



# BANK FINANCE RATINGS

## Special Report

**B**ank Finance Ratings (BFRs) incorporate the underlying credit risk of the borrower and the support provided by the collateral and covenants package, which improve the recovery prospects of specific financings. BFRs have gained momentum internationally over the past decade as a result of the increased emphasis on credit risk management. The expanding recognition of the need and acceptance for such ratings is evident by the fact that by 1999 bank financings worth more than US\$1 trillion were rated (mainly in U.S. and Europe) and this volume continues to grow. BFRs have also gained widespread acceptance in Asia following the financial crisis faced by the region in the late 90's and by 1999 syndicated financings of approximately US\$ 70b had been rated.

A BFR combines JCR-VIS's assessment of an organization's ability to meet its unsecured financial obligations with the likelihood of ultimate repayment of the particular financing being rated through the enforcement of securities and/or other covenants by the lender. The higher the entity (i.e. senior unsecured debt) rating, the

more importance is given to timeliness of repayment of the financing as the probability of default diminishes; the lower the entity rating, more emphasis is placed on the recovery prospects of the financing in the post-default scenario.

The initial process of assigning a BFR is similar to that of an entity rating i.e. JCR-VIS's analysts examine all qualitative and quantitative factors that impact the credit quality of the borrower. Once the entity rating has been arrived at, our analysts review the specific characteristics and the structure of the financing being rated in order to determine the extent to which the lender is advantaged or disadvantaged with respect to the unsecured creditors of the borrower in the case of default on that particular financing.

The financing structure is analyzed to cover such factors as the positioning of the financing in the capital structure (e.g. the higher the positioning, the better will be the chances of ultimate recovery),

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the repayment schedule of the financing (e.g. shorter tenor and faster amortization of the financing) may mitigate the level of uncertainty associated with the future performance of the borrower), quality and realizability of security against the financing and any additional protection provided to the lender by the financing covenants.

Assessment of quality of securities includes, among other factors, their current valuation (including forced sales values), nature of charge, probability of obsolescence, and the level of enforceability of the securities as

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incorporated in the legal documentation. Both possible post-default scenarios, i.e. liquidation and reorganization are considered for assessing the ultimate recovery prospects of the financing. The asset valuation technique used will vary according to the nature of the business of the borrowing entity and of the underlying securities. Presence of other covenants does not automatically translate into a higher rating. However, the covenants can serve to reinforce the security package.

The above explained analysis determines the degree of variation of the BFR from the entity rating of the borrower. Secured financings may normally receive a rating that is one to three notches higher than the entity rating of the borrower. JCR-VIS adjusts its notching policy as the rated entities approach investment grade resulting in smaller variations from their entity ratings

for higher rated entities. As the ratings become higher the reliance on collateral becomes progressively lower.

Conversely, in the lower

rating grades the ultimate recovery prospects and claim priority assume greater importance.

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Global studies have indicated a strong correlation between BFRs and the amount of ultimate financing loss in default situations. BFRs provide important independent risk appraisals of specific financings, ease in financing syndication and an objective basis for pricing of bank financings linked to the risk factor indicated by the rating. A further potential benefit is the possible creation of a secondary market for re-packaged rated financings (such markets already exist in most developed economies) providing lenders with a fresh source of funding and increasing the flexibility of the lender's asset portfolio.

JCR-VIS places the BFRs under surveillance for their outstanding tenor and will monitor the financial performance of the borrower, status of security and enforcement of covenants of the financing being rated and specific BFRs may be maintained, upgraded or downgraded at any time during their tenor. For the purpose of maintaining uniformity, JCR-VIS rates BFRs on its long-term rating scale.

**Important Rating Considerations in BFRs**

**I. Management & Controls**

- Quality & stability of top management tier
- Succession planning
- Information technology
- Internal controls

**II. Resources / Risks**

- Vulnerability to changes in regulatory & fiscal policies
- Industry dynamics & business risk
- Diversity in product mix

**III. Asset Quality**

- Asset mix: deployment of assets
- Growth in assets
- Future BMR / capex requirements

**IV. Operating Performance**

- Sources of revenues & stability and quality of earnings
- Operational efficiency
- Effective utilization of financial leverage

**V. Liquidity**

- Cash flows (level, growth, seasonality/cyclicality)

- Debt coverage
- Availability of un-utilized credit lines
- Matching of funds

**VI. External Support**

- The financial strength and support of the sponsors of the borrower
- Third party guarantees, if any

**VII. Capital Structure of the Borrower**

- Existing capital structure
- Proposed capital structure with induction of new financing
- Position of the prospective financing in the proposed capital structure

**VIII. Financing Structure**

- Repayment schedule
- Nature of collateral
- Determination of asset value secured as collateral against the prospective financing
- Legal documentation
- Realizability of collateral
- Strength of financial & restrictive covenants in protecting the lender's interests



*President & CEO,  
JCR-VIS*

*Founder, VIS Group*

**Faheem Ahmad** has diverse experience with international consulting agencies in USA & Middle East. He has also held senior positions with local industrial and financial groups. In 1994, he established Vital Information Services (Pvt.) Limited, which is a leading capital market research house. VIS has the largest data bank of corporate Pakistan. His major research work includes copy righted F&J financial strength rankings, Musharaka Variable Income Securities and stock market indices. The VIS group includes JCR-VIS Credit Rating Company Limited and News-VIS Credit Information Services (Pvt.) Limited, the first private credit bureau of Pakistan. The majority of share holders in group companies include the largest publication house in Pakistan and major financial institutions.

He obtained his B.S in Civil Engineering from NED University of Engineering and Technology, Karachi. He also has Masters degrees in Engineering and Business Administration from USA. His research work has been published in various international journals.



*Assistant  
Vice President*

**Saad Ahmed Madani** currently leads in investment banking & DFIs ratings. He has worked extensively on industry and Islamic Finance ratings and is also involved in ratings of various leasing companies and commercial banks.

He is a Chartered Accountant (CA) from the Institute of Chartered Accountants of Pakistan.



*Financial  
Analyst*

**Sadaf Shabbir** is involved in ratings in the industrial, leasing and commercial banking sectors. Prior to joining JCR-VIS, she worked on several projects pertaining to strategic planning and organizational building.

She holds a Masters degree in Business Administration from the Institute of Business Administration, Karachi.

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