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UNIT 15 & 16

CREDIT RATING IN INDIA

In Indian context the scope of credit rating is limited generally to debt, commercial paper, fixed deposits and of late mutual funds as well. So it's the instrument which is rating and not the company. The issuer company gets strength and credibility with the grade of rating awarded to the credit instrument it intends to issue to public for raising funds. Rating, in a way, reflects upon the issuers strength and soundness of operations, management, organization behavior and expresses a view on its prospective composite performance and also the organisational behavior based on the study of past results.

Further the rating will differ for different instruments to be issued by the same company with in the same times span. For example credit rating for debenture issue will differ to that of commercial paper or certificate of deposit for the same company because of nature of obligation is different in each case.

FUNCTION OF CREDIT RATING AGENCY

Credit rating serves the following functions:

- (1) Provides superior Information
- (2) Low cost information
- (3) Basis for a proper risk and return
- (4) Healthy discipline on corporate borrowers
- (5) Greater credence to financial and other representation
- (6) Formation of public policy

BENEFITS OF CREDIT RATING

For different class of persons different benefits accrue from use of rated instruments. Such benefits directly accruing to investors through rated instruments are:

(A) BENEFITS TO INVESTORS

- (1) Safeguards against bankruptcy
- (2) Recognition of risk
- (3) Credibility of issuer
- (4) Easy understandability of investment proposal
- (5) Saving of resources
- (6) Independence of investment decisions
- (7) Choice of investments
- (8) Benefits of rating surveillance

(B) BENEFITS OF RATING TO COMPANY

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Company which had its credit instrument or security rated by a credit rating agency is benefited in many ways as summarized below:

- (1) Lower cost of borrowing
- (2) Wider audience for borrowing
- (3) Rating as marketing tool
- (4) Reduction of cost in public issues
- (5) Motivation for growth
- (6) Unknown issuer
- (7) Benefits to brokers and financial intermediaries

DISADVANTAGES OF CREDIT RATING

- (1) Biased rating and misrepresentations
- (2) Static study
- (3) Concealment of material information
- (4) Rating is no guarantee for soundness of company
- (5) Human bias
- (6) Reflection to temporary adverse conditions
- (7) Down grade
- (8) Difference in rating of two agencies

TYPES OF RATING

Following are the different kinds of rating:

- (1) Bond/debenture rating
- (2) Equity rating
- (3) Preference share rating
- (4) Commercial paper rating
- (5) Fixed deposits rating
- (6) Borrowers rating
- (7) Individuals rating
- (8) Structured obligation
- (9) Sovereign rating

CREDIT RATING AGENCIES IN INDIA

CREDIT RATING INFORMATION SERVICES OF INDIA LIMITED

CRISIL has been promoted by Industrial Credit and Investment Corporation of India Ltd. (ICICI) and Unit Trust of India Ltd. (UTI) as a public limited company with its *headquarters at Mumbai*. CRISIL incorporated in 1987, pioneered the concept of credit rating in India and developed the methodology for rating of debt in the context of India's financial monetary and regulatory system. *It was the first rating agency to rate Commercial Paper Programme in 1989, debt instruments of financial institutions and banks in 1992 and asset-backed securities in 1992.*

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The main objective of CRISIL has been to rate debt obligation companies. Its rating provides a guide to the investors as to the risk of timely payment of interest and principal on a particular debt instrument. It had also envisaged to cover under credit rating all securities viz., fixed deposits, commercial papers, equity and preference shares and real estate project. Of late CRISIL has rated two mutual funds of two finance companies viz Cholomandalam assets management company and J.M. finance's assets management company.

