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Credit Rating Companies and Their Activities in Bangladesh: An Evaluation

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Abstract

This paper focuses briefly on the rating activities as well as the quality of ratings as adopted by the credit rating companies based in Bangladesh. Although there are 08 rating companies currently operating in Bangladesh, this study reveals that nearly 70% of the total rating services offered by the companies as of December, 2012, were concentrated only to Credit Rating Information and Service Limited and Credit Rating Agency of Bangladesh Limited. Apart from some other challenges like clients' undue bargaining and unusual number of issued ratings, the quality of ratings is reportedly satisfactory with high retention of investment grade ratings. In conclusion, the paper offers some significant implications based on findings.

Keywords: Credit Rating Companies, Rating Activities, Rating Qualities, Bangladesh

1. Introduction

Credit rating refers to an 'opinion' of the Credit Rating Companies (CRCs) or Credit Rating Agencies (CRAs) with regard to the creditworthiness or the relative degree of risk associated with timely payment of interest and principal on a debt instrument. The ratings are a comment on the relative likelihood of default in comparison with other rated instruments. In other words, a rating indicates the probability of default of the rated instrument and therefore provides a benchmark for measuring and pricing credit risk (Ministry of Finance, India, 2009). The most significant aspect of credit rating is that it is made available for public, influencing decisions taken by participants in financial markets (National Institute of Securities Market [NISM], 2009).

CRCs offer predictions as to the likelihood that a particular debt instrument will be repaid, in part or whole (Ekins & Calabria, 2012). They play a key role in financial markets by helping to reduce the

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information asymmetry between lenders and investors, on one side, and issuers on the other side, about the creditworthiness of companies (corporate risk) or countries (sovereign risk) (Elkhoury, 2008). They assess a firm's financial viability by scrutinizing all the necessary documents about the company, its management team and business model, highlight and analyze the same in terms of their capability to repay the debt in case borrowings are made from the banking sector and highlight the overall health of the enterprise (Subramanian & Nehru, 2012). In such a context, many countries now consider credit rating to be important in the financial market for instance, the Indian financial system has now come to regard credit rating as an integral part of the framework for credit and investment decisions regardless of the size of the enterprise. (Mukhopadhyah, 2006).

In fact, there is a strong logic for the existence of CRCs, but the recent times have witnessed the CRCs being accused of significant lapses and laxity in performance of their vital functions, especially after the Enron debacle and the more recent sub-prime mortgage crisis in the United States of America (USA) (Jain & Sharma, 2008). It is said that CRCs overestimated the credibility of the contracting parties to honour the structured obligations and this has led to investors being saddled with poor quality, illiquid paper with systemic implications (NISM, 2009). The situation in Bangladesh is, however, different on account of lower complexity levels in securitized transactions with very little systemic implications. Nevertheless, the possibility of asymmetric information between the issuers of financial instruments and all others due to unwise behavior of the CRCs cannot be ignored.

As the CRCs perform a valuable function by producing and assembling information which many investors in less transparent markets would find prohibitive to develop on their own (Smith & Walter, 2001), the initialization of rating business by forming bond-rating agency by John Moody in the USA in 1990 was not an accident in history. Rather, the CRCs worldwide are trying to maintain a good reputation for accurate ratings by preserving the value of their ratings in security markets. As to the critical role of determining the credit quality of debt securities, CRCs consider many dimensions such as financial strength and transition risk so that bonds with the same credit rating may be comparable with respect to overall credit quality, but may differ with respect to specific credit quality characteristics (Cantor, as cited in Ryan, 2012).

Against the above backdrop, it is very important to facilitate rating business in a country in order to make the financial regularities effective and thereby increase the financial strength of that country. But the development of credit rating in Bangladesh is still at its early stage. Although the background of credit rating in Bangladesh starts with the intention of making public issues, both Initial Public Offerings (IPO) and rights issues (Credit Rating Company Rules, 1996) trustworthy, it has eventually added more instruments in financial and non-financial markets such as debt issue, bank loan, corporate entity, financial institutions like banks, insurance companies, leasing companies, project financing, Small and Medium Enterprises (SME), non-business services like hospitals within the last 15 years under the regulatory framework of the Bangladesh Securities and Exchange Commission (BSEC). Later on, in line with the Basel II Committee recommendation, Bangladesh Bank (BB) and the Insurance Development and Regulatory Authority (IDRA) have also appeared as regulatory bodies of the CRCs by making credit rating compulsory for banks, non-banking financial institutions including insurance companies. However, so far 08 CRCs, Credit Rating Information and Service Limited (CRISL), Credit Rating Agency of Bangladesh Limited (CRAB), National Credit Ratings Limited (NCRL), Emerging Credit Rating Limited (ECRL), ARGUS Credit Rating Services Limited (ACRSL), WASO Credit Rating Company (BD) Limited (WCRCL), Alpha Credit Rating Limited (ACRL) and The Bangladesh Rating Agency Limited (BDRAL) have as of December, 2012 come

under the regulatory framework of the BSEC. Among them, CRISL and CRAB have covered almost 70% of total rating services by 2012.

Therefore, it is considered relevant to conduct research on the activities of CRCs in Bangladesh and the quality of those activities that goes in favour of the objectives of introducing these CRCs. But it is observed that no adequate research has so far been conducted on the rating activities as well as the quality of rating activities of CRCs in Bangladesh, although a number of research work has been done in this context in many other countries including India on both government and private initiatives. In fact, with the exception of some articles (such as Ahmed, 2012; Faruque, 2012; Haroon, 2012; Islam, 2012; Dastider, 2014; Farzana, 2015) in daily newspapers, no systematic studies were conducted in the local context. This reveals that there is a research gap in Bangladesh regarding the rating activities and the quality of rating activities of the credit rating companies which are areas that needs to be attended.

Given the above described context with this preamble, the aim of this study are to identify the working procedures of the CRCs and to evaluate the quality of those ratings of the CRCs in Bangladesh.

This paper commences with the introduction, highlighting the problem statement and aims of the study, followed by a review of literature with reference to an overview of CRCs, the methods applied for data analysis, data analysis with a special attention to the characteristics and working procedures of the CRCs in Bangladesh, evaluation of rating activities and quality of rating activities of the CRCs in Bangladesh, and finally with conclusion and implications.

