March 30, 2016

Special Report
Joint Seminar with India's CARE Ratings

Haruhiko Shiono, General Manager, Global Marketing and Sales, Relationship Management Department
Satoshi Nakagawa, Special Advisor to the President for Global Strategy & Special Representative for Asia

Japan Credit Rating Agency, Ltd. (JCR) and Credit Analysis and Research Ltd. (CARE Ratings), a leading credit rating agency (CRA) in India, signed a Memorandum of Understanding (MoU) in December 2015 to collaborate with each other as strategic business partners*1. Subsequently, in March 2016, the two rating agencies held a first joint seminar in Mumbai, India. In this seminar, their representatives explained the objective of this alliance by saying, "Through the cooperation between the two leading rating agencies in India and Japan, we would like to enhance our support for Indian and Japanese companies' fund raising in both countries with our ratings, thereby contributing to the consolidation of the two countries' economic and financial partnership." This report aims to explain the background and purpose of JCR's alliance with CARE Ratings, to make succinct introduction about CARE Ratings, and to share the outcome of the first joint seminar.

*1 http://www.jcr.co.jp/reportqa/pdfen/2015122910e.pdf

1 Fast growing Indian economy

India is a federal republic in South Asia with a population of nearly 1.3 billion. Its GDP per capita stands at just slightly above US$1,600, yet its total GDP exceeds US$2 trillion. Robust private consumption underpinned by the rising middle class has enabled the country to sustain domestic demand-led growth in recent years. In fiscal 2015 (between April 2015 and March 2016), it grew 7.6% in real GDP terms. India's CPI inflation once stayed over 10% year-on-year and the current account deficit widened close to 5% of GDP. However, its macroeconomic stability has recently improved markedly thanks to the lower oil prices and well calibrated monetary policy.

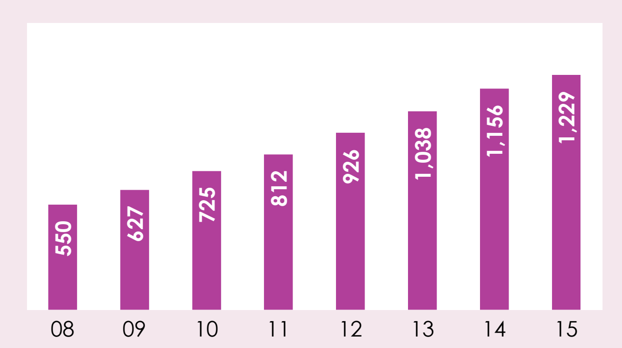
The Modi administration, since taking office in 2014, has been putting efforts to modernize its economic system through upgrading the infrastructure, propping up the manufacturing industry, enhancing the transparency of its financial and capital markets, promoting foreign direct investment, and improving the business climate. It is not easy to carry out such reforms in a large country like India with a population of nearly 1.3 billion and inheriting the legacy of vested interests and bureaucracy. Nevertheless, the current government is tackling the difficult challenges such as formation of the bankruptcy code, introduction of a nationwide Goods and Services Tax (GST), and consolidation of the banking system. Should such reforms bear fruit, India may have considerable potential to sustain a robust economic growth for a long time to come.

2 Japanese companies' interest and investment in India

India, embracing vast population and high growth, attracts strong interests by Japanese companies as well. In the "Survey Report on Overseas Business Operations by Japanese Manufacturing Companies" which the Japan Bank for International Cooperation (JBIC) conducts annually, India has been ranked No.1 as "the promising country for business development in the medium term" for two consecutive years in FY2014 and FY2015*2. As the reason, "future growth potential of local market" was cited most in the survey.