CRISIL'S RATING PROCESS

CRISIL'S ratings processes in as given below:

- (1) **Request of the company:** The rating process beings at the request of a company desirous of having its issue obligations under proposed instrument rated by CRISIL.
- (2) **Assignment to analytical team:** On receipt of the above request CRISIL assigns the job to an analytical team that will be responsible for carrying out the rating assignment
- (3) **Obtaining and processing of data:** The analytical team which generally contains two experts, obtain requisite information from the client company and analyses the same. To obtain clarification and better understanding of the client's operations the team meets and interacts with company's executives.
- (4) **Findings presentation:** The findings of the team comprises of investigation process are presented to Rating committee (which comprises some directors not connected with any CRISIL shareholders) which then decides on the rating.
- (5) **Communication of decision:** The decision of the rating committee is communicated to the client company with remarks that the company if it so likes may present some additional information for reconsideration of rating grade assigned to tis instrument. In case the company has nothing to produce as additional fact the rating grade is formally confirmed to the company by CRISIL.
- (6) **Monitoring of change of rating:** Once the company has decides to use rating CRISIL is obliged to monitor the rating over the life of the instrument. Depending upon new information or developments concerning the company, CRISIL may change the rating. Any change so effected is made public by CRISIL.

CRISIL'S RATING METHODOLOGY

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CRISIL analyses five factors while assessing the instrument. These five factors are as follows:

- (1) Business analysis
 - (a) Industrial risk
 - (b) Market position of the company within the industry
 - (c) Operating efficiency
 - (d) Legal position
- (2) Financial analysis
- (3) Management evaluation
- (4) Regulatory and competitive environment
- (5) Fundamental analysis

RATING SYMBOLS

CRISIL assigns ratings only to rupee denominated debt instruments. Instruments which have the same rating are of similar but not identical investment quality. This is because the number of rating categories is limited and hence cannot reflect small differences in the degree of risks.

For preference shares the letter “pf” are prefixed to the debenture rating symbols. The fixed deposit rating symbols commence with “F” and the short term instruments use the letter “P” from the concept of ‘Prime.’

The term debentures includes all securities with an original maturity of more than one year. The term short-term instruments refers to securities with an original maturity of up to one year.

CRISIL RATING SYMBOLS FOR DEBETURES

High Investment Grades

AAA (Triple A)* Highest Safety

AA (Double A)* High safety

Investment Grades

A* Adequate safety

BBB (Triple B)* Moderate safety

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BB (double B)* Inadequate Safety

B* Higher Risk

C * Substantial Risk

D* Default

N.M * Not Meaningful

CRISIL RATING SYMBOLS FOR FIXED DEBENTURES

Investment Grades

FAAA (F triple A) * Highest safety

FAA (F Double A)* High Safety

FA * Adequate Safety

Speculative Grades

FB * Inadequate Safety

FC* Higher Risk

FD* Default

N.M* Not Meaningful

CRISIL RATING SYMBOLS FOR TERM INSTRUMENT

P-1- this rating indicates that the degree of safety regarding timely payment on the instrument *is very strong*.

P-2- This rating indicates that the degree of safety regarding timely payment on the instrument *is strong*; however the relative degree of safety is lower than that for instruments rated P-1.

P-3- This rating indicates that the degree of safety regarding timely payment on the instrument *is adequate*; however the instrument is more vulnerable to the adverse effects of changing circumstances than an instrument rated in the two higher categories.

P-4- This rating indicates that the degree of safety regarding timely payment on the instrument *is minimal* and it is likely to be adversely affected by short term adversity or less favourable conditions.

P-5-This rating indicates that the instrument is expected to be in default on maturity or is in *default*.

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N.M* Not Meaningful- Instruments rated NM are in default or are expected to default on maturity or are *vulnerable to default*. Such instruments have factors present in them, which render the rating outstanding meaningless. Such instruments are extremely speculative and returns from these instruments may be realized only on reorganisation or liquidation.

High Investment Grades

AAA (so) (Triple A s o) * Highest Safety

AA (so) (Double A s o)* Higher Safety

Investment Grades

A (so)* adequate Safety

BBB (so) (Triple B s o)* Moderate Safety

Investment Grades

BB (so) (Double B s o)* Inadequate safety

B(so)* High Risk

C (so) * Substantial Risk

D(so)* Default

INVESTMENT INFORMATION AND CREDIT RATING AGENCY

ICRA Ltd. (formerly Investment Information and Credit Rating Agency of India Ltd). ICRA has been promoted by Industrial Finance Corporation of India as its main promoter with its *headquarters at New Delhi*. It is an independent company limited by shares with an authorized share capital of Rs. 10 crore against which Rs. 5 crore is paid up. IFCI has contributed by UTI, LIC, GIC, PNB, Central Bank of India, Bank of Baroda, UCO Bank etc.

