a high proportion of CRISIL's 'B' category ratings were upgraded to investment grade (7.7%), an anomaly arising due to lower number of data points in this category.

Methodology

The study is based on the "static pool" method, which assumes that all ratings remain current till such time as it is revised. A static pool is formed at the beginning of each year covered by the study and the behavior of the pool is followed from that point. All companies included in the study are sorted into these pools. The pools are static in the sense that their membership remains constant over time. Once a company is included in a pool, it is always in that pool until it is withdrawn. All the entities are then followed year on year within each pool.

To compute one-year transition rates, each entity's rating category at the beginning of a year was compared with its category at the beginning of the next year. The underlying assumption is that all ratings are reviewed atleast once a year and hence, the behavior of ratings at the end of each calendar year is assumed to be current and included in the rating statistics. Multiple rating changes within one year were recorded as only a single rating change in the study.

A company that remained rated for more than one year was counted as many times as the number of years it was rated. For instance, a company continually rated from 1 January, 1995 to 1 January, 2000 would appear in five consecutive one-year transition matrices, while companies first appearing on 1 January, 2002 appear in the 2002 rating transition only (unless withdrawn).

Scope

The long-term rating histories of manufacturing, infrastructure and financial services companies as well as state government entities are included in the analysis. The Structured Obligation (SO) ratings, short-term instrument ratings and fixed-deposit ratings are excluded from the study. The long-term debt instrument ratings include those assigned to non-convertible debenture (NCD) programmes, partly convertible debenture (PCD) programmes, bonds, preference shares and optionally convertible debenture programmes. The statistics of all the rating changes are based on the ratings outstanding in the public domain as on date. Multiple ratings assigned to different debt issues (such as NCDs and PCDs) of a single company are taken as a single data point and the rated debt amounts are ignored.

Multi-year rating transitions can also be computed for periods of two and three years. A two-year transition rate is computed by comparing each entity's rating at the end of the reference year with its rating at the beginning of previous year. The three-year transition ratios are also computed in a similar manner. The one year, two year and three year, rating transition matrices by rating category and sub-category, i.e., including the '+' and '-' ratings within each rating category, are computed and are available with CRISIL.