

# Rating Caribbean Companies

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*Changing Perspectives Seminar*  
Caribbean Actuarial Association  
04 December 2008

**Caribbean Information & Credit Rating Services Limited**

# Shareholding By Regional Players



## Central Banks

- Central Bank of T&T
- Central Bank of Barbados
- Eastern Caribbean Central Bank

## Commercial Banks

- Capital & Credit Merchant Bank
- Citibank T&T
- First Caribbean International Bank
- First Citizens Bank
- Inter Commercial Bank
- NCB Jamaica
- RBTT Bank
- Republic Bank
- Scotiabank, T&T

## Mutual Funds/Unit Trust

- Fortress Fund, Barbados
- Unit Trust Corporation, T&T

## Insurance/Conglomerates

- CL Financial
- Guardian Holdings Limited
- National Insurance Board, T&T
- New India Assurance
- Sagicor Life Inc

## Multilateral Agencies

- Caribbean Development Bank
- Inter-American Development Bank

## Brokerage Houses

- CMMB
- JMMB

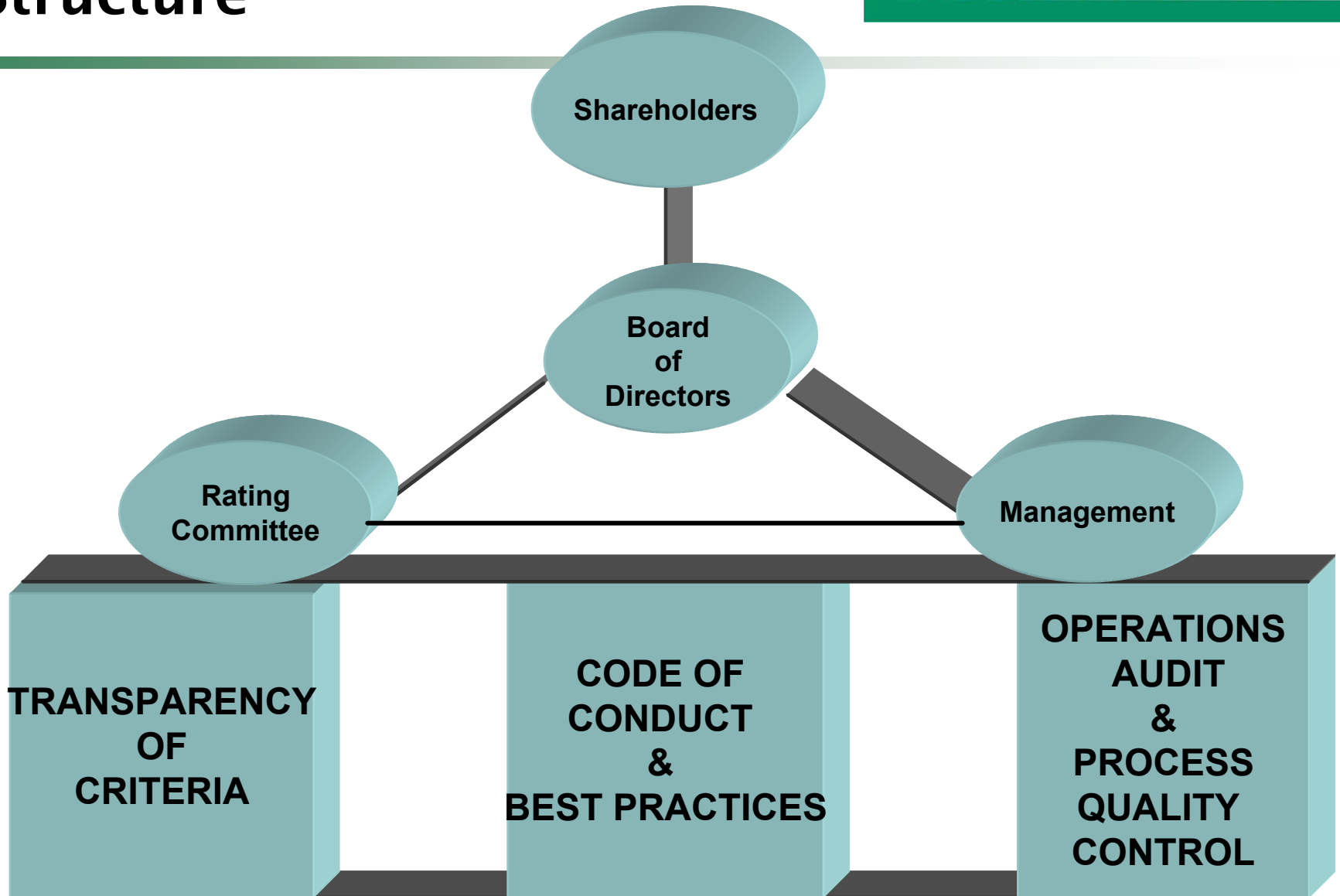
## Stock exchange

- T&T Stock Exchange

## Technical Consultant

- CRISIL

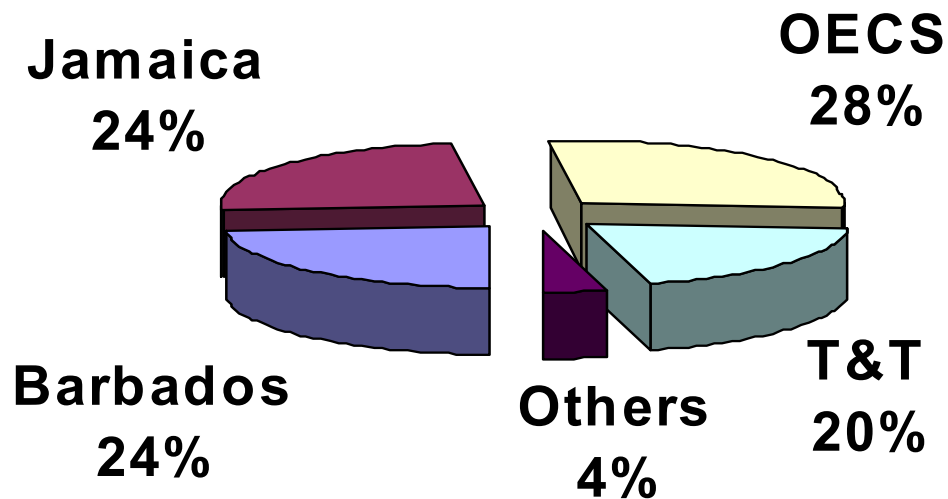