ICRA was established to provide: Information and guidance to institutional and individual investors and creditors; enhance the ability of borrower/issuers to access the money market and the capital market for tapping a large volume of resources from a wider range of investing public; assists the regulators in promoting the transparency in the financial markets; or, finally, the intermediaries with a tool to improve efficiency in the funds raising process.

The range of services offered include

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Rating service : As an early in the credit rating business, ICRA is one of the most experienced credit rating agencies in India today. *ICRA rates rupee denominated debt instruments issued by manufacturing companies, commercial banks, non banking finance companies, financial institutions, public sector undertaking and municipalities among others.* The obligation include long term instruments such as bonds and debentures, medium terms instruments such as fixed deposit programmes and short term instruments such as commercial papers and certificate of deposit. ICRA also rates structured obligations and sector specific debt obligations such as instruments issued by Power, Telecom and infrastructure companies. Other service include credit assessment of large, medium and small scale units for obtaining specific lines of assistance from commercial banks financial institutions and financial service companies.

Information service: The information service group focuses on providing authentic data and value added products used by intermediaries, financial institutions, banks, asset managers, institutional and individual investors and others. Value added services include ICRA's pioneering concept of Equity Grading providing a critical input on a company's earning prospects of equity investors. Other products include corporate reports, equity assessment, mandate based studies and sector/industry specific publications.

Advisory Services: Advisory Services Division offers wide ranging management advisory services which include strategic counseling, restructuring solutions, client specific need based studies in the banking and financial service, corporate and other core sector.

RATING METHODOLOGY

ICRA considers all relevant factors that have a bearing on the future cash generation of the issuers. These factors include: industry characteristics, competitive position of the issuer, operational efficiency, management quality, commitment to new projects and other associate companies and finding policies of the issuer. A detailed analysis of the past financial statements is made to assess the performance under the real world business dynamics. Estimates of future earnings under various scenarios are drawn and evaluated against the claims and obligations that require servicing over the tenure of the instrument being rated. Primarily, it is relative comfort level of the issuer to service obligations that determine the rating. *Key areas considered in a rating analysis includes the following:*

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- (1) **Business risk:** Industry characteristics, performance and outlook, operating position (capacity, market share, distribution system, marketing networks, etc) technological aspects, business cycle, size and capital intensity.
- (2) **Financial risk:** Financial management (capital structure, liquidity position, financial flexibility and cash flow adequacy, profitability, leverage, interest coverage) projection, with particular emphasis on the components of cash flow and claims there on, accounting policies and practices, with particular reference to practices of providing for depreciation, income recognition, inventory valuation, off balance sheet liabilities and claims, amortization of intangible assets, foreign currency transactions etc. are seen and evaluated.
- (3) **Management assessment:** Background and history of issuer, corporate strategy and philosophy, organizational structure, quality of management, capability under stress, personnel policies including succession planning.
- (4) **Environment analysis:** Regulatory environment, operating environment, national economic outlook, areas of special significance to the company, pending litigation, tax status, possibility of default risk under a variety of future scenarios.

ICRA'S RATING PROCESS

The rating process follows:

- (a) **Rating request :** Rating is initiated by a formal request (or mandate) from the prospective issuer. This mandate spells out the terms of the rating assignment. Important issues that are covered include: building the credit rating agency to maintain confidentiality, the right to the issuer to accept or not to accept the rating and issuer to provide information required by the credit rating agency for rating and subsequent surveillance.
- (b) **Rating team:** The team usually comprises two members. The composition of the terms is based on the expertise and skills required for evaluating the business of the issuer
- (c) **Information requirements:** Issuers are provided a list of information requirements and the broad framework for discussions. These requirements are derived from the experience of the issuers business and broadly conforms to all the aspects which have a bearing on the rating.
- (d) **Secondary information:** ICRA also draws on the secondary source of information including its own research division. The credit rating agency also has a panel of industry experts