2. CRCs: An Overview

A credit rating company is different from a mercantile credit agency, which usually supplies general information on corporations. It is also different from a credit bureau, which collates information on credit record of corporates or even individuals. Nor is it a credit-assessing agency like the credit department of a commercial bank (NISM, 2009). It means a person or a company engaged in the business of assessing and evaluating the credit-worthiness of any issue of listed securities or securities to be listed with particular regard to the issuers' ability to perform any obligations imposed on the issuer thereon (Securities Exchange Commission of Sri Lanka, SEC, 2015).

Literature review reveals that the CRCs are helpful to lenders. It is seen that as to solve a basic problem of finance such as "how do lenders determine the creditworthiness of potential borrowers and assure themselves of the continued soundness of borrowers after a loan has been extended?" it can be stated that specialist lenders may be able to generate their own information. But non-specialist lenders e.g., the general public may need assistance in developing information about bond issuers; and even specialist lenders may want help when they venture beyond their traditional boundaries of lending - e.g., lending to new or unfamiliar bond markets (White, 2001). In such cases, CRCs might be the best option for lenders to get the problems resolved.

In this background, it is further exhibited that the CRCs are now helping not only investors providing opinions and defining a truly global benchmark for credit risk, but also regulators taking much of the responsibility for assessing debt risk. However, Siong (2006) highlighted the major roles played by the CRCs in his study. Among others, he focused on protecting investors via independent, third party opinion on the credit risk or default risk of issuers or issues; providing a common yardstick

to evaluate default risk for investment decision making; monitoring and disseminating credit opinions on rated issuers or issues in a timely and efficient manner; bridging the information gap between issuers and investors and a source of credit surveillance for investors; assisting regulatory authorities in developing and facilitating implementation of prudential guideline requirements for example, Basel II; and helping issuers to do a primary market issue of bonds or equity at a considerable price.

Keeping much of these prospects in mind the journey of CRCs was initiated in the beginning of the twentieth century in the USA. In fact, the demand for credit rating gradually increased worldwide in both developed and developing countries. It is seen that after a century, since the voyage of credit rating had first started in the USA, the Government of Bangladesh realized the importance of credit rating in the financial markets and allowed CRCs to do rating business under a certain regulatory framework monitored mainly by the BSEC and somewhat by the BB and the IDRA. As a result of the assessment made by the CRCs, now an entity in Bangladesh can minimize its cost of funding under Basel II accord if it obtains an investment grade rating as it can enter into the capital market for borrowing money or acquiring equity capital by having itself rated by a CRC, and can gain higher market price in the secondary market by obtaining an investment grade rating. Moreover, a bank or a non-banking financial institution or an insurance company also has to mandatorily obtain credit rating from a CRC to comply with its regulatory requirement. As such, the presence of a CRC in Bangladesh now gets a momentum. At the same time, the activities a CRC performs and the quality of its activities can help stabilize the financial market. Different authors from both individual and institutional efforts have conducted their studies on the performance of credit rating agencies in terms of their rating activities and the quality of ratings in other countries.

While investigating into the role of credit rating in issuance of corporate bonds in China, a study by Murakami (2009) demonstrated that, by using rating distribution that is relatively more secured, over time, corporate bonds were getting more importance in issuance than enterprise bonds of equal grade (AAA). In their study, Langohr and Langohr (2008), while describing how to obtain and maintain a credit rating in their book entitled “The Rating Agencies and their Credit Ratings: What They are, How They Work and Why They are Relevant”, broadly reviewed the rating distribution of rating announcement, pricing of different rating services publicly scheduled by the international CRAs, and the using of rating default and transition matrices for judging the rating quality.

NISM, (2009) assessed the long term performance of CRAs in India and used a simple model, built around net worth, leverage and interest Coverage, to detect deteriorations in creditworthiness. While discussing about the activities performed by CRAs, the Ministry of Finance, Government of India (2009) pointed out in its Report of the Committee on Comprehensive Regulation for Credit Rating Agencies that the quality of ratings is affected by timeliness of adjustment of the ratings and opined for a one year time horizon, the temporary component may get more weightage than for long time horizon.

While presenting the overview of credit rating agencies in India, Ohta (n.d.) noted that accumulated default ratings, transition, yield, and ratings are used by each credit rating agency to measure their performance and found that rating default statistics from domestic rating agencies are prone to greater variability than those from international rating agencies.

Rousseau (2006) in his study on enhancing the accountability of credit rating agencies stated that a good starting point is to examine the credit rating’s own track record and a basic approach to

evaluate the reliability of ratings is to compare them with actual default statistics. Credit Rating Information Services of India Limited (CRISIL (2013) in its brochure recognized that the performance of a CRA is best judged through its default and transition statistics.

In the context of Bangladesh, no comprehensive studies were found. Thus, this paper finds a research gap in Bangladesh on the rating activities and quality of those activities adopted by the domestic CRCs. Against this background of research gap, and motivated by urgency of such research, this study, therefore, aims at investigating into the activities of the CRCs in Bangladesh and the quality of those activities. In this regard, this paper attempts to review the working procedure and pricing of the rating services of the domestic CRCs; rating distribution by long term rating notches and investment grade; and to evaluate the average rating default and transition over one-year period of time. It also aims at pointing out flaws in CRCs and some important implications for concerned authorities for betterment of the credit rating system in Bangladesh based on findings.