# CariCRIS' Governance Structure



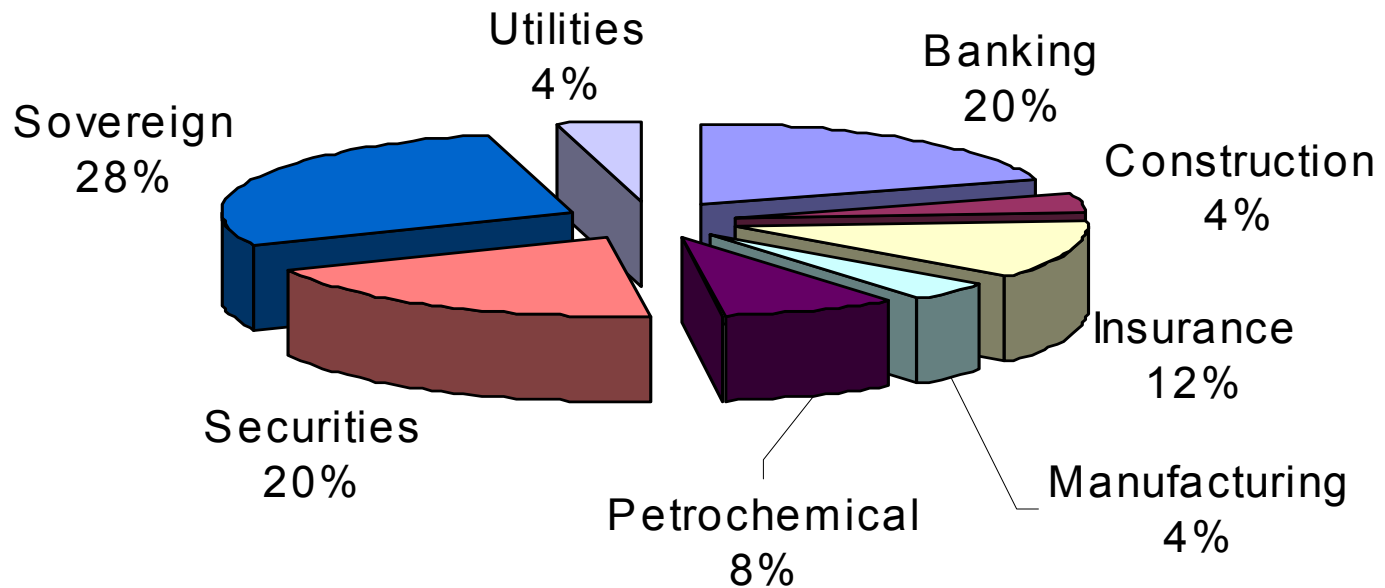
# Rating Distribution by Geography



Ratings Completed to November 2008 : 27



# Rating Distribution by Sector



# Caribbean Debt Markets- Characteristics



- Debt Markets
  - Dominated by Government issuances
  - Private placement dominated
  - Scarce secondary trading
  - Limited market participants
  - Relatively low level of transparency & disclosure
  - Absence of scientific risk-based pricing of risk
    - Pricing anomalies

# Role of Ratings



- Still the best descriptor of credit risk
- Credit ratings improve transparency and provide for investor protection
  - Deep and thorough initial assessments
  - Ongoing surveillance
  - Reports published on website
  - Anyone can access at anytime
  - Maintain financial discipline
  - Likely cost benefits

# Role of CariCRIS' Ratings in the region



- Will help to create a market for corporate credit
- Will help to create a secondary bond market
  - Creates liquidity in bond portfolios
  - Leads to clarity in pricing of credit risk
  - More resilience in financial system