*2 https://www.jbic.go.jp/en/information/press/press-2015/1203-44407

Charts & Graph 1 Japanese companies in India



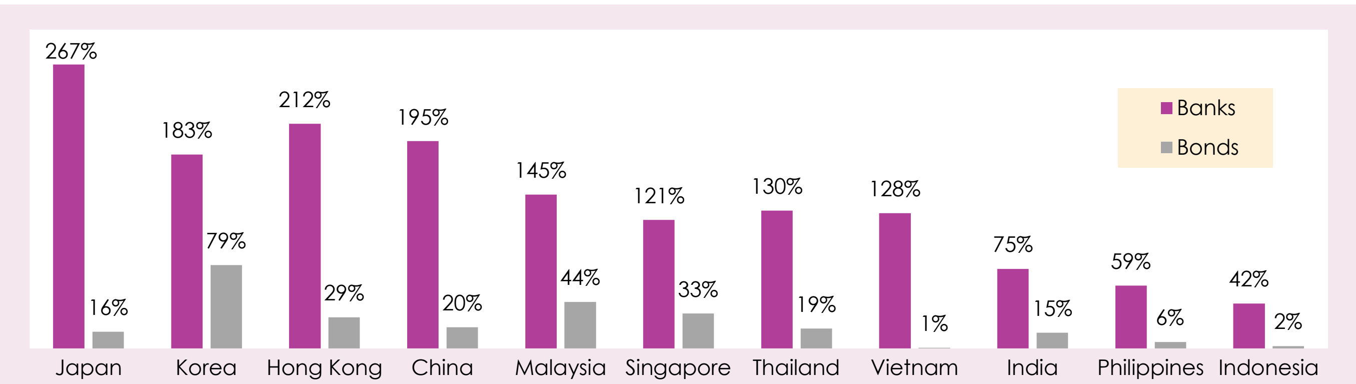
Source: Embassy of Japan in India

Against such background, the number of Japanese companies in India has been increasing steadily. According to the survey by the Embassy of Japan in India and Japan External Trade Organization (JETRO), it stood at 1,229 as of October 2015[*3]. Such number is yet small compared to the counterparts in East Asian and Southeast Asian countries according to the "Survey of Overseas Business Activities" undertaken every year by the Japanese Ministry of Economy, Trade and Industry. Perhaps, the challenges such as infrastructure shortage may have made it difficult for Japanese companies to position India in their manufacturing and distribution network they formed in East Asia and Southeast Asia. Today, most of the companies operating in India still appear to focus on its domestic market backed by enormous population. Potentially, India may be able to become an export base for third country markets such as the Middle East and Africa in light of some similarity in taste with Indian consumers. Unlocking such potential, however, may require significant improvement in business environment including infrastructure, on which the current administration's continuous efforts will remain critical.

3 Fund Raising Environment in India

What kind of challenges do Japanese companies in India face in raising funds? First, an overview is shown regarding the financial system in India. As of the end of March 2016, the outstanding balances of the banking system's credit to commercial sector[*4] and the corporate bonds[*5] stood at INR84 trillion (equivalent to 62% of GDP) and INR20 trillion (15%), respectively. A comparison of these numbers with the counterparts in East Asia may reveal that (i) The size of external financing in terms of the aggregated bank lending and corporate bonds is relatively small, (ii) Like the counterparts in East Asia, India also has a "bank-dominated financial system" where the bank borrowings outweigh the corporate bonds, and (iii) despite the limited degree of financial deepening, the corporate bond market has certain significance[*6]. Moreover, the Indian banking system may be characterized that: (a) The share of the public sector

Charts & Graph 2 Balance of Bank Borrowing and Corporate Bond (GDP%, End-2015)



Source: ADB・EIU

*3 http://www.in.emb-japan.go.jp/PDF/2016_j_cos_list_pr.pdf
*4 http://rbidocs.rbi.org.in/rdocs/Bulletin/DOCs/08T905F5B676052484E81DC0572F60E2772.XLS N.B. The bank lending in the graph is bigger as it includes that to the public sector.
*5 http://www.sebi.gov.in/cms/sebi_data/statistics/corporate_bonds/outstandingcorpdata.html
*6 The list of issuers is available on the website of the Securities and Exchange Board of India (SEBI): http://www.sebi.gov.in/cms/sebi_data/statistics/corporate_bonds/publicissuedata.html

banks in terms of asset size amounts to 70% of the total banking system, (b) Those public sector banks are confronted with a problem of high non-performing loan ratio that stands as high as 9-17%, and (c) The banking system is rigorously regulated, supervised and controlled by the Reserve Bank of India, the country's central bank.

Such strict control by the authorities is also affecting Japanese companies' fund-raising activities directly. For example, in India, a minimum lending rate is set for the local currency borrowing, which pushes up the borrowing rate to above 10% per anum. Besides, strict External Commercial Borrowing (ECB) regulations are in place for the borrowings from overseas even including those from parent companies. According to the on-site hearing by JCR, foreign companies in India normally borrow in the local currency (i.e. Indian Rupee) for short-term working capital and in foreign currencies from parent companies or foreign banks (including Japanese banks) for long-term capital investment. In addition, recently, larger companies have more actively resorting to issuing commercial papers (CP) and corporate bonds so as to eschew banks' intermediary cost and the interest rate regulations on banks.

4 Mandatory Rating Requirement in India

As one of the challenges in local fund raising, mandatory rating requirements stand in India. The Securities and Exchange Board of India (SEBI) requires a credit rating from a local CRA in case the debt security is listed on the Indian Stock Exchange for both public and private issuances. Moreover, the Reserve Bank of India obligates to solicit a credit rating from a local CRA when borrowing from banks for more than INR 100 mil for the purpose of risk weight calculation under BASEL II guidelines. These regulations are applied to foreign companies including Japanese as well.

