

[Issued in August 2024]

Overview

CARE Ratings (Africa) Private Limited's (CRAF) fund Credit Quality Rating (CQR) is an opinion on the overall credit quality of a debt fund scheme. The rating captures the fund's overall exposure to the default risk based on the credit quality of individual securities in the portfolio. The CQR is aimed at providing an independent opinion on the fund's weighted average credit quality and acts as a tool for the investors to evaluate credit risk of such fund schemes.

What fund ratings are not?

- CRAF's Fund CQR is not a recommendation to purchase, sell, or hold a security/fund. They comment neither on the current market price, suitability for a particular investor nor on the prospective performance of the fund with respect to appreciation, volatility of net asset value (NAV), or yield of the fund. The ratings do not address the fund's ability to meet the payment obligations to the investors.
- The ratings are not an opinion on the fund management practices (including fund structure, expense ratios & marketing activities), financial performance as well as management quality of an AMC and hence do not comment upon the business practices.
- The ratings are also not indicative of compliance & reputation risks, liquidity, market and sectoral risks.

Rating Methodology

CRAF's Fund CQR is based on evaluation of the fund's stated investment strategy and portfolio credit risk. It involves evaluation of credit quality of individual securities as well as diversification of portfolio. CRAF uses the concept of credit scores assigned to individual securities, as per credit scoring matrix developed by it.

CRAF's Credit Scoring Matrix

In the credit scoring matrix, a credit score is computed based on the credit rating and residual maturity of individual security. Exceptions include instruments with put options, whereby earlier of residual maturity or put option date is considered. Such credit score assigned to each security is arrived at using CRAF's historical data on defaults, updated at regular intervals, adjusted for data limitations. The credit score is lower for higher ratings and vice versa. The portfolio credit score is arrived at by using the weighted average (using proportion of the exposure in the scheme) credit score for each security in the scheme.

The portfolio credit score reflects the credit quality rating of the fund and is a summation of credit score of each security in the fund.

For assigning a rating (and subsequently to maintain the rating at a given level), the fund credit score has to be within the benchmark fund score of the rating category. CRAF has derived separate credit scoring matrix for its long-term and short-term rating scales.

CRAF will generally assign long-term credit quality rating to a fund; however, upon specific requests from AMCs, the fund can also be rated on the short-term scale subject to the fund meeting the following criteria:

- All of the fund's holdings should have a residual maturity of less than one year
- The fund's mandate is to invest predominantly in short-term debt securities

To assign a rating, CRAF would typically analyse the latest 6 months' portfolio to arrive at the credit score based on the credit score of the scheme for each of these 6 months. For schemes that are yet to be launched, CRAF discusses the proposed investment-mix in terms of the credit quality that the fund manager intends to maintain. Once the schemes are launched for regular investments, a detailed review of the investment portfolio shall be carried out.

Credit Quality of Individual Securities

The credit quality of individual securities in the scheme is assessed by using CareEdge group-assigned ratings wherever such ratings are outstanding. In case of securities not rated by CRAF, the lowest rating assigned by other credit rating agencies (CRAs) is used as a guide. Subsequently, if CRAF has additional information which it feels has not been factored in the other CRA rating, it will form its internal view on the rating and may deviate from the other CRA rating. In case of unrated securities, CRAF forms an internal view on the rating by considering publicly available information about the issuer.

Furthermore, in case of securities where ratings are under 'Rating watch with Negative Implications' or have a 'negative' outlook, CRAF will stress the portfolio score by considering appropriately notched down rating for such securities.

Concentration factor

The regulatory guidelines may limit investments in debt instruments issued by a single issuer as a percentage of fund's NAV for certain securities based on rating or sector. CRAF shall factor in concentration risks in line with the regulator-defined thresholds for debt fund schemes. In case of any breach in exposure limit, the score of a notched down rating shall be considered and a higher credit score may be applicable for the exposure over and above regulator-defined thresholds.