# What can be rated?



## Debt/Notional debt issued by:

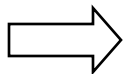
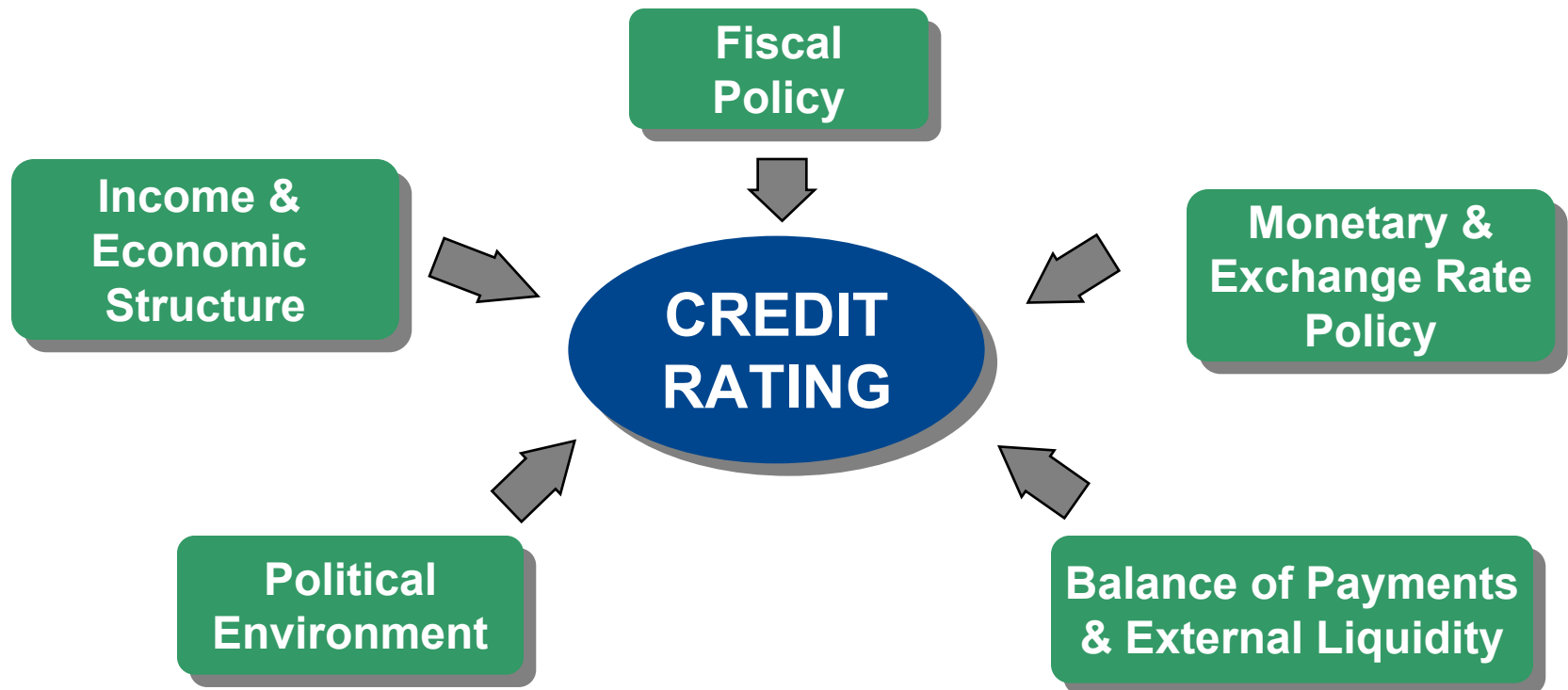
- Sovereigns
- Manufacturing/ Service companies
- Statutory Bodies/Public Sector Companies
- Financial institutions & Banks
- Finance Companies
- Credit Unions
- Holding Companies
- Insurance Companies
- Mutual Funds

## Such as:

- Bonds
- Bank Deposits
- Commercial Paper
- Term Loans
- Preference shares
- Secured debt
- Unsecured debt
- Mortgage backed securities
- Asset backed securities
- Structured obligations

CariCRIS will primarily assign *issue* specific ratings.