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who provide guidance on specific issues to the rating team. The secondary sources generally provide data and trends including policies about the industry;

(e) Management meeting and plant visits: Rating involves assessment of number of qualitative factors with a view to estimate the future earnings of the issuer. This requires intensive interactions with issuers' management specifically relating plans, future outlook, competitive position and funding policies. Plants visits facilitate understanding of the production process, assess the state of equipment and main facilities, evaluate the quality of technical personnel and form an opinion on the key variables that influence level quality and cost of production. These visits also help in assessing the progress of project under implementation;

(f) Preview meeting: After completing the analysis the findings are discussed at length in the internal committee comprising senior analysts of the credit rating agency. All the issue having a bearing on the rating are identified. At the stage an opinion on the rating is also formed.

(g) Rating committee meeting: This is the final authority for assigning ratings. A brief presentation about the issuers business and the management is made by the rating team. All the issues identified during discussions in the internal committee are discussed. The rating committee also considers the recommendation of the internal committee for the rating. Finally a rating is assigned and all the issues which influence the rating are clearly spelt out;

(h) Rating communication: The assigned rating along with the key issue is communicated to the issuer's top management for acceptance. The rating which are not accepted are either rejected or reviewed. The rejected rating are not disclosed and complete confidentiality is maintained.

(i) Rating reviews: If the rating is not acceptable to the issuer, he has a right to appeal for a review of the rating. These review are usually taken up only if the issuer provides fresh inputs on the issue that were considered for assigning the rating. Issuers response is presented of the Rating Committee. If the inputs are convincing the Committee can revise the initial rating decision

(j) Surveillance: It is obligatory on the part of the credit rating agency to monitor the accepted rating over the tenure of the rated instruments. The issuer is bound by the mandate letter to provide information to the credit rating agency. The ratings generally reviewed every year, unless the circumstances of the case warrants an early review. In a surveillance review the initial rating could be retained or revised (upgrade or downgrade).

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ICRA's Long-Term Debt Fund Credit Risk Rating Scale

This scale is used to rate the underlying credit risk of debt funds portfolio on the long term rating scale.

mf AAA = The higher-credit-quality rating assigned by ICRA to debt funds.

mf AA = The high-credit-quality rating assigned by ICRA to debt funds.

mf A = The adequate-credit-quality rating assigned by ICRA to debt funds.

mf BBB = The moderate-credit-quality rating assigned by ICRA to debt funds.

mf BB = The adequate-credit-quality rating assigned by ICRA to debt funds.

mf B = The risk-prone-credit-quality rating assigned by ICRA to debt funds.

mf C = The poor-credit-quality rating assigned by ICRA to debt funds.

mf D = The lowest- credit-quality rating assigned by ICRA to debt funds.

mf D = The lowest- credit-quality rating assigned by ICRA to debt funds.

ICRA's Short-Term debt fund Credit Risk Rating Scale

This scale applies to debt funds with weighted average maturity up to one year. Such funds would generally include liquid funds and cash funds. Benchmark maturity for this scale is 12 months.

mf A1 = The highest-credit-quality short-term rating assigned by ICRA to debt funds.

mf A2 = The above-credit-quality short-term rating assigned by ICRA to debt funds.

mf A3 = The moderate-credit-quality short-term rating assigned by ICRA to debt funds.

mf A4 = The risk-prone-credit-quality short-term rating assigned by ICRA to debt funds.

mf A5 = The lowest-credit-quality short-term rating assigned by ICRA to debt funds

CARE

CARE is a rating and information service company promoted by IDBI jointly with investment institutions, banks and finance companies. The company commenced its operations in October 1993 and announced its first rating in 1933. Service offered by CARE are:

(1) Credit rating: CARE undertakes credit rating of all types of debt instruments both short-term and long-term. Credit rating is an opinion on the relative ability and willingness of an issuer to make timely payments on specific debt or relative obligations over the life of the instrument.

