

# **CRISIL Ratings bond fund credit quality ratings criteria**

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## Executive summary

CRISIL Ratings' Credit Quality Ratings (CQRs) reflect the weighted average credit quality of debt investments of debt mutual fund schemes or bond exchange traded funds (ETFs). CRISIL Ratings assigns a credit score to each security in a scheme corresponding to the security's credit quality, and the scheme's rating is based on the weighted average credit score of all underlying securities. The credit scores for individual securities are derived from the default and transition rates of CRISIL Ratings' portfolio. The ratings of debt fund schemes also reflect the degree of adherence to warranties shared by the asset management company (AMC). The warranties stipulate, among other considerations, the quality of securities the schemes may invest in. As per the warranties, the schemes need to maintain, at all times, a credit score that corresponds to the assigned rating. If a fund fails to adhere to the warranties, CRISIL Ratings reserves the right to take appropriate rating action, including downgrade of the rating.

## Scope of criteria

This article<sup>1</sup> outlines CRISIL Ratings' approach for assessing CQRs of debt fund schemes. CRISIL Ratings' CQR serves as a tool for investors to assess the weighted average portfolio credit quality of a debt mutual fund scheme or a bond ETF. The assigned rating is valid only for the particular scheme and is not an opinion on the AMC's willingness or ability to make timely payments to the investor. The rating is also not an opinion on the practices of the fund manager, the quality of management, or stability of the fund's net asset value (NAV). The rating is also not an indicator of other risks, such as those pertaining to liquidity, interest rates, or sectoral and group exposure, of funds.

## Rating scale

Bond fund CQRs range from 'CRISIL AAAmfs' to 'CRISIL C-mfs' on the long-term scale, and 'CRISIL A1+mfs' to 'CRISIL A4mfs' on the short-term scale. The long-term scale is applicable to all open- and close-ended schemes with original contracted maturity of more than a year. The short-term scale is applicable only for close-ended schemes with original contracted maturity of up to a year (*refer to Table 1 for the ratings symbols and their definitions*).

**Table 1: Rating symbols and definitions**

Long-term fund ratings	
Rating	Definition
CRISIL AAAmfs	Schemes with this rating are considered to have the <b>highest degree of safety</b> regarding timely receipt of payments from the investments that they have made.
CRISIL AAmfs	Schemes with this rating are considered to have the <b>high degree of safety</b> regarding timely receipt of payments from the investments that they have made.
CRISIL Amfs	Schemes with this rating are considered to have the <b>adequate degree of safety</b> regarding timely receipt of payments from the investments that they have made.
CRISIL BBBmfs	Schemes with this rating are considered to have the <b>moderate degree of safety</b> regarding timely receipt of payments from the investments that they have made.
CRISIL BBmfs	Schemes with this rating are considered to have <b>moderate risk of default</b> regarding timely receipt of payments from the investments that they have made.
CRISIL Bmfs	Schemes with this rating are considered to have <b>high risk of default</b> regarding timely receipt of payments from the investments that they have made.
CRISIL Cmfs	Schemes with this rating are considered to have <b>very high risk of default</b> regarding timely receipt of payments from the investments that they have made.

*Note: The ratings from 'CRISIL AAmfs' to 'CRISIL Cmfs' may be modified by the addition of a '+' (plus) or '-' (minus) sign to reflect comparative standing within the category.*

### Short-term fund ratings

<sup>1</sup> This article has been updated to include the applicability of CQRs for bond ETFs. For the previous version of this article, which was published in Dec 2019, please refer to [https://www.crisil.com/content/dam/crisil/criteria\\_methodology/funds/archive/criteria-bondfund-dec2019.pdf](https://www.crisil.com/content/dam/crisil/criteria_methodology/funds/archive/criteria-bondfund-dec2019.pdf)

Rating	Definition
CRISIL A1mfs	Schemes with this rating are considered to have <b>very strong degree of safety</b> regarding timely receipt of payments from the investments that they have made.
CRISIL A2mfs	Schemes with this rating are considered to have <b>strong degree of safety</b> regarding timely receipt of payments from the investments that they have made.
CRISIL A3mfs	Schemes with this rating are considered to have <b>moderate degree of safety</b> regarding timely receipt of payments from the investments that they have made.
CRISIL A4mfs	Schemes with this rating are considered to have <b>minimal degree of safety</b> regarding timely receipt of payments from the investments that they have made.

Note: The ratings from 'CRISIL A1mfs' to 'CRISIL A4mfs' may be modified by the addition of a '+' (plus) sign to reflect comparative standing within the category.

