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RATINGS NEPAL

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INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS

WORLD INVESTOR WEEK 2023

IOSCO World Investor Week 2023

What is Credit Rating ?

Credit rating is essentially the opinion of the rating agency on the relative ability and willingness of the issuer of a debt instrument to meet the debt service obligations as and when they arise.

Why do rating agencies use symbols like AAA, AA, rather than give marks or descriptive credit opinion ?

The advantage of rating symbols is their simplicity, which facilitates universal understanding. Rating companies also publish explanations for their symbols used as well as the rationale for the ratings assigned by them, to facilitate deeper understanding.

Does credit rating constitute an advice to the investors to buy ?

It does not. The reason is that some factors, which are of significance to an investor in arriving at an investment decision, are not taken into account by rating agencies. These include reasonableness of the issue price or the coupon rate, secondary market liquidity and pre-payment risk. Further, different investors have different views regarding the level of risk to be taken and rating agencies can only express their views on the relative credit risk.

What kind of responsibility or accountability will attach to a rating agency if an investor, who makes his investment decision on the basis of its rating, incurs a loss on the investment ?

A credit rating is a professional opinion given after studying all available information at a particular point of time. Nevertheless, such opinions may prove wrong in the context of subsequent events. Further, there is no privity of contract between an investor and a rating agency and the investor is free to accept or reject the opinion of the agency. Nevertheless, rating is essentially an investor service and a rating agency is expected to maintain the highest possible level of analytical competence and integrity. In the long run, the credibility of a rating agency has to be built, brick by brick, on the quality of its services.

A smart investor:

- Conducts thorough research and due diligence to analyze the financial health of companies, market trends, and economic conditions to make informed decisions.
- Uses multiple sources of information including credit rating reports to make informed decisions.
- Incorporates risk assessment to gauge the level of risk associated with an investment by differentiating between low-risk and high-risk assets in order to make prudent choices that align with their risk tolerance.
- Seeks to diversify their portfolios to manage risk, using for e.g., credit ratings, to identify assets with varying levels of risk, enabling them to create well-balanced portfolios that are resilient in different economic conditions.
- Monitors credit ratings to help them anticipate potential credit events and assess the likelihood of default and correspondingly take necessary actions to protect their investments and minimize losses.
- Understands that resilient investing is a long-term endeavor - avoids knee-jerk reactions to short-term market fluctuations and aims to capitalize on the power of compounding to achieve their financial goals.
- Stays informed about market developments, investment strategies, and emerging opportunities through continuous learning, which allows them to adapt and refine their investment approach over time.
- May use credit ratings as a tool to assess the creditworthiness of the potential investments and accordingly appropriate risk in their portfolio–a higher rating usually indicates a relatively safer investment while a lower rating may suggest more risk. Having a diversified risk-appropriated investment plan can help them navigate changing economic conditions and market fluctuations.

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