Ongoing Review, Monitoring & Surveillance

CRAF reviews the rating of fund schemes on an on-going basis to support its published rating opinions. As such, portfolio of the fund is reviewed on quarterly basis. In addition, detailed annual review of the fund is also undertaken. The fund has to maintain the fund credit score within the benchmark fund score associated with a given rating level. If in any particular month, the fund credit score breaches the benchmark, CRAF generally provides a curing period of one month to the AMC to correct the situation and realign the score. If the fund credit score is not corrected within the curing period, CRAF would consider revising the rating. Further, if CRAF believes that the fund score is unlikely to be realigned in the one-month time frame, it may directly act on the ratings without providing any curing period.

CRAF would construe sale of downgraded securities from the scheme as an act of portfolio realignment. A write-off of downgraded/defaulted exposures will not be considered as realignment, and CRAF will assign the downgraded rating on the entire par value of such exposures in the latest portfolio while calculating the overall credit score. CRAF will continue to do this for a period of at least six months from the date of complete write-down of such investment or till full redemption/sale of such securities, whichever is earlier. This is done so as to reflect the deterioration in the credit quality of the fund even though the fund's NAV would adjust upon such default. However, post any downgrade of the rating of the scheme, CRAF would monitor the scheme's portfolio for at least three months before revising the rating upwards based on the revised portfolio.

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About:

CareEdge is a knowledge-based analytical group that aims to provide superior insights based on technology, data analytics and CARE Ratings (Africa) Private Limited (CRAF) is the first credit rating agency to be licensed by the Financial Services Commission of Mauritius in May 2015. It is also recognized by Bank of Mauritius as External Credit Assessment Institution (ECAI) from May 2016. CRAF is also licensed by Capital Markets Authority of Kenya to operate as a Credit Rating Agency in Kenya. CRAF intends to expand across other geographies in Africa with Mauritius as its hub of operations. With an equitable position in the Mauritius capital market, CARE Ratings (Africa) Private Limited provides a wide array of credit rating services that help corporates to raise capital and enable investors to make informed decisions backed by knowledge and assessment provided by the company.

CRAF's shareholders are CARE Ratings Limited, African Development Bank, MCB Equity Fund and SBM (NFC) Holdings Limited.

CRAF gets its technical support in the areas such as rating systems and procedures, methodologies, etc. from CARE Ratings Limited on an ongoing basis. CARE Ratings Limited, with an established track record of rating companies over almost three decades, follows a robust and transparent rating process that leverages its domain and analytical expertise backed by the methodologies congruent with the international best practices.

CRAF's Rating Committee consist of full-time members comprising of Senior Rating officials from CARE Ratings Limited and a panel of experienced professionals from Mauritius and African Development Bank.

CRAF has had a pivotal role to play in developing bank debt and capital market instruments including MMIs, corporate bonds and structured credit.

Disclaimer:

CARE Ratings (Africa) Private Limited ("CRAF")'s ratings are opinions on the likelihood of timely payment of the obligations under the rated instrument and are not recommendations to sanction, renew, disburse or recall the concerned bank facilities or to buy, sell or hold any security. CRAF's ratings do not convey suitability or price for the investor. CRAF's ratings do not constitute an audit on the rated entity. CRAF has based its ratings/outlooks on information obtained from sources believed by it to be accurate and reliable. CRAF does not, however, guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. Most entities whose bank facilities/instruments are rated by CRAF have paid a credit rating fee, based on the amount and type of bank facilities/instruments. CRAF may also have other commercial transactions with the entity. In case of partnership/proprietary concerns, the rating /outlook assigned by CRAF is, inter-alia, based on the capital deployed by the partners/proprietor and the financial strength of the firm at present. The rating/outlook may undergo change in case of withdrawal of capital or the unsecured loans brought in by the partners/proprietor in addition to the financial performance and other relevant factors. CRAF is not responsible for any errors and states that it has no financial liability whatsoever to the users of CRAF's rating. CRAF's ratings do not factor in any rating related trigger clauses as per the terms of the facility/instrument, which may involve acceleration of payments in case of rating downgrades. However, if any such clauses are introduced and if triggered, the ratings may see volatility and sharp downgrades.