# Assessment Framework - Sovereign Entities

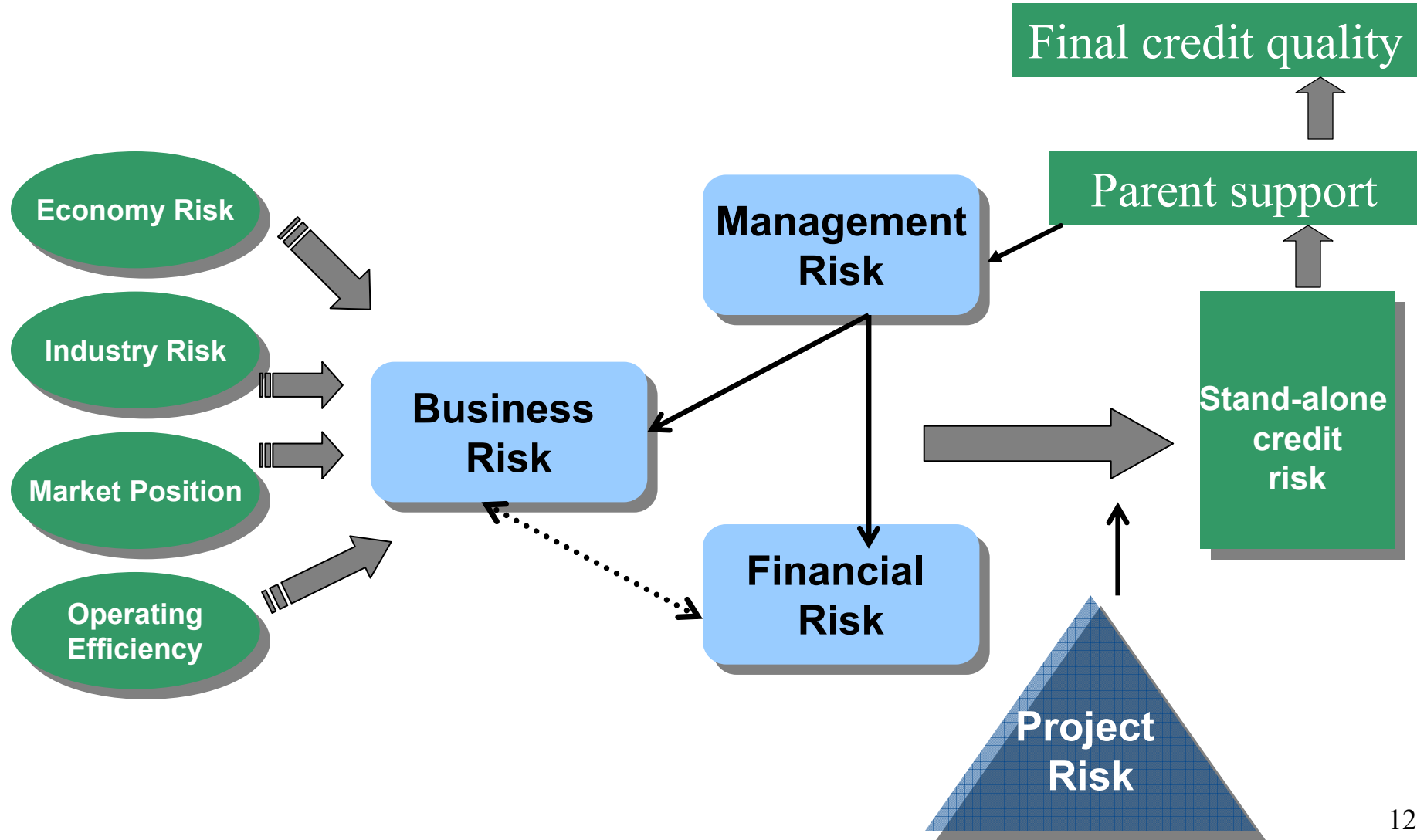


# CariCRIS Assessment Framework - Sovereigns



← Risk Categories →				
Income & Economic Structure	Fiscal Policy	Monetary & Exchange rate Policy	Balance of payments & External Liquidity	Political Environment
Quality of economic management	Coherence	Central Bank Independence	Trade competitiveness	Transparency in economic policy
Economic diversity & resilience	Robustness & stability of Gov't Revenue	Financial system soundness	Investment attractiveness	Continuity of policies
Human Development Index	Expenditures effectiveness & pressures	State of the insurance industry	Reserves & External debt position	Stability of political institutions
Size (in terms of GDP)	Overall deficits	Capital market development	Adequacy of reserves	
Growth prospects	Overall indebtedness	Record on inflation management		
Efficiency - private sector participation	Debt culture	State of the banking system		

# Assessment Framework - Manufacturing & Service Sectors



# Industry Risk



- We attempt to measure common risks faced by all the companies operating in the industry. However, the impact of these risks on individual company varies.
  - State of the Industry
  - Demand-Supply Scenario
  - Prices
  - Government Policy – stated or implied/tendency to intervene
  - Extent of competition
  - Importance of the industry to the economy
  - Stage of life cycle of the product

- Company specific analysis covers analysis of company's market position.
  - Provides insight into current strengths
  - Ability to sustain competitive advantage
- Understanding pricing power and ability to sustain stable volume growth is critical to understand revenue generation capacity. The following parameters need to be evaluated:
  - Market size and segments addressed
  - Market share and trend
  - Understand customer preferences / brand loyalty
  - Product Range - Dependence (in terms of cash generation) on small product range increases vulnerability
  - Dependence on single client despite reasonable product range
  - Price elasticity of demand
  - Prospects for growth

- Competitive advantages

- Cost
- Technology/ product quality
- Brand
- Marketing network & distribution strengths
- Long term contracts for product off take/ marketing arrangements
- Regulation

sustainability of these parameters needs to be evaluated

- Comparison of key players should be made to check whether relative rating on above parameters is reflected in financial performance. Parameters used can be
  - Price realizations - Indicating pricing power, brand premium
  - Volume growth - to check market share trend
  - Operating margins - operating cost structure
  - Return on capital - profitability and capital efficiency