3. Methods

The study is based on secondary data. Data relating to evaluation of the rating activities, procedures applied thereon, and the quality of ratings of the CRCs, have been collected from the secondary sources such as the documents published in print as well as on websites maintained by the CRCs, and notably by the BSEC and BB. Some credit rating reports published online both at home and abroad have been surveyed meticulously. Further, some working paper reports, journal articles, and books found in both hard and electronic copies have also been reviewed for literature. In the context of evaluation of CRCs based in Bangladesh, despite some dissimilarities, 11 (eleven) years rating data published by the domestic CRCs from the inception of rating activities in 2002 to 2012 have been analyzed. For the purpose of evaluation, the percentage calculations and tabular presentations of rating data, distribution of ratings by long-term rating notches and by investment grade ratings, transition matrices and default statistics of ratings have been used. In calculating transition matrix, one-year average rate of transition of ratings has been applied in line with the international rating agency, The Pakistan Credit Rating Agency Limited (PACRA). The PACRA has described it as one of the alternative criteria of PACRA rating transition methodology (PACRA, 2010). Under this criterion, each one-year transition matrix displayed all rating movements between rating categories at the modifier level from the beginning of the year through year-end. For each rating listed in the matrix's left-most column, there have been eight ratios listed in the rows, corresponding to the long term rating notches from AAA (triple A grade for highest safety or capacity) to D (default grade). On the other hand, one-year default statistics of rating has been determined by identifying the rating changes as default from the beginning of the year through year-end which has already been shown in the rating transition matrix. Further, along with this rating default, rating changes as upward and downward grading, from lower to higher grade and higher to lower grade respectively, in order to show the quality of rating.

4. Analysis

4.1 CRCs in Bangladesh

The formation of CRC in Bangladesh began under the regulation entitled 'The Credit Rating Companies Rules, 1996 (subsequently amended in 2009)' and shaped by the BSEC. CRISL has been a precursor of credit rating services in this country since 1995, the year of its establishment under this rule. Within next 15 years 07 more CRCs have emerged in this country in the shape of CRAB in

2003, NCRL (2010), ECRL (2009), ACRSL (2011), WCRCL (2009), ACRL (2011) and BDRAL (2009). However, a synopsis of the CRCs operating at present in Bangladesh is exhibited in Table 1.

Table 1: Synopsis of the CRCs Currently Operating in Bangladesh

Name of the CRCs	Established in	License from BSEC Obtained in	BB's Recognition as ECAI Obtained in	Works Commenced in	Technical Collaboration with	Workforce (as of Dec., 2012)
CRISL	1995	2002	2009	2002	RAM ^a , Malaysia & JCR-VIS ^b , Pakistan	80
CRAB	2003	2004	2009	2004	ICRA ^c , India	70
NCRL	2010	2010	2010	2010	PACRA ^d , Pakistan	35
ECRL	2009	2010	2010	2010	MARC ^e , Malaysia	30
ACRSL	2011	2011	2011	2011	DP Information Group, Singapore	30
WCRCL	2009	2012	2012	2012	FISL ^f , Hong Kong	19
ACRL	2011	2012	2011	2012	TurkRating, Turkey	33
BDRAL	2009	2012	2013	2011	SMERA ^g , India	30

As to the legal status of the CRCs, they all are public limited joint venture companies and CRISL, CRAB, NCRL & ECRL acquired ACRAA membership as of January, 2012.

- Notes:
- a. RAM = Rating Agency Malaysia Berhad
 - b. JCR-VIS = JCR-VIS Credit Rating Co. Limited
 - c. ICRA = ICRA Limited
 - d. PACRA = Pakistan Credit Rating Agency Limited
 - e. MARC = Malaysia Rating Corporation Berhad
 - f. FISL = Financial Intelligence Services limited
 - g. SMERA = SME Rating Agency of India Limited

Source: Mazumder & Mazumder (2015)

Table 1 presents that, all of them being public limited joint venture companies, the CRCs have received licenses from the BSEC in 2002 (CRISL), 2004 (CRAB), 2010 (NCRL and ECRL), 2011 (ACRSL) and 2012 (WCRCL, ACRL and BDRAL) and they commenced functioning as well, in the year of receiving the licenses from BSEC except BDRAL, which has started functioning in 2011. On the other hand, they have obtained BB's recognition as External Credit Assessment Institution (ECAI) in 2009 (CRISL and CRAB), 2010 (NCRL and ECRL), 2011 (ACRSL and ACRL), 2012 (WCRCL) and 2013 (BDRAL). Having a separate rating committee and a technical collaboration with some foreign CRCs, their workforces consist of 80 (CRISL), 70 (CRAB), 35 (NCRL), 30 (ECRL), 30 (ACRSL), 19 (WCRCL), 33 (ACRL) and 30 (BDRAL) members as of 31 December, 2012. It is further observed that only 04 CRCs (CRISL, CRAB, NCRL and ECRL) have taken the membership in the Association of Credit Rating Agencies in Asia (ACRAA) as of January, 2012.

Rating services (i.e., types of rating) and methodology of rating used by CRISL, CRAB, NCRL, ECRL, ACRSL, WCRCL, ACRL and BDRAL are similar to each other. Among these companies

only BDRAL is involved in SME rating activities. In fact, the CRCs in Bangladesh mostly perform corporate entity ratings, financial institutional ratings, equity (IPO and right offers) ratings, insurance company ratings, and project finance ratings etc. Different quantitative and qualitative factors analyzed by the CRCs in rating arena can be clustered into five areas: i) Industry and Business Analysis, ii) Financial Analysis, iii) Management Approach Analysis, iv) Environment Analysis and v) Regulatory Framework Analysis.

CRISL, CRAB, NCRL, ECRL, ACRSL and WCRCL use a similar rating process while BDRAL uses bank-led process for only SME rating. The rating process that ACRL uses were not displayed on their website until 31 December, 2012. None except CRISL have exposed the Memorandum of Understanding (MOU) agreement in their rating processes between the rating company and the client about the terms and conditions including rating fees. Another important feature of rating that can be pointed out is that the rating reports do not state that the 'rating is fully free and fair from the client interference', which is essential but it is strangely not clearly mentioned in the rating processes maintained by the CRCs.

All of the domestic CRCs follow the International Organization of Securities Commission (IOSCO) code of conduct and they have adopted Issuer Pay Model as their business model under which their main source of revenue, i.e., the rating fee, comes from the issuers.

Except for BDRAL the rating notches or symbols or scales used by the CRCs in Bangladesh are of two types – long term and short term. BDRAL's rating notches are in the short run defined as SME rating. BB has recommended some specific rating grades for mapping the CRCs (ECAIs) ratings with BB Rating Grade in order to have equivalent measurement of different ratings of the CRCs. In this connection, BB calculates the rating grades using risk-weights: risk-weights of 20%, 50%, 100%, 150% are for grade 1, 2, (3, 4) and (5, 6) in the long run and (S1, SME1), (S2, S3, SME2, SME3), (S4, SME4) and (S5, S6, SME5, SME6) respectively in the short run. Here, Grade 1, S1 and SME1 indicate highest safety or capacity; grade 2, S2 and SME2 imply high safety or capacity; grade 3, S3 and SME3 represent average safety or capacity; grade 4, S4 and SME4 indicate below average safety or capacity; grade 5, S5 and SME5 imply inadequate safety or capacity and grade 6, S6 and SME6 indicate high risk of default.

As to the mapping of CRCs rating notches with BB Rating Grades shown in Appendix 1, it is found that the meaning of the notches containing the same literal symbol, A, B, C, and D with plus and minus sign and numerical modifier 1, 2, 3 used by the CRCs for indicating the degree of quality of different ratings in the long and short run is quite similar for CRISL, CRAB, NCRL, ECRL, ACRSL, WCRCL and ACRL. BDRAL uses notches only for SME rating in the short run. In line with the equivalent BB Rating Grades, CRISL, NCRL, ECRL, ACRSL and ACRL use similar rating notches aligned with S & P and Fitch's notches; likewise, CRAB and WCRCL use similar rating notches aligned with Moody's notches. BDRAL's notches are aligned with the rating notches used by Dun & Bradstreet South Asia and Middle East Limited (D&B-SAMEL) and SME Rating Agency of India Limited (SMERA) of India. Quantity of long term notches used by all CRCs except for BDRAL ranges from 18 to 26 and short term notches are equally 06. The number of BDRAL's rating notches is 08.

From the rating notches with definition classified by the CRCs in Bangladesh shown in Appendix 2, it is seen that an issuer receiving a rating under investment grade is considered safe (risk-free or

less risky) to make the investment or to allow credit in terms of financial strength (credit worthiness and ability to pay the money), management quality and business reputation. On the other hand, a rating under speculative grade shows a signal with risky condition of the issuer to the investor or to the lender so as to make the latter cautious in making decision, and the rating under default grade gives a message about the issuer's failure status or worst condition or bankruptcy in all respects. Now, to see the position of rating fee, a comparative picture of rating fees disclosed by a number of CRCs of some South-East Asian countries including Bangladesh is shown in Table 2.

Table 2: Fee Structure of Some CRCs in South-East Asian Countries Including Bangladesh

Countries and Their CRCs	Entity Rating	
	Initial Rating Fee (Amt . in '000 Taka) ^a	Annual Surveillance Rating Fee (Amt. in '000 Taka) ^a
Bangladesh		
CRAB	Max. 550 – Min. 200	Max. 400 – Min. 150
NCRL	Max. 400 – Min. 50	Max. 300 – Min. 45
ECRL	Max. 800 – Min. 250	Max. 700 – Min. 200
ACRL	Max. 800 – Min. 150	Max. 700 – Min. 100
BDRAL	Max. 40.25 – Min. 13.80 (For SME Rating)	-
India		
CARE	290 to 0.10% of the amount outstanding min.	145 to 0.05% of the amount outstanding min.
CRISIL ^b	98 to 180 min. (For SME Rating)	-
Pakistan		
PACRA	297.50 to 850 min.	Min. 10% plus Initial Rating
JCR-VIS	297.5 to 850 min.	255 to 807.5 min.
Malaysia		
MARC ^b	Min. 3,600 to 0.06% of the amount outstanding (For Instruments Rating)	Min. 2,400 to 0.04% of the amount outstanding (For Instruments Rating)

Notes: a. Indian Rupee (Rs.), Pakistani Rupee (PKR) and Malaysian Ringgit (RM) have been converted into Bangladeshi Taka (TK.) at an exchange rate of Rs. 1.00 = TK. 1.45, PKR 1.00 = TK. 0.85, and RM 1.00 = TK. 24.00 in 2012.

b. Entity rating fee has not been found on the respective websites.

Source. CRAB, NCRL, ECRL, ACRL, BDRAL, CARE, CRISIL, PACRA, JCR-VIS and MARC websites (see Appendix No. 5).

Almost all of the CRCs in Bangladesh disclose the pricing of their rating services on their respective websites except for CRISL, ACRSL and WCRL. Table 2 exhibit maximum and minimum amount of rating fees as structured by the CRCs in Bangladesh and in some South-East Asian countries for initial and annual surveillance entity ratings.

It is found from Table 2 that the rating fees charged by the CRCs in Bangladesh are substantially lower compared to some rating agencies in South East Asia. The maximum rating fee (TK. 800,000) charged by a Bangladeshi CRC (ECRL or ACRL) is even lower than the maximum limit of minimum charge (TK. 850,000) set by a Pakistani CRC, Pakistan Credit Rating Agency Limited (PACRA) or

JCR-VIS Credit Rating Company Limited (JCR-VIS), for an initial entity rating. Malaysian CRC, Malaysian Rating Corporation Berhad (MARC), on the other hand, charges a minimum fee of TK. 3,600,000 for an instrument rating, which is 450% higher than the maximum rating fee in Bangladesh. After comparing even Credit Rating Information Services of India Ltd. (CRISIL)'s fee to BDRAL's fee for a SME rating, it is observed that CRISIL's one is almost 450% more than that of BDRAL. So it is clear that the rating services are provided at considerably lower rates in Bangladesh. Nevertheless, Bangladeshi CRCs are facing the challenge of their survival due to the emergence of a surplus number of CRCs in an economy far too smaller in size in terms of Gross Domestic Product (GDP) than those in some Asian Countries like China, Japan, India, South Korea, Indonesia, Thailand, Malaysia, Singapore and Pakistan (See Appendix No. 3), where the average number of CRCs is still below 05 (See Appendix No. 4). The CRCs cannot demand even their pre-arranged fees because of undue competition. Thus, they had to cut their respective charges by more than 50% during the year of 2012. As a result, an uneven bargaining power for the clients for managing 'superior ratings' is created (Haroon, 2012). In line with this unhealthy competition, the credit rating market is becoming oversaturated by increasing the number of ratings at an irrational rate (see Table No. 3).