## Rating methodology

CRISIL Ratings' CQRs reflect:

1. Weighted average credit quality of the scheme's portfolio of investments
2. Extent of adherence to the list of warranties shared by the AMC

## Assessing credit quality of a scheme

The credit quality of underlying securities are the primary inputs in assessing the overall credit quality of debt fund schemes. The credit score applied to each underlying security corresponds to its rating and is derived from the default and transition rates of CRISIL Ratings' portfolio: the lower the rating, the higher the credit score. The relative differentiation between credit scores also accounts for potentially severe redemption pressures that a fund may face if any security in its portfolio is downgraded. CRISIL Ratings also factors in the residual maturity of securities the scheme has invested in.

CRISIL Ratings periodically reviews its credit scores to factor changes in the default and transition rates of CRISIL Ratings. The credit scores for individual securities, updated for the most recent performance of CRISIL Ratings, are given below (Table 2).

**Table 2: Credit scores applied to ratings of individual securities within a scheme<sup>2</sup>**

Rating of security	Credit score if residual maturity is up to 1 year	Credit score if residual maturity is more than 1 year
G-Secs	0	0
AAA	3	3
AA+	3	7
AA	3	10
AA-	3	17
A+	10	25
A	10	30
A-	25	45

<sup>2</sup> While assigning credit scores to securities with put options, the residual maturity is computed based on the earliest put option date. Call options available with the issuer do not impact the computation of residual maturity. A scheme's investments in state development loans (SDLs) issued by state governments are assigned a credit score of 3 (corresponding to a 'CRISIL AAA' rating), given their higher risks than Government of India (GoI) securities, but lower risks than state-government-guaranteed instruments, and the Reserve Bank of India's (RBI's) intervention in monitoring payments on these loans. For the scheme's counter-party exposures, such as swaps, derivative contracts and bill rediscounting facilities, the credit score will correspond to the counterparty's rating. Cash is assigned a score of 0. For bank fixed deposits with an original maturity of less than a year, the credit score will be based on the short-term rating (certificates of deposit rating) of the bank.

Rating of security	Credit score if residual maturity is up to 1 year	Credit score if residual maturity is more than 1 year
BBB+	40	60
BBB	50	75
BBB-	100	150
BB category	250	250
B category	400	400
C category	800	800
A1+	3	-
A1	10	-
A2+	25	-
A2	40	-
A3+	50	-
A3	100	-
A4+	250	-
A4	400	-
D	1000	1000
Equity	1000	1000

The credit score applied to each security is weighted by the proportion of the scheme's assets invested in the security, to arrive at the scheme's weighted average credit score. The rating on the scheme depends on the weighted average credit score thus arrived at (see Table 3).

**Table 3: Scoring table for CQR of schemes**

For schemes rated on the long-term scale	
Weighted average credit score of scheme	Scheme's credit quality rating
0.00 – 5.00	CRISIL AAAmfs
5.01 – 7.00	CRISIL AA+mfs
7.01 – 10.00	CRISIL AA mfs
10.01 – 17.00	CRISIL AA-mfs
17.01 – 25.00	CRISIL A+mfs
25.01 – 30.00	CRISIL Amfs
30.01 – 45.00	CRISIL A-mfs
45.01 – 60.00	CRISIL BBB+mfs
60.01 – 75.00	CRISIL BBBmfs
75.01 – 150.00	CRISIL BBB-mfs
> 150.00	CRISIL BB+mfs to CRISIL C-mfs

  

For schemes rated on the short-term scale	
Weighted average credit score of scheme	Scheme's credit quality rating
0.00 – 5.00	CRISIL A1+mfs
5.01 – 10.00	CRISIL A1mfs
10.01 – 25.00	CRISIL A2+mfs
25.01 – 40.00	CRISIL A2mfs

For schemes rated on the short-term scale	
Weighted average credit score of scheme	Scheme's credit quality rating
40.01 – 50.00	CRISIL A3+mfs
50.01 – 100.00	CRISIL A3mfs
100.01 – 250.00	CRISIL A4+mfs
> 250.00	CRISIL A4mfs

### Credit scores for securities not rated by CRISIL Ratings

If a debt fund scheme invests in a security not rated by CRISIL Ratings, the security's credit score is based on the CRISIL Ratings' rating outstanding on a similar security of the issuer. However, if the issuer has no rating by CRISIL Ratings, the fund manager is required to share with CRISIL Ratings all relevant information on the security. CRISIL Ratings will arrive at its own independent opinion on the credit quality of the security based on the information provided by the fund manager and / or other publicly available information. If CRISIL Ratings' view on the security results in a deterioration of the fund's credit quality, the fund manager will be informed of the breach in credit scores. However, in the interim, till CRISIL Ratings arrives at its credit view on the security, the fund manager may use the lowest rating assigned by other credit rating agencies (CRAs) for the non-CRISIL Ratings rated security, in order to check whether the credit score of the fund is consistent with the rating on the scheme.