- Analysis focusses on ability to produce quality goods at competitive cost on a consistent basis
  - Cost structure
  - Input related risks
    - Access to key inputs
      - Level of vertical integration
      - long-term contacts for raw materials
      - labour relations - union
      - assured, quality supply of critical utilities
    - Pricing power of suppliers
    - Appropriate Technology - In-house R&D, access to new products from a strong group
  - Effective logistics - critical for bulky items like cement or perishables, or dispersed markets
  - Environmental issues

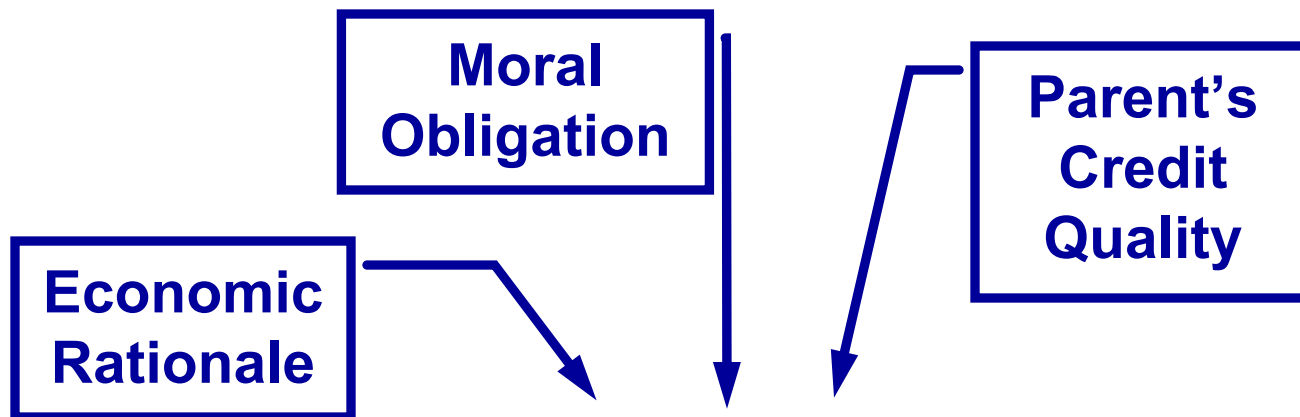
# CariCRIS Assessment Framework for Manufacturing and Service Entities



## Risk Categories

		Risk Categories				
		INDUSTRY RISK	BUSINESS RISK	FINANCIAL RISK	MANAGEMENT RISK	PROJECT RISK
Risk Parameters	Industry Characteristics		Operating Efficiency	Accounting Quality	Track Record	Completion Risk
	Competition within industry		Market Position	Past Financials	Financial Conservatism	Funding Risk
	Industry Financials			Financial Flexibility	Attitude to Risk	
				Future Cash Flow Adequacy	Payment Record	
					Optional Parameters	

# Parent Support



# Assessment framework for banks & finance entities

## The CRAMEL framework



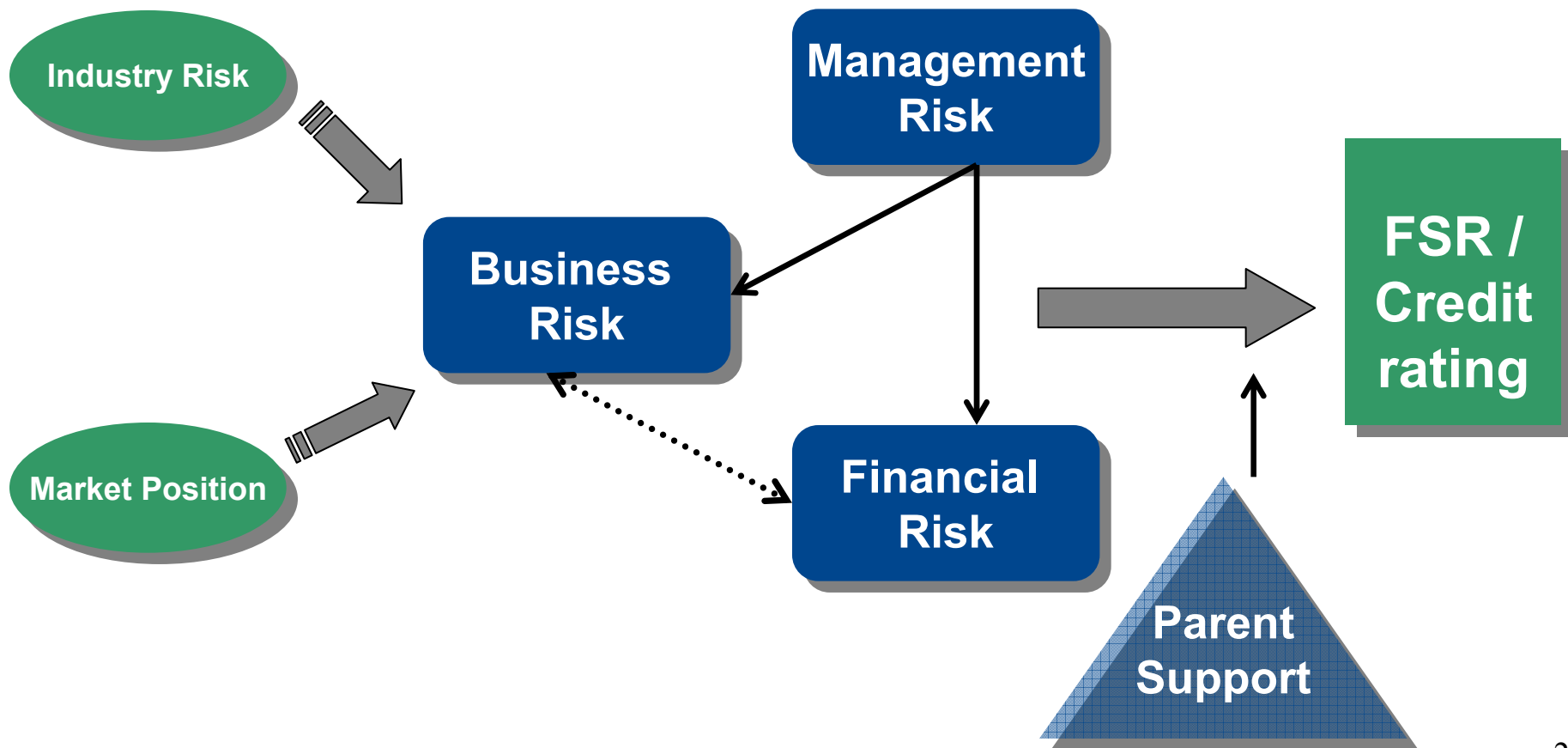
# CariCRIS Assessment Framework for Banks & Finance Entities



← Risk Categories →

Capital Adequacy	Resources	Asset Quality	Management	Earnings	Liquidity/ALM
Existing level, sustainability	Stability and size of deposit base	Asset composition	Integrity	Level	System support – access to call money markets
Quality (Tier 1)	Retail penetration	Client profile for corporate assets	Goals and strategies	Diversity of income sources	Growth rate in deposits
Capital Coverage for NPAs	Forex resource raising ability	Quality of lending	Systems – risk management	Composition of revenue streams	Stability of deposit base
Size	Growth in deposits	NPA levels / slippage to NPA	Risk appetite	Stability in earnings – core fee based income	Asset Liability Management
Flexibility	All-in-cost of raising resources	Estimate of weak assets	Stability and pro-activeness of top management	Operational expense levels	Interest rate risk
Growth plans	Diversity	Movement of provisions, write-offs	Motivation of staff		

# Assessment Framework for Insurance companies



# Types of Insurance Company Ratings



- Both Financial Strength Ratings and Debt ratings can be done
- FSR – indicates the company’s ability to meet all its policyholder obligations
  - Does not indicate timeliness of payment or likelihood of use of defense such as fraud to deny claims
  - For global insurance companies, any forex restrictions not factored in
- Debt ratings – emphasis on extent of debt, maturity profile, financial flexibility to meet maturing debt obligations