4.2 Rating Activities of CRCs in Bangladesh

Rating activities as pioneered by CRISL in Bangladesh since 2002 was followed by CRAB in 2004 and other agencies. Due to insufficient data it is not possible to present year-to-year rating activities of the CRCs. Nevertheless, the author has attempted to present their rating activities in terms of the number of ratings and distribution of ratings as per data sufficiency. Table 3 presents the position of the CRCs in terms of ratings performed by 2012.

It is found from Table 3 that CRAB and CRISL together occupied maximum share (almost 70%) of the rating market, where CRAB held 39.85% and CRISL held 29.56% till 2012; although BDRAL executed a considerable percentage (13.04%) of total ratings in SMEs only in two years from 2011 to 2012. Table 3 also reveals that the trend of ratings is on the increase sharply from year to year, which represents a rapid growing tendency of rating services in Bangladesh. Information reveals that 23.25% of total ratings have been performed during the period of 2002-2010 preceded by only 5.44% in 2002-2008, whereas 76.75% (more than three-fourth) of total ratings have been completed only in 2011 and 2012. Almost 50% of total (3,172 out of 6,725) ratings have been done in only one calendar year (2012), , which raises some questions over the credibility of CRCs in Bangladesh. In this connection, Faruque (2012) has rightly commented by referring to a BSEC rule that if a CRC follows "at least 15 days needed to evaluate a company", then a total of 28,500 working days is required to evaluate 1,900 companies in a year. Table 4, however, depicts a picture of industry-wise ratings in percentage in Bangladesh during the period from 2002 to 2012.

Table 3: Position of CRCs in Terms of Ratings Performed by 2012

Name of CRCs	Number of Rating Assignments ^a					Market Share (% of Total)
	2002-2008	2009-2010	2011	2012	Total	
CRISL	202	846 ^c	630	310 ^d	1988	29.56
CRAB	164	352 ^c	850	1314	2680	39.85
NCRL	-	-	180	313	493	7.33
ECRL	-	-	215	293 ^e	508	7.55
ACRSL	-	-	6	166	172	2.56
WCRCL	-	-	-	7	7	0.11
ACRL ^b	-	-	-	-	-	-
BDRAL	-	-	108 ^f	769	877	13.04
Total	366	1198	1989	3172	6725	
Yearly data (% of Total)	5.44	17.81	29.58	47.17		100
	23.25		76.75			

Notes: a. Figures may vary in keeping with the actual data.

b. No data have been found on ACRL website.

c. Figures not found from any sources, thus assumed to be the difference between total and the sum of other reported years.

d. Data up to November 14, 2012.

e. Data up to November 5, 2012.

f. BDRAL started to conduct rating in 2011 before receiving license in 2012

Source: Compiled and calculated by the author with reference to Faruque (2012, p. 6); CRISL, CRAB, NCRL, ECRL, ACRSL, WCRCL and BDRAL websites (see Appendix No. 5).

Table 4 shows that the trading and service sectors are far ahead of other three sectors in terms of getting rated (initial or surveillance) on an average, during the period from 2002 to 2012. About 57% of total ratings have been done in trading and service while around 39% have been in manufacturing, 3.86% in financial [i.e. bank, non-banking financial institution (NBFI) and insurance] and 0.18% in bond industries during this period. This shows that only around 4% of total ratings have been made in financial and bond sectors. Besides this, although there are about 2,204 non-government organizations (NGOs) currently registered and working especially in micro-financing mostly in the rural areas of Bangladesh, only CRISL and CRAB have performed a negligible percentage (around 1%) of their total ratings in NGOs. However, the picture of long-term rating notches distributed in 2012 by the CRCs is shown in percentage in Table 5.

Table 4: Position of CRCs in Terms of Ratings Performed in Percentage by Industry

Industry Type (Rating Type: Initial or Surveillance)	CRISL (2002-2012)	CRAB (2004-2012)	NCRL (2011-2012)	ECRL (2011-2012)	ACRSL (2011-2012)	WCR-CL (2012)	ACRL (2012) ^a	BDRAL (2011-2012)	Average (2002-2012)
Financial (Bank, NBFIs and Insurance)	9.5	5	5	2.5	5 ^c	-	-	-	3.86
Trading and Services ^b	54 ^d	53.2 ^d	46.25	58	62	43	-	82	56.92
Manufacturing ^b	36	41	48.75	39.5	33	57	-	18	39.04
Bond	0.50	0.80	-	-	-	-	-	-	0.18
Total	100	100	100	100	100	100	-	100	100

Note: a. No data available on ACRL website.
b. Includes corporate/entity and bank loan ratings in maximum cases as rating category.
c. Includes no Bank ratings.
d. Includes NGO ratings (approximately 0.40% by CRISL and 0.63% by CRAB).

Source: Calculation has been done by the author with reference to CRISL, CRAB, NCRL, ECRL, ACRSL, WCRCL and BDRAL websites (see Appendix No. 5).

Table 5: Distribution of Ratings in 2012 in Percentage by Long-Term Rating Notches

Rating Notches ^a	CRISL	CRAB	NCRL	ECRL	ACRSL	WCRCL	ACRL ^b	Average
AAA	1.34	0.35	0.00	1.10	0.00	0.00	-	0.46
AA	6.69	10.13	2.92	3.66	2.65	0.00	-	4.34
A	32.77	17.58	50.36	12.09	52.98	0.00	-	27.63
BBB	54.85	37.83	40.88	73.15	39.73	100	-	57.70
BB	3.68	30.27	5.84	9.63	4.64	0.00	-	9.05
B	0.67	3.61	0.00	0.37	0.00	0.00	-	0.78
CCC – D	0.00	0.23	0.00	0.00	0.00	0.00	-	0.04
Total	100	100	100	100	100	100	-	100

Notes: a. Rating notches of BDRAL have not been considered for reviewing the rating distribution due to its unique nature of short term rating type (i.e., SME rating only)

b. No data available on ACRL website

Source: Calculation has been done by the author with reference to CRISL, CRAB, NCRL, ECRL, ACRSL and WCRCL websites (see Appendix No. 5).