### Factoring concentration risks

Securities and Exchange Board of India's (SEBI's) circular dated November 29, 2022 limits investments in debt instruments issued by a single issuer at 10% of the fund's NAV for AAA rated securities. The limit may be extended to 12% with the approval of the board of trustees and the board of the AMC. Similarly, the threshold for AA and A and below rated securities has been defined as 8% and 6% respectively with 2% permissible extension (with prior approval of the board of trustees and the AMC board). In case of a breach of exposure limit to a single issuer as mentioned above, for all the new schemes, CRISIL Ratings will analyze the same and if deemed appropriate, apply higher credit scores — corresponding to the rating of a notch lower than the issuer's rating – for the scheme's excess exposure to a single issuer beyond the threshold limit.

### List of warranties

A debt fund scheme's portfolio of investments is dynamic in nature. To protect investors from possible decline in the scheme's credit quality due to changes in its portfolio composition, CRISIL Ratings obtains a set of warranties from the fund manager. The warranties pertain to:

- Quality of investments in order to maintain a credit score consistent with the rating on the scheme
- Approach to estimate credit scores while investing in non-CRISIL Ratings rated securities
- Sharing of relevant information on non-CRISIL Ratings rated securities
- Sharing of portfolio details with CRISIL Ratings on a monthly basis
- Curing period in case of breach of credit score limit applicable to the scheme's rating
- Sharing of information on any major developments that may impact the performance of the rated scheme

As per the warranties, the AMC is to maintain, at all times, a credit score consistent with the rating on the scheme.

## Surveillance process

Bond fund ratings are placed under continuous surveillance by CRISIL Ratings after they are published. CRISIL Ratings reviews the fund's holdings every month, and re-evaluates the rating based on new information, whenever warranted. Changes, if any, in rating and their reasons will be communicated to the AMC prior to their dissemination to the public.

Fresh investments in low rated securities, or downgrades of existing securities in a scheme may lead to the credit score of the scheme breaching the limit corresponding to its assigned rating. If CRISIL Ratings believes the breach is marginal, and may be cured quickly, a curing period of up to 30 days is provided to the AMC to restore the credit score to within the limit applicable to the assigned rating. However, if the breach in credit score is substantial and/or CRISIL Ratings believes that the breach may not be rectified within a reasonable time, appropriate rating action (including placing of the rating on watch, or downgrade of the rating) may be taken, without providing a curing period. If the AMC fails to comply with any of the warranties, CRISIL Ratings may take appropriate rating action, including downgrade of the rating.

If the AMC corrects the scheme's portfolio following a downgrade of its CQR, the revised credit score may warrant an upgrade in rating. CRISIL Ratings will, however, upgrade the rating only if the scheme maintains consistency in its credit score for a review period of at least three months. A higher review period of six months may be considered in case the correction in portfolio is achieved through write-down of investments.

## Withdrawal policy

Ratings on open ended debt mutual fund can be withdrawn by CRISIL Ratings after receiving request for withdrawal from the AMC, however such ratings will be placed on notice of withdrawal for 30 days. The period of notice of withdrawal will begin from the date of publishing the rating rationale of Notice of Withdrawal.

## Conclusion

CRISIL Ratings' CQRs reflect the weighted average credit quality of debt investments of debt mutual fund schemes or bond ETFs. The ratings also reflect the degree of adherence to warranties shared by the AMC. As per the warranties, the schemes need to maintain, at all times, a credit score that is consistent with the assigned rating. If a fund fails to adhere to the warranties, CRISIL Ratings reserves the right to take appropriate rating action, including downgrade of rating.



## About CRISIL Limited

CRISIL is a leading, agile and innovative global analytics company driven by its mission of making markets function better.

It is India's foremost provider of ratings, data, research, analytics and solutions with a strong track record of growth, culture of innovation, and global footprint.

It has delivered independent opinions, actionable insights, and efficient solutions to over 100,000 customers through businesses that operate from India, the US, the UK, Argentina, Poland, China, Hong Kong and Singapore.

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## About CRISIL Ratings

CRISIL Ratings pioneered the concept of credit rating in India in 1987. With a tradition of independence, analytical rigour and innovation, we set the standards in the credit rating business. We rate the entire range of debt instruments, such as, bank loans, certificates of deposit, commercial paper, non-convertible / convertible / partially convertible bonds and debentures, perpetual bonds, bank hybrid capital instruments, asset-backed and mortgage-backed securities, partial guarantees and other structured debt instruments. We have rated over 33,000 large and mid-scale corporates and financial institutions. We have also instituted several innovations in India in the rating business, including rating municipal bonds, partially guaranteed instruments and infrastructure investment trusts (InvITs).

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