# CariCRIS Assessment Framework for Insurance companies



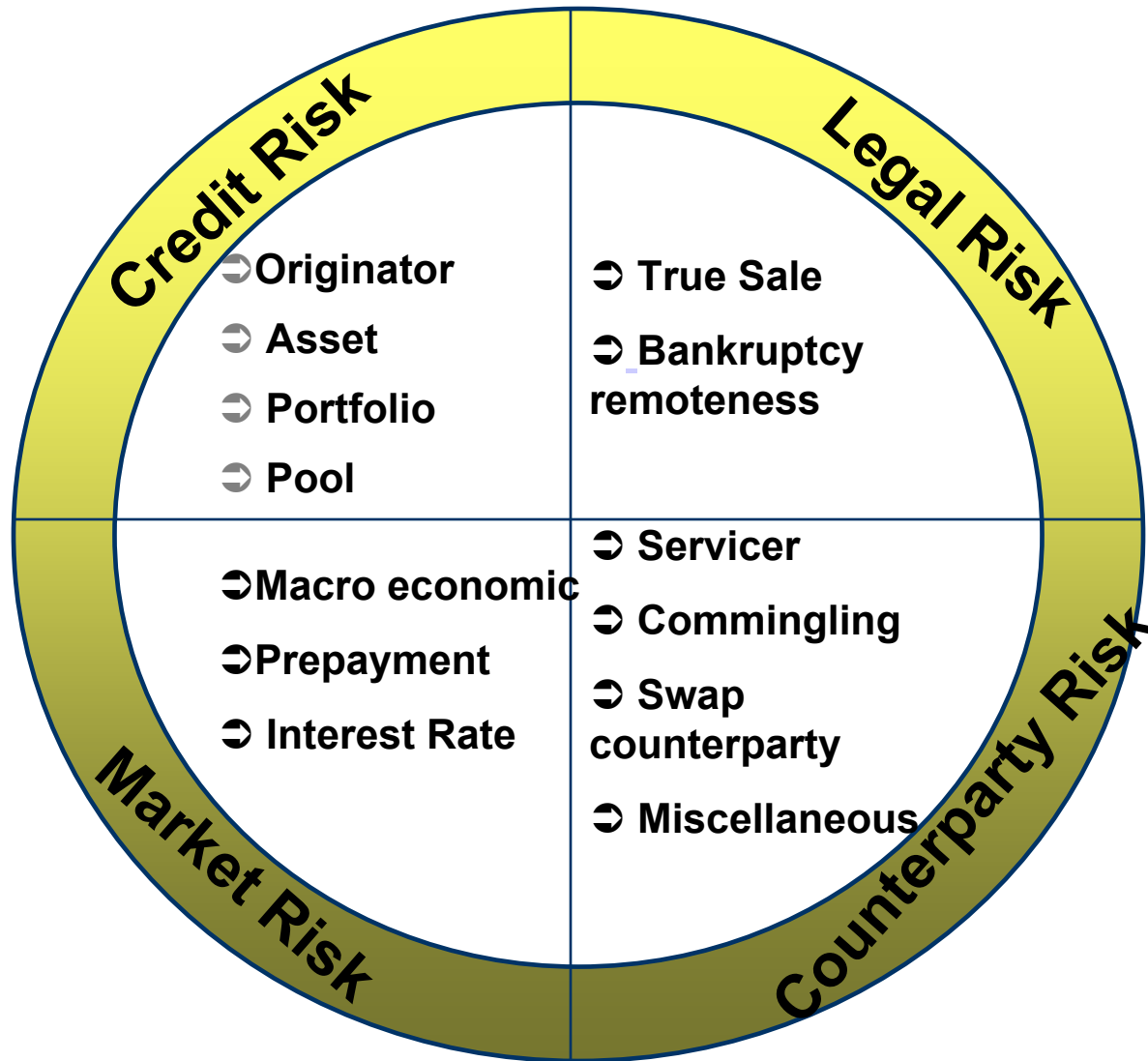
## Risk Categories

INDUSTRY RISK	MARKET POSITION	FINANCIAL RISK	MANAGEMENT RISK	PARENT SUPPORT
Industry characteristics	Business mix (Life Vs Annuities, P&C Vs Others)	Capitalisation	Management competence	Economic rationale for support
Extent of penetration	Pricing philosophy and pricing power	Expense & Claims ratios	Risk appetite	Moral obligation
Growth prospects	Underwriting policy	Reinsurance	Management integrity	Parent's credit quality
Regulatory framework	Distribution channels	Profitability		
Investment guidelines	Reinsurance philosophy	Reserve strength		
Pricing freedom	Asset quality / Asset management	Liquidity		
Availability of past data	Technology & Risk management	Financial flexibility		

- Analytical framework for analysing short-term debt is similar to the framework for long-term debt
  - More emphasis on ability to generate cash to meet short term obligations
- Separate scale used by all rating agencies
- Linkage normally between ST and LT ratings
  - Typically ST instruments are rolled over (refinanced) and ability to refinance on an ongoing basis is typically linked to the long-term rating

- Credit analysis of short-term debt involves two additional aspects
  - Quantum of short term debt that can be supported
    - Higher proportion of ST debt increases the risk
    - Free (unencumbered) cash flow considered which will be available to pay short term debt in case refinance not available
  - Liquidity back-up to support the short-term obligations (e.g. unutilised bank line of credit)
    - Provide the necessary support to withstand short-term disruptions in market
    - Highly confidence sensitive

