Ratings Methodology - Fund Credit Quality

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Overview

CARE Ratings South Africa (Pty) Limited (CARE SA) fund Credit Quality Rating (CQR) is an opinion on the overall credit quality of a debt mutual 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?

- CARE SA 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

CARE SA 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. CARE SA uses the concept of credit scores assigned to individual securities, as per credit scoring matrix developed by it.

CARE SA 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 CARE SA 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. CARE SA has derived separate credit scoring matrix for its long-term and short-term rating scales.

CARE SA 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, CARE SA would typically analyse the latest 3 months' portfolio to arrive at the credit score based on the credit score of the scheme for each of these 3 months. For schemes that are yet to be launched, CARE SA 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 CARE SA -assigned ratings wherever such ratings are outstanding. In case of securities not rated by CARE SA, the lowest rating assigned by other credit rating agencies (CRAs) is used as a guide. Subsequently, if CARE SA 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, CARE SA 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, CARE SA will stress the portfolio score by considering appropriately notched down rating for such securities.

Concentration factor

CARE SA shall factor in concentration risks in line with the regulator-defined thresholds for debt mutual 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

CARE SA reviews the rating of mutual fund scheme on an on-going basis to support its published rating opinions. As such, portfolio of the fund is reviewed on monthly 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, CARE SA 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, CARE SA would consider revising the rating. Further, if CARE SA 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.

CARE SA 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 CARE SA will assign the downgraded rating on the entire par value of such exposures in the latest portfolio while calculating the overall credit score. CARE SA 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, CARE SA 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 Us:

CARE Ratings South Africa (Pty) Limited (CareEdge South Africa) is incorporated in 2023 to provide credit ratings and related services in South Africa. CARE SA is a wholly owned subsidiary of CARE Ratings Africa (Private) Limited (CareEdge Africa), which is a part of CareEdge Group based in India. In October 2024, CareEdge South Africa has received its license from the Financial Sector Conduct Authority (FSCA) of South Africa. CARE SA provides Ratings of various instruments such as Bonds, Money Market Instruments, Bank Deposits, Structured Finance and Bank Facilities. CareEdge South Africa also does Issuer Rating (Banks, Corporates, NBDTIs & Insurance companies). Please visit CareEdge South Africa website - https://www.careedgesouthafrica.com.

About CareEdge Group

CARE Ratings Ltd. (CareEdge Ratings)

CareEdge Ratings, based out of India and the parent company of the CareEdge group, was incorporated in 1993 and is the one of the largest Credit Rating Agency (CRA) of India and features amongst the top ten credit rating agencies globally. Since inception, CareEdge Ratings has rated USD 2.5 trillion worth of debt and has undertaken over 95,000 rating assignments which includes ratings of large, mid and small corporates as also sub sovereign and state utility companies. Please visit CareEdge website - https://www.careratings.com.

CARE Ratings (Africa) Private Limited

In the quest of supporting the development of capital market in African Union, CareEdge Group has set up the first rating agency of Mauritius - CARE Ratings (Africa) Private Limited (CareEdge Africa) in 2014, which is licensed by Financial Services Commission of Mauritius and Capital Markets Authority of Kenya. CareEdge Africa is also recognised by the Bank of Mauritius as External Credit Assessment Institution (ECAI). CareEdge Africa's shareholders are CARE Ratings, India (CARE Ratings), African Development Bank (AfDB), MCB Equity Fund (MEF) and SBM (NFC) Holdings Limited (SNHL). Please visit CARE Ratings Africa website - https://www.careratingsafrica.com.