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(2) Information services: The broad objective of the Information Service will be to make available information on any company local body industry or sector required by a business enterprise. Value addition through incisive analysis will enable the users of the service like individual mutual funds investment companies CARE also prepares credit reports on companies for the benefit of banks and business counterparts.

(3) Equity research: Another major activity of CARE will be Equity Research. This will involve extensive study of the shares listed in the major stock exchanges and identification of the potential winners and losers among them on the basis of the fundamentals affecting the industry, economy, market share, management capabilities, international competitiveness and other relevant factors.

(4) Rating of parallel marketers of LPG and kerosene: CARE undertakes performance of parallel marketers of Liquefied Petroleum Gas (LPG) and Superior Kerosene Oil (SKO) as notified by Government of India.

CARE's Rating Process

The process involves: (i) Client gives request for rating and submits information and details schedules; (ii) CARE assigns team analyses the information; (iii) The team interacts with the clients, undertakes site visits; (iv) The client interact with the Team responded to queries raised and provides any additional data necessary for the analyses; (v) The team analyses the data submitted by the Client and put up to Internal committee of CARE for previews analyses; (vi) Rating committee of CARE awards rating to the Client (vii) Client may ask for review of the rating assigned and furnish additional information for the purpose. Client has the option not to accept the final rating in which CARE will not publish the rating or monitor it; and finally (viii) If the rating is accepted to the Client CARE gives it for notification and a periodic surveillance is undertaken by CARE.

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INVESTMENT MANAGEMENT

001. The sacrifice of certain present value for the uncertain future reward is referred to as
a) Investment b) Expenditure c) Liability d) All of these
002. Which of the following is correct?
a) Speculation is a short-run phenomenon
b) Speculation involves a higher level of risk and a more uncertain expectation of returns
c) The speculator takes action only when the probabilities are higher in his favour
d) all of these
003. A good investment plan should have
a) Safety b) Liquidity c) Capital growth d) All of these
004. Business risk is otherwise known as
a) Operating risk b) Financial risk c) Insurance risk d) None of these
005. Financial risk is created by the use of
a) Debentures b) Preference shares c) Equity shares d) both a) and b)
006. Business risk is concerned with
a) EBIT b) PAT c) Both a) and b) d) None of these
007. Financial risk is concerned with
a) Earnings before interest and tax b) Earnings available to equity share holders
c) Earnings available to debenture holders d) All of these
008. Investments are exposed to
a) Purchasing power risk b) Market risk c) Regulatory risk d) All of these
009. Which of the following statement is correct?
a) People make investment with a future end date in mind
b) A gamble is a very short-term investment in a game of chance
c) Speculation lasts longer than gambles but are briefer than investments
d) All of these
010. Any body of individuals whether incorporated or not constituted for the purpose of regulating or controlling the business of buying , selling or dealing in securities is called as
a) Stock Exchange b) Money market c) Buillion market d) None of these
011. Securities include
a) Shares b) Debentures stock c) Bonds d) All of these
012. At present there are ____ stock exchanges in India.
a) 23 b) 20 c) 24 d) 30

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013. Which of the following stock exchange has a nation wide trading?
a) OTCEI b) NSE c) ICSE d) All of these
014. The trading platform of a stock exchange is accessible only to
a) Brokers b) Companies c) Government d) All of these
015. Securitas Contracts (Regulation) Act was passed in
a) 1946 b) 1956 c) 1976 d) None of these
016. The Security Exchange Board of India Act was passed in
a) 1990 b) 1991 c) 1992 d) 1988
017. Which of the following legislations is not related with securities market?
**a) The SEBI Act, 1992 b) The Companies Act, 1956
c) The Securities Contracts (Regulations) Act, 1956 d) None of these**
018. SEBI has powers for
**a) Protecting the interest of investors in securities
b) Promoting the development of the securities market
c) Regulating the securities market d) All of these**
019. The responsibility of regulating the securities market in India lies in the hands of
**a) Department of Economic Affairs b) Department of Company Affairs
c) Reserve Bank of India and SEBI d) All of these**
020. Over the Counter Exchange of India (OTCEI) was established in
a) October 1990 b) November 1993 c) January 1990 d) April 1990
021. OTCEI has been promoted by
a) UTI b) ICICI c) IDBI d) All of these
022. The trading document of OTCEI will include
a) Counter Receipt b) Sales confirmation slip c) Both a) and b) d) None of these
023. National Stock Exchange of India was set up in
a) 1990 b) 1991 c) 1992 d) 1993
024. A member NSE is connected to central computer through
a) VSATS b) BSATS c) TSATS d) MSATS
025. The trading system at NSE is known as
a) RATE b) NEAT c) MEAT d) CATE
026. NEAT means
**a) National Exchange for Automated Trading
b) National Exchange and online Trading
c) Nation wise Electronic and Trading d) None of these**
027. The NSE commenced its operation in Wholesale Debt Market in
a) 1994 b) 1995 c) 1996 d) 2000