# Securitisations - Analytical Framework



# CariCRIS Rating Scales



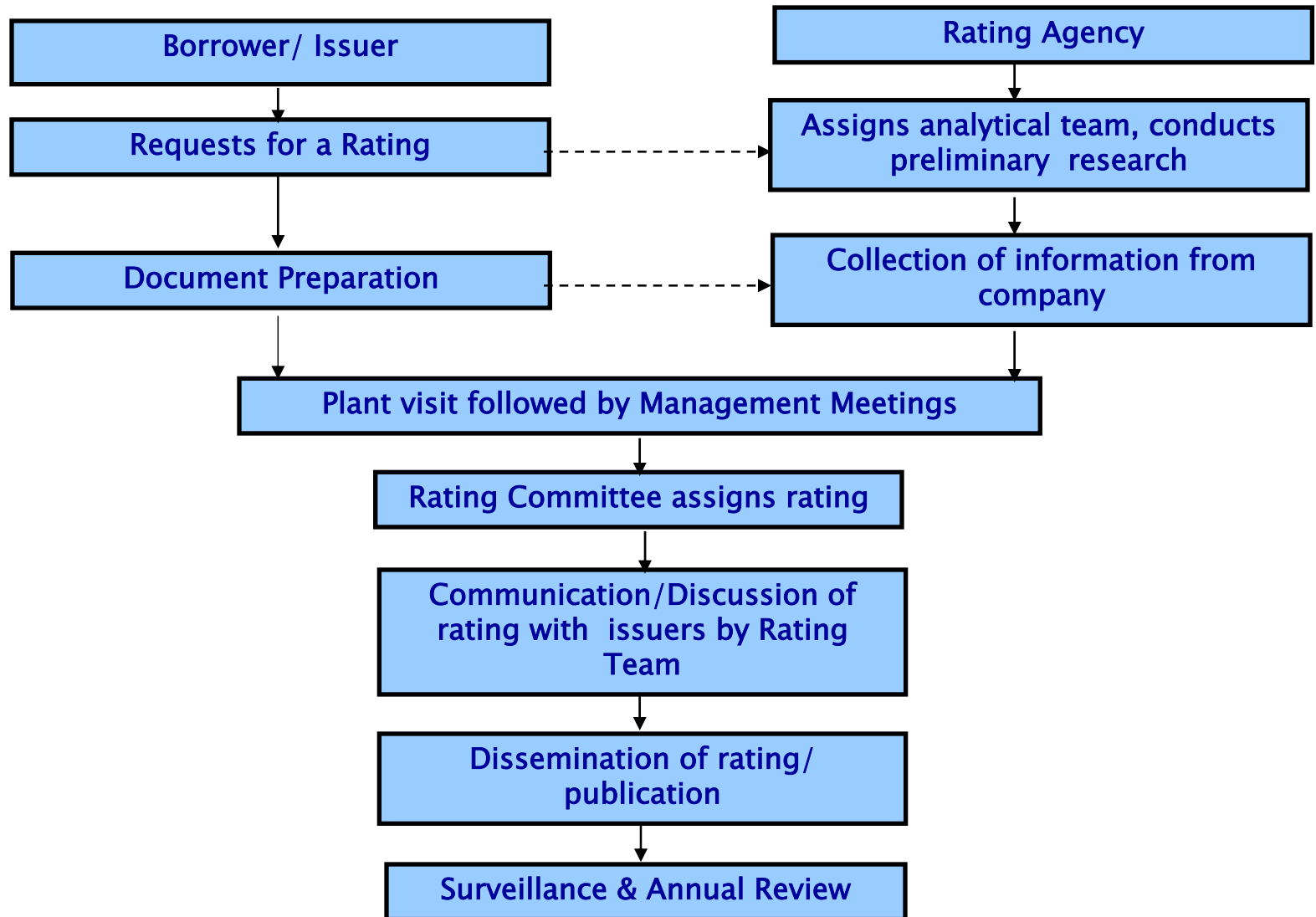
## Long Term Rating Scale

Regional	National	Definition
<i>CariAAA</i>	**AAA	Highest
<i>CariAA (+/-)</i>	**AA (+/-)	High
<i>CariA (+/-)</i>	**A (+/-)	Above Average
<i>CariBBB (+/-)</i>	**BBB (+/-)	Average
<i>CariBB (+/-)</i>	**BB (+/-)	Below Average
<i>CariB (+/-)</i>	**B (+/-)	Weak
<i>CariC(+/-)</i>	**C(+/-)	Poor
<i>CariD</i>	**D	Default

## Short Term Rating Scale

Regional	National	Definition
<i>CariP1 / P1+</i>	**P1 / P1+	Highest
<i>CariP2 / P2+</i>	**P2 / P2+	High
<i>CariP3 / P3+</i>	**P3 / P3+	Average
<i>CariP4</i>	**P4	Below Average
<i>CariP5</i>	**P5	Default

# CariCRIS Rating Process



# Requirements & Cost



- Information requested in advance
  - Last 5 years' Annual Reports & Audited Financial Statements
  - Financial Projections for next 3 years
  - Details of the instrument to be rated
- Maximum of 3 days of meetings with Senior Management
  - Individual meetings to minimise disruption
- Entire process completed in 4-6 weeks
- Cost
  - Initial Rating Fee: 10 bps (0.1%)
  - Annual Surveillance Fee: 5 bps (0.05%)

# Benefits of a CariCRIS rating



## **Investors**

- Eases risk identification and diversification
- Risk based pricing of Investments
- Greater depth of research, being locally based

## **Issuers**

- A proactive step towards transparency
- An independent, unbiased assessment
- Enhances credibility & acceptability
- Increases access to funding
- Encourages financial discipline

## **Regulatory authorities**

- Investor protection
- Market discipline

## **Intermediaries**

- Fixing coupon rates
- A second opinion

# CariCRIS' Independent Bond Valuation Service



- Need for uniform valuation standards
- Valuation of illiquid regional fixed income securities
  - Attempt at standardising methodology
  - TT\$, BB\$, JM\$, EC\$, US\$
  - Yield curves constructed for each currency and updated regularly
  - Interest rate risk captured through modified duration & credit risk through credit rating
  - Liquidity risk also catered for
  - Comprehensive fixed income report
  - Stress testing of portfolios
  - Already being utilised by Mutual Funds co. in Barbados

**THANK YOU**

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