Table 5 shows that the average percentage of instruments with ‘A’ rating was 27.63% and ‘AAA to A’ rating was 32.43%; ‘B’ rating was 0.78% and ‘BBB to B’ rating was 67.53%; and ‘CCC to D’ rating was only 0.04% in 2012. More than half (57.70%) of the ratings on an average assigned by the CRCs have been ‘BBB’ and almost all the rated instruments (99.18%) received ‘AAA to BB’. Most of the CRISL ratings (94.31%) have been marked with ‘AA to BBB’, CRAB ratings (95.81%) with ‘AA to BB’, NCRL ratings (91.24%) with ‘A to BBB’, ECRL ratings (94.87%) with ‘A to BB’, ACRSL ratings (92.71%) with ‘A to BBB’, and WCRCL ratings (100%) with ‘BBB’. The distribution of the rating grades of the CRCs in 2012 is shown in percentage by investment grade category in Table 6.

Table 6: Distribution of Ratings in 2012 in Percentage by Investment Grade Category

Category	Long-Term Rating Notches	CRISL	CRAB	NCRL	ECRL	ACRSL	WCRCL	ACRL
Investment Grade	AAA, AA, A, BBB	95.65	65.89	94.16	90.00	95.36	100	-
Non-Investment Grade	Speculative Grade BB, B, CCC, CC, C	4.35	34.11	5.84	10.00	4.64	0.00	-
Default Grade	D	0.00	0.00	0.00	0.00	0.00	0.00	-
Total		100	100	100	100	100	100	-

Source: Calculated Based on Table 5 & Appendix 2

It is found from Table 6 that apart from CRAB all other CRCs have distributed their ratings 90% or above to the investment grades, where CRAB has distributed 65.89% to the investment grades and 34.11% to speculative grades (i.e., non-investment grades) in 2012. Almost 80-90% or above spread has been found between the rating grades (investment grades and speculative grades) assigned by CRISL, NCRL, ECRL, ACRSL and WCRCL, whereas, CRAB's spread was only 31.78% in this circumstance. CRAB is therefore assumed to be more conservative or defensive in assigning rating grades than its competitors, which might enable CRAB to avoid the risk of providing wrong information about the strength and weakness of the rated instruments.

4.3 Quality of Rating Activities of CRCs in Bangladesh

To judge the performance of the CRCs in terms of their rating quality, their transition matrices (i.e., rating migrations) and default statistics may be the best measures over a period of time horizon. In such a case, since the rating history of Bangladesh started in the recent past, one-year average transition matrix and default statistics of ratings have been considered worthwhile. Thus, one-year average transition of ratings for 2012 is shown in percentage in Table 7.

Table 7: One-year Average Rate of Transition of Ratings in Percentage

		Rating To (End of Year 2012)							
Transition		AAA	AA	A	BBB	BB	B	CCC-C	D
Rating From (Beginning of Year 2012)	Period (One Year)	AAA	AA	A	BBB	BB	B	CCC-C	D
	AAA	100	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	AA	0.00	94.50	5.17	0.00	0.00	0.00	0.00	0.33
	A	0.00	5.35	90.45	3.75	0.00	0.00	0.00	0.45
	BBB	0.00	0.00	8.33	90.25	0.82	0.00	0.00	0.60
	BB	0.00	0.00	0.00	13.24	86.13	0.00	0.00	0.63
	B	0.00	0.00	0.00	0.00	0.00	100	0.00	0.00
	CCC-C	0.00	0.00	0.00	0.00	0.00	0.00	100	0.00

Source: CRISL, CRAB, NCRL, ECRL, ACRSL and WCRCL's Rating data. Calculated by averaging the rate of transition or migration of their ratings

Table 7 shows one-year transition matrix of CRISL, CRAB, NCRL, ECRL, ACRSL and WCRCL in percentage. The vertical axis of the table indicates the rating notches assigned by the CRCs at the beginning of the year 2012 and the horizontal axis represents the ratings in the end of the year 2012. The highlighted diagonal of the table contains the stability rates of different rating categories. Rates on the left of the diagonal indicate upgraded to higher ratings and on the right indicate downgraded to lower ratings including the default ratings. 100% of 'AAA' rated instruments from investment grade and 100% of 'B' and 'CCC-C' rated instruments from speculative grade remained in those categories one year later. The rate of retention of 'AA', 'A', and 'BBB' from investment grade and 'BB' from speculative grade was 94.50%, 90.45%, 90.25%, and 86.13% respectively during the same period. Having no upgrades 'AA' rated instruments downgraded 5.17% to 'A' and 0.33% to 'D'. 'A' rated instruments upgraded 5.35% to 'AA' and downgraded 3.75% to 'BBB' and 0.45% to 'D'. Similarly 8.33% of 'BBB' ratings upgraded to 'A' and 0.82% downgraded to 'BB' and 0.60% to 'D'; and 13.24% of 'BB' ratings upgraded to 'BBB' and 0.63% downgraded to 'B' ratings. A summarized form of these transitions is, however, shown in Table 8 to indicate default statistics.

Table 8: One-Year Average Default of Ratings in Percentage by the Long-Term Rating Notches

	AAA	AA	A	BBB	BB	B	CCC-C	D	Average
Default Rating	0.00	0.33	0.45	0.60	0.63	0.00	0.00	-	0.29
Upgrade Rating	0.00	0.00	5.35	8.33	13.24	0.00	0.00	-	3.84
Downgrade rating	0.00	5.17	3.75	0.82	0.00	0.00	0.00	-	1.39
Stable Rating	100	94.50	90.45	90.25	86.13	100	100	-	94.48
Total	100	100	100	100	100	100	100	-	100

Source: Based on Table 7

As to the default statistics of the CRCs, cumulative default rate could not be prepared and presented due to insufficient data. Nonetheless, the author has tried henceforth to present one-year average default rate along with the rate of rating upgrade, downgrade and stability by the long-term rating notches in Table 8.

Table 8 shows average rate of default and transition or migration towards up and down of ratings by the long-term rating notches for 2012. Here, the overall retention ratio of the rating grades is over 90%. It indicates that the ratings that are offered by the CRCs in Bangladesh are almost stable for most instruments. Although the stability of ratings does not necessarily mean they are accurate (Bangladesh Bank, 2013), users of rating system usually value stability because ratings affect behavior and the actions taken on the basis of ratings may change. Table 8 also shows that the rate of upgrade ratings exceeds in most cases the rate of downgrade ratings except higher investment grade 'AA'. However, the average rate of upgrade ratings (3.84%) is higher than that of downgrade ratings (1.39%) over the year 2012. In addition, average default rating under all rating categories is less than 0.30% over this period of time. Therefore, it can be inferred that the ratings done by the CRCs in Bangladesh over a one year time horizon provide a reasonable measure of the relative chances of an instrument's default and pose no immediate threats to maintaining corporate financial stability in Bangladesh.

5. Conclusion and Implications

The CRCs are still in its infant stage in Bangladesh, but their activities have got a vast momentum by this time in the financial sector of this country. This paper has found that during the last 15 years of rating services, there have been 08 CRCs performing their jobs with almost 7,000 rating activities done so far. An evaluation of the activities of the CRCs brings to attention the succession at which the CRCs are being given licenses, the rate at which the rating market is expanding and the rating fee at which they are getting involved in uneven bargaining with the clients for their survival, the quality of rating accordingly may confront question and finally the objective of introducing credit rating may be adversely affected. These facts warrant the attention of concerned authorities.

The findings show that almost 70% of entire rating market in Bangladesh is under the possession of only two relatively old CRCs (CRISL & CRAB), the other CRCs, which are newly entrants, have been struggling with their survival and may lead to the uneven competition among them. As a result, on one side, the clients or issuers may get indulged in undue bargaining for pricing and favorable ratings grade and on the other side, the CRCs may lose their credibility on the information they have been providing.

About 50% of total ratings (3,172 out of 6,725) done in a single year (2012) raise question over the credibility of the CRCs in Bangladesh. Another important thing is that apart from CRAB all other CRCs have distributed their ratings 90% or above to the investment grades, where CRAB has distributed 65.89% in 2012. As a consequent, almost 80-90% or above spread has been found between the rating grades (investment grades and speculative grades) assigned by CRISL, NCRL, ECRL, ACRSL and WCRCL, whereas, CRAB's spread was only 31.78% in this circumstance. Moreover, the domestic CRCs do not update rating process and rating result on website. Their MOU does not state the rating process including rating fees. They are not maintaining homogeneous pricing system and they do not update and disclose their fee structures on website, those who disclose, the rating fees are seen relatively lower than that of other Asian CRCs.

In the context of rapidly growing credit rating activities and some flaws in their activities it is warranted that these should be monitored at a short span of time interval by a separate vigilant team or division of both BSEC and BB so that practical reasons for any unanticipated high graded or abrupt downgraded rating can be traced out to avoid the risk of providing wrong information about the strength and weakness of the rated instruments. In this connection, BSEC's rule "at least 15 days needed to evaluate a company" should be strictly maintained by the CRCs in order to prevent the number of ratings from rising at an irrational height within a calendar year. The domestic CRCs should strictly follow the instructions of their regulators about having homogeneous pricing system for credit rating and disclosing the schedule of credit rating fees annually in order to prevent unethical price competition among them and to forestall the client's interruption on final rating as well. The competitive fee culture among the CRCs should not be allowed anymore. It is recommended needed that the regulatory authorities should set a feasible and uniform pricing system for all domestic CRCs that best fit with international standard. Another important fact is that under current situation no more development of CRCs should be franchised to come to the market which may lead to undue cut throat competition, otherwise, the quality of ratings will no doubt fall and the purpose of giving licenses to the CRCs will adversely affect the whole economy of the country.

The findings also refer that despite having regulatory obligation about being rated as high risk prone areas in Country's financial sector, only around 4% of total ratings have been made in financial and bond sectors in Bangladesh until December, 2102. In addition, a trivial percentage (around 1%) of total ratings has been made in NGOs although a huge number of NGOs have been working especially in micro-financing mostly in the rural areas of Bangladesh. So the domestic CRCs have an ample opportunity to expand their rating nets towards these sectors in order to minimize the risk associated with financing by as well as borrowing from these sectors.

Apart from these difficulties, the CRCs have so far been performing with not much discomfort. As per the finding results, the quality of the activities of the domestic CRCs has been found considerably satisfactory so far. With above 90% retention and below 1% default of investment grade ratings, the rating activities of the domestic CRCs showed a stable position of ratings in terms of migration over the year of 2012. Moreover, the average rate of ratings upgraded (3.84%) was higher than that of ratings downgraded (1.39%) over the same period of time horizon. However, if they are monitored with proper supervision they are expected to play a far-reaching role in maintaining the stability and discipline of the financial market of the country.

It is to be mention here that this study cannot pass over some limitations. Major limitations confronted by the study include its inability to carry out a more elaborate search into the natures and

activities of the CRCs working in Bangladesh, and inadequate published materials either in print or on the official websites of the organizations concerned. If these hindrances could be forborne, the study could gain an unheard-of analytical and comprehensive shape. Nevertheless, the related parties are expected to find a timely opportunity for introspection starting from almost a primary initiative in Bangladesh like this study.

The author of this paper also believe that the further studies of domestic credit rating companies from the standpoint of accountability, transparency and above all credibility can be useful for the quality enhancement of the rating companies as well as for the sake of financial stability of a developing market like Bangladesh in particular and for other stakeholders including users of financial market information.