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- a) Credit rating provides investors with rating symbols which carry information in easily recognizable manner
 b) Credit rating provides a clue to the credibility of the issuer company
 c) Rating symbol can be understood by an investor which needs no analytical knowledge on his part
 d) All of these
043. Fixed deposits programmes are medium-term unsecured borrowings. Rating of such programme is called
 a) Debenture rating b) Rating of bond c) Fixed deposit rating d) None of these
044. Rating of debentures issued by corporate government etc.. is called
 a) Debenture rating b) Fixed rating c) Flexible rating d) All of these
045. Rating of equity shares issued by a company is called
 a) Flexible rating b) Variable rating c) Equity rating d) Equality rating
046. Rating of borrowers is called as
 a) Debentures rating b) Borrowers rating c) Lenders rating d) Man rating
047. Rating of individuals is called as
 a) Individual credit rating b) Firm credit rating c) Industry rating d) None of these
048. CRISIL is headquartered at
 a) Delhi b) Mumbai c) Pune d) Hyderabad
049. CRISIL was incorporated in
 a) 1987 b) 1977 c) 1982 d) 1992
050. CRISIL has promoted by
 a) ICICI b) UTI c) Both a) and b) d) RBI
051. CRISIL is a
 a) Public limited company b) Private limited company
 c) Statutory company d) None of these
052. The concept of credit rating was pioneered by
 a) CRISIL b) IFCI c) ICRA d) None of these
053. The first rating agency which rated commercial paper programme in 1989 was
 a) SFC b) CRISIL c) ICRA d) IFCI
054. CRISIL analyses _____ factor while assessing the instruments.
 a) Six b) five c) Seven d) Eight
055. CRISIL assigns ratings only to _____ denominated debt instruments.
 a) Dollar b) Rupee c) Yen d) Pound
056. The credit rating symbol 'AAA' (Triple A) of CRISIL refers to
 a) Highest safety b) High safety c) Adequate safety d) Moderate safety
057. The credit rating symbol 'AA' (Double A) of CRISIL refers to
 a) Highest safety b) High safety c) Adequate safety d) Moderate safety

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058. The credit rating symbol 'A' of CRISIL refers to
a) Adequate safety b) High safety c) Highest safety d) Moderate safety
059. The credit rating symbol 'BBB' (Triple B) of CRISIL refers to
a) Adequate safety b) Moderate safety c) Highest safety d) High safety
060. The credit rating symbol 'BB' (Double B) of CRISIL refers to
a) Default b) Moderate safety c) Inadequate safety d) Not meaningful

1 (a)	2 (d)	3 (d)	4 (a)	5 (d)	6 (a)	7 (b)	8 (d)	9 (d)	10 (a)
11 (d)	12 (a)	13 (d)	14 (a)	15 (b)	16 (c)	17 (d)	18 (d)	19 (d)	20 (a)
21 (d)	22 (c)	23 (d)	24 (a)	25 (b)	26 (a)	27 (a)	28 (d)	29 (a)	30 (b)
31 (d)	32 (d)	33 (b)	34 (d)	35 (a)	36 (a)	37 (d)	38 (b)	39 (a)	40 (a)

TO HAVE FULL STUDY MATERIAL

CONTACT

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