Among all the local CRAs which both SEBI and the RBI authorize, India's three largest rating agencies in light of the history, the number of ratings and rating coverage may be CARE Ratings, CRISIL and ICRA. The majority shares of CRISIL and ICRA are actually held by the US' McGraw Hill Financial Inc., a parent company of S&P, and the Moody's, respectively. Therefore, CARE Ratings stands out as an independent local CRA in India.

5 About CARE Ratings

CARE Ratings was established in 1993 by a group of Indian financial institutions. It is headquartered in Mumbai and has 10 branches throughout India. The current major shareholders are: Life Insurance Corporation of India (Shareholding ratio: 9.94%), Canara Bank (9.90%), IDBI Bank Ltd (6.21%), State Bank of India (4.69%), etc. It has a rating coverage across diverse range of instruments and industries, whose sectorial expertise extends to Banks, NBFCs, Industrial Sector, Service Sector, Public Finance, SMEs, Micro Finance, Securitization and Structured Finance, among others. The number of rated entities stood at 11,450 as of 31 March 2016. It has especially a wide coverage for large companies, having the highest market share among the companies listed in ET-500 (54%), BS 1000 (46%) and FE 500 (52%). Furthermore, CARE Ratings is one of the founding members of the Association of Credit Rating Agencies in Asia (ACRAA), together with JCR. Mr D.R. Dogra, Managing Director & CEO of CARE Ratings, sits on ACRAA's board.

6 Alliance between JCR and CARE Ratings

JCR signed a Memorandum of Understanding with CARE Ratings in December 2015. It is aimed to strengthen the economic and financial partnership between India and Japan through qualitative and quantitative enhancement of information and analyses. In particular, through the cooperation with CARE Ratings, JCR intends to (i) consolidate its support to Japanese companies that raise funds in India and (ii) boost the provision of information to Japanese investors to enable more and more Indian entities to raise funds in Japan.

To achieve the former objective, JCR stands ready to introduce CARE Ratings to those Japanese companies that need a local rating in India and explain JCR's views and perspectives on such Japanese companies to CARE Ratings so that the context particular to Japan can also be factored in when CARE Ratings assigns a rating to Japanese companies. Given that CARE Ratings is the only major independent rating agency in India, it may be able to assign ratings not affected by the level of the ratings assigned by the US rating agencies. With JCR's explanation, it is expected that the ratings could be assigned from a more objective viewpoint taking into account the circumstances particular to Japan.

Moreover, JCR plans to provide Japanese companies, through joint seminars and reports, with the latest update of India's economic, financial and industrial development as well as regulatory frameworks with the local rating agency who knows the local situation more than anyone. In the next joint seminar planned in Tokyo, representatives from CARE Ratings will explain the background and prospects of India's banking sector that is in the midst of non-performing loan problem, as well as state owned enterprises as the government's privatization program is taking shape.

On the latter front, by having CARE Ratings as one of the important local information sources, JCR aims to enhance the quality and quantity of information provision on India. Under the negative interest rate environment, Japanese institutional investors and banks seem to be increasingly interested in foreign bonds and cross-border lending. As the leading credit rating agency in Japan, JCR would like to support such effort of portfolio diversification by Japanese institutional investors and financial institutions and invigoration of Tokyo market. For that purpose, JCR is willing to enhance its provision of information and analyses by fully utilizing the network it has built with local CRAs.

7 First Joint Seminar in Mumbai

In this section, we would like to introduce the gist of our first joint seminar with CARE Ratings. It was held in a ball room in a hotel in Mumbai, India, and participated by the audience from India's local companies, institutional investors, arrangers and media.

In the seminar, at the outset, a brief explanation was made on the CARE-JCR alliance by Mr D. R. Dogra, Managing Director & CEO of CARE Ratings. Subsequently, presentations were made on CARE Ratings, JCR and the Japanese financial markets by the representatives of the two rating agencies.

After those presentations by the organizers, two speeches were delivered from the perspective of promoting India-Japan partnerships, namely one from

Mr Arun Saha, Joint Managing Director & CEO of Infrastructure Leasing & Financial Services Limited (IL&FS), and the other from Dr. Tirthankar Patnaik, Chief Strategist & Head of Research, Mumbai Brach, Mizuho Bank. They kindly shared their views regarding how beneficial and how big potential is to exploit India-Japan partnerships. In the last session, a number of questions were posed by the audience that included the interests and risk tolerance of Japanese investors to India and concrete ideas of CARE-JCR alliance. The seminar ended successfully with a networking reception. JCR plans to organize the joint seminars with CARE Ratings regularly, both in India and Japan, so as to maximize the benefit of this strategic alliance.

Japan Credit Rating Agency, Ltd.
Jiji Press Building, 5-15-8 Ginza, Chuo-ku, Tokyo 104-0061, Japan
Tel. +81 3 3544 7013, Fax. +81 3 3544 7026