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Appendices

Appendix 1: Mapping of CRCs' Rating Notches with BB Rating Grades

BB Grade	Equivalent Rating Notches Used by the CRCs in Bangladesh			
	CRISL, NCRL, ECRL, ACRSL, ACRL		CRAB, WCRCL	BDRAL
Long Term				
1	AAA, AA+, AA, AA-		AAA, AA1, AA2, AA3	
2	A+, A, A-		A1, A2, A3	
3	BBB+, BBB, BBB-		BBB1, BBB2, BBB3	
4	BB+, BB, BB-		BB1, BB2, BB3	
5	CRISL = B+, B, B-, CCC+, CCC, CCC-, CC+, CC, CC-; NCRL, ECRL = B+, B, B-; ACRSL = B+, B, B-, CC+, CC, CC-; and ACRL = B+, B, B-, CCC		CRAB = B1, B2, B3, CCC1, CCC2, CCC3, CC; and WCRCL = B1, B2, B3, CCC	
6	CRISL, NCRL, ACRSL = C+, C, C-, D; ECRL = C, D; and ACRL = CC+, CC, CC-, C+, C, C-, D		CRAB = C, D; and WCRCL = CC1, CC2, CC3, C+, C, C-, D	
Short Term				
S1 and SME1	ST-1,	N-1, ECRL-1, ST-1, AR-1	ST-1, P-1	SE1, ME1
S2 and SME2	ST-2,	N-2, ECRL-2, ST-2, AR-2	ST-2, P-2	SE2, ME2
S3 and SME3	ST-3,	N-3, ECRL-3, ST-3, AR-3	ST-3, P-3	SE3, ME3
S4 and SME4	ST-4,	N-4, ECRL-4, ST-4, AR-4	ST-4, P-4	SE4, ME4
S5 and SME5	ST-5,	N-5, ECRL-5, ST-5, AR-5	ST-5, P-5	SE5, ME5
S6 and SME6	ST-6,	N-6, ECRL-6, ST-6, AR-6	ST-6, P-6	SE6, SE7, SE8, ME6, ME7, ME8
No. of Rating Notches Used	Long Term = 26, 20, 18, 23, 20 (orderly); Short Term = 6		Long-Term = 22, 24 (orderly); Short-Term = 6	SME = 8
Alignment with IRAs	S & P and Fitch		Moody's	D&B-SAMEL and SMERA of India

Source: CRISL, CRAB, NCRL, ECRL, ACRSL, WCRCL, ACRL, BDRAL and BB websites (See Appendix No. 5). IRAs stand for International Rating Agencies

Appendix 2: Rating Notches with Definition Classified by the CRCS in Bangladesh

Rating Grade	Rating Notches Used by			Definition of Rating Notches
	CRISL, NCRL, ECRL, ACRSL and ACRL	CRAB and WCRCL	BDRAL	
Investment Grade	AAA	AAA	SE1, ME1	Highest Safety / Capacity
	AA+, AA, AA-	AA1, AA2, AA3	SE2, ME2	High Safety / Capacity
	A+, A, A-	A1, A2, A3	SE3, ME3	Adequate Safety / Capacity
	BBB+, BBB, BBB-	BBB1, BBB2, BBB3	SE4, ME4	Moderate Safety / Capacity
Speculative Grade	BB+, BB, BB-	BB1, BB2, BB3	SE5, ME5	Inadequate Safety / Capacity
	B+, B, B-	B1, B2, B3	SE6, ME6	Weak Capacity and High Credit Risk
	CCC+, CCC, CCC-, CC+, CC, CC-, C+, C, C-	CCC1, CCC2, CCC3, CC, C	SE7, ME7	Vulnerable / Near to Default
Default Grade	D	D	SE8, ME8	Default

Source: Designed by the author using information from CRISL, CRAB, NCRL, ECRL, ACRSL, WCRCL, ACRL and BDRAL websites (see Appendix No. 5).

Appendix 3: GDP Size in Some Asian Countries in 2013 (Amount in Billion US\$)

China- 9,240.0	South Korea- 1,305.0	Malaysia- 313.2
Japan- 4,920.0	Indonesia- 868.3	Singapore- 297.9
India- 1,877.0	Thailand- 387.3	Pakistan- 232.3
		Bangladesh- 150.0

Source: World Bank (2013)

Appendix 4: Number of CRCs in Some Asian Countries as of 31 December 2012

Countries	No. of CRAs	Source
China	07	http://www.iima.or.jp/Docs/newsletter/2013/NLNo_15_e.pdf
Japan	07	http://www.fsa.go.jp/en/regulated/licensed/cra.pdf , and http://www.iima.or.jp/Docs/newsletter/2013/NLNo_15_e.pdf
India	06	http://203.199.247.102/cms/sebi_data/attachdocs/1378192045802.pdf
South Korea	04	http://www.iima.or.jp/Docs/newsletter/2013/NLNo_15_e.pdf
Indonesia	03	http://www.iima.or.jp/Docs/newsletter/2013/NLNo_15_e.pdf
Thailand	04	http://www.set.or.th/en/links/credit.html
Malaysia	04	http://vpr.hkma.gov.hk/pdf/100315/ar_12/ar_12.pdf
Singapore	03	http://www.iima.or.jp/Docs/newsletter/2013/NLNo_15_e.pdf
Pakistan	02	http://www.secp.gov.pk/annualreport/2013/Annual-Report-2013_Part1.pdf
Total	40	
Average	4.44	

Appendix 5: Website Addresses of BB and Some Domestic and Foreign CRCs

Name (in Alphabetic Order)	Website Addresses
Alpha Credit Rating Ltd. (ACRL)	http://alpharating.com.bd
ARGUS Credit Rating Services Ltd. (ACRSL)	http://www.acrsibd.com
Bangladesh Bank (BB)	www.bb.org.bd
The Bangladesh Rating Agency Ltd. (BDRAL)	http://www.bdral.com
Credit Analysis and Research Ltd. (CARE)	http://www.careratings.com
Credit Rating Agency of Bangladesh Ltd. (CRAB)	http://www.crab.com.bd
Credit Rating Information Services of India Ltd. (CRISIL)	http://www.crisil.com/index.jsp
Credit Rating Information and Service Ltd. (CRISL)	http://www.crisibd.com
Emerging Credit Rating Ltd. (ECRL)	http://www.emergingrating.com
JCR-VIS Credit Rating Co. Ltd. (JCR-VIS)	http://www.jcrvis.com.pk
Malaysian Rating Corporation Berhad (MARC)	http://www.marc.com.my/home/index.php
National Credit Ratings Ltd. (NCRL)	http://www.ncrbd.com
Pakistan Credit Rating Agency Ltd. (PACRA)	http://www.pacra.com
WASO Credit Rating Company (BD) Ltd. (WCRCCL)	http://www.wasocreditrating.com