Rating Criteria for Ratings Supported by Parent/ Group/ Government

1. Introduction

The credit rating of an entity is primarily determined by its standalone credit profile. However, in certain circumstances, the entity's creditworthiness may also be influenced by its association with its parent company, group company or government. Under the criteria, the rating process begins with the assessment of the entity's standalone rating. This baseline rating may then be notched upward or downward or may remain the same on the basis of support from the parent or group entities or government during periods of stress.

The Company reserves the right to amend this policy from time to time in accordance with the applicable regulations, circulars, and directives issued by the Securities and Exchange Board of India. This rating criteria will be reviewed annually.

For the purposes of this policy, support refers to financial assistance that the parent/ group/ government is reasonably expected to provide in times of stress. Such assistance may take the form of loans, equity infusions, extended credit terms, or advances, etc, and is intended to help the rated issuer/ entity address cash flow mismatches or funding shortfalls that could otherwise lead to delay/ default in repayment of obligations. Importantly, support does not encompass ongoing or pre-committed financial contributions, such as capital injections for expansion, or measures to maintain a target capital structure. Nor does it include operational support such as business opportunities, technology transfers, or shared distribution networks. These operational factors are considered in the standalone rating itself, not in the assessment of notching.

It is to be noted that individual promoters, private equity firms, and other financial investors are generally not classified as a parent entity or a group entity for the purpose of evaluating extraordinary support. Private equity firms and similar investors typically manage diversified portfolios, operate with limited investment horizons, and may lack the incentive to provide financial assistance beyond their committed capital. Consequently, their involvement does not materially influence the assessment of notches based on parental support, unless specifically prescribed.

The impact on the parent/ group rating while supporting its weaker entity may be influenced by frequency and size of support in relation to the overall scale of operations and profitability of the parent/ group company. Further, in case of a weak parent, the parent rating may be influenced by dividends from subsidiary/ group entities. The strength of the parent/ consolidated group balance sheet to absorb the contingent liabilities that may arise out of the support to its joint ventures/ subsidiaries or group entities may be weighed in the impact to parent rating.

2. Criteria for Notching Standalone Ratings Basis Government Support

a. Overview

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The evaluation of credit risk for entities supported by central or state governments incorporates an analysis of their institutional linkages with the respective authorities. Public Sector Enterprises (PSEs), as well as entities predominantly owned by PSEs, may benefit from varying degrees of government support. The extent of such support depends on factors such as their legal status, policy functions, strategic relevance, and the potential systemic impact of default within the sector.

These linkages are integrated into the standalone credit risk profile of the entity as an additional analytical layer. This framework may result in appropriate notching depending on the entity's independent creditworthiness, calibrated according to the government's historical track record, the probability of intervention, and the expected magnitude of support.

b. Types of government-related entities

I. Central Government Entities

1) Public Sector Undertakings (PSUs): Companies with majority government shareholding operating in commercial sectors.
2) Statutory Corporations: Entities established by specific acts of parliament with defined mandates.
3) Departmental Enterprises: Government departments operating on commercial principles.

II. State/Provincial Government Entities

1) State PSUs: Companies majority-owned by state/provincial governments.
2) State Utilities: Power distribution and transmission entities.
3) Urban Local Bodies: Municipal corporations and city development authorities.

Regulatory and Policy Entities

1) Development Finance Institutions: Entities providing long-term financing for infrastructure.
2) Export Credit Agencies: Entities facilitating international trade through credit and guarantees.
3) Agricultural/Rural Development Bodies: Entities implementing government schemes for priority sectors.

c. Criteria for Notching Standalone Ratings Basis Government Support

ACER's criteria is applied to the issuers that are majority-owned by the Government of India (GoI) and to entities not directly held by the government but majority-owned by PSUs. As a result, PSEs encompass a wide spectrum of entities that are likely to receive distress support from the GoI.

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This framework aims to provide a structured perspective on how government linkages influence credit ratings, with particular emphasis on the criteria used to determine the extent of change in rating. By combining standalone risk analysis with government support considerations, the approach offers a more comprehensive view of an entity's creditworthiness.

ACER considers the following to assess the strength of the linkages between the entity and the government and decide the notching support, if any.

d. Assessment of government support

i. Strategic importance of the entity to the central/ state government

Strategic importance of the entity to the central/ state government is assessed on the basis of the ownership and control of the latter in the entity. Entities that operate in the favoured and priority business area that is critical to long-term growth, form a key part of the central/ state government diversification objectives that hold high strategic importance and are generally more likely to receive extraordinary financial support, when required. However, the extent of support will be dependent on government debt levels, fiscal deficit, and budgetary flexibility.

ACER notes that strategic importance is not based on any legally binding commitment and any rating change remains susceptible to changes in the government's stance. The government may revise the strategic relevance of an entity if further investments become uneconomic or if its broader strategic priorities shift.

ii. Track record of past central/ state government support to the entity

The government's established track record of extending support to entities demonstrates its commitment to intervene during periods of financial stress. This commitment is further evidenced through explicit financial measures, including budgetary allocations especially in companies that are aligned with government policies, subsidy disbursements, facilitation of banking arrangements, and equity and debt support. Past track record of timely financial support establishes the intent of the support to the entity.

iii. Legal linkages between the entity and the central/ state government

Support of the government to the entity in the form of corporate guarantee, letter of comfort, others highlight the explicit support to the entity in the time of financial stress and establish the strength of the legal linkages. If the corporate guarantee is unconditional and irrevocable with a defined payment mechanism, extended by the government to the entity, then the rating of the entity is notched accordingly.

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Government support in the form of letter of comfort is not legally binding but form a moral obligation for the government. The presence of such arrangements establishes the strength of moral and legal linkages between the entity and the government, and the rating of the entity may be appropriately notched depending on the strength of the support.

Government intervention is critical in cases of default in entity that can impact financial flexibility and liquidity across any other group entities or related sectors. Political and social implications may also lead to urgent government intervention in an entity and will be appropriately analyzed. Reputational risk for the government in case of default at the supporting entity could result in a systematic risk that could trigger instability in the financial system.

iv. Rating Framework for Ratings with Government Support

ACER Ratings adjusts the ratings of the entity on the basis of strength of their linkages with the government. The framework considers timely financial support to the entity in the time of stress. The extent of notch adjustment to the standalone rating of the entity will be decided by the strategic and legal importance of the entity to the government, along with reputational risk to the government in case of a default at any such entity.

Support from the Central/ State government	**Typical Characteristics**	**Rating Support**
High	Majority ownership; important policy role; high social/ political implications; strategic sector; systemic default impact	Favourable
Moderate	Sizeable ownership; moderately critical and socially important; low to moderate political implications	Neutral to Favourable
Low	Commercial operations where alternatives exist; competitive sector; not a focussed area as per government's policies	Unfavourable to Neutral

e. Explicit Government Guarantees

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Where the government provides explicit, unconditional, and irrevocable guarantees with a defined payment mechanism for specific debt instruments, those instruments may be rated at par with the sovereign, subject to verification of corporate-guarantee documentation and payment mechanisms. Such instruments typically carry a suffix indicating credit enhancement as per the SEBI guidelines for notching for credit enhanced instruments.

f. State/Provincial Government Support

For entities owned by state/provincial governments, support expectations are generally lower than for central government entities due to more limited fiscal capacity, competing demands on state resources, and varying credit quality across states. The state government has its own creditworthiness, and it caps the rating benefit available to entities supported by the State Government. In case credit ratings are not available for a state government, some factors for its assessment and derivation include analysis of fiscal and economic indicators, and institutional and regulatory framework.

g. Key Takeaways

1. Ratings of entities supported by central/ state government are assessed as per their importance in the strategic and priority government areas, role in critical regulatory and policy functions amongst other factors and may be accordingly notched.
2. Policy role and default implications are few of the primary dimensions for assessing government support likelihood.
3. Disinvestment plans and track record of support are some critical factors in determining support expectations.
4. Entities supported by the state government are generally capped at the relevant state government's creditworthiness. In case, the rating of the state government is not available, then the rating is derived on the basis of fiscal and economic data. Thereafter, the ratings of entities supported by such state governments, may factor the support.
5. Explicit government guarantees may allow specific instruments to be rated in line with the ACERs policies.

3. Criteria for Notching Standalone Ratings Basis Parent Support

a. Overview

The evaluation of credit risk for entities supported by a parent incorporates an analysis of their strategic, operational and legal linkages. These linkages are integrated into the standalone credit risk profile of the entity as an additional analytical layer. This framework may result in a rating adjustment (either notch-up or notch-down or no adjustment) relative to the entity's independent creditworthiness, calibrated according to the financial risk profile of the parent company.

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The rating of an obligor is primarily driven by its standalone credit profile, which evaluates its individual business, financial, and management risks. However, when an entity is associated with a parent company, the final rating may be adjusted through a process called notching to reflect the potential benefits or risks derived from that association.

b. Criteria

ACER's criteria for any entity with parent support is based on the extent of support from the parent, nature of parent support, strategic importance of the entity to the parent and reputational risk to the parent in case of financial stress at the entity.

Parent support analysis applies specifically to direct parent-subsidiary relationships where a clearly identifiable parent company holds significant shareholding in the rated entity. This framework also extends to step-down subsidiaries, where the ultimate parent company rather than an intermediate holding company is considered the primary source of potential support. The assessment of parent support is anchored in two core analytical dimensions: the parent's ability to provide support and the parent's willingness to do so.

Parent's ability to support is established on the fact that the parent must possess sufficient financial capacity to extend meaningful support to the subsidiary. This is typically assessed along with the parent's own credit rating, with the expectation that the parent's rating may influence the subsidiary's standalone profile. The rating of the parent is derived based on key parameters including business risk profile, financial risk profile, industry trends, etc., in case no credit rating is available for the parent.

Parent's willingness encompasses the parent's demonstrated commitment and strategic intent to stand behind the subsidiary. This includes historical patterns of support and the existence of formal support mechanisms such as guarantees, etc.

c. Parent subsidiary linkage (PSL)

There needs to be a parent subsidiary relationship between entities for the PSL to be applicable. In all cases where the PSL is applicable, the standalone credit rating of the subsidiary is evaluated on the basis of the subsidiary's financial risk profile, business risk profile and other risks as per company policies. Given below are the key heads on the basis of which linkages between parent and its subsidiary are assessed.

1. **Operational linkages**

Operational linkages may be established on the basis of control of parent over management of subsidiary, extent of parent control over subsidiary, integration of internal functions (such as treasury, etc.) between parent and subsidiary, and operational overlap including sharing of technology, etc.

2. **Strategic linkages**

Strategic linkages may be assessed on the basis of importance of the subsidiary to the functioning and business of the parent entity, its criticality to expansion plans, common brand name and similar line of business.

3. **Financial linkages**

Financial linkages may also be established if there is support from the parent for allowing financial flexibility to the subsidiary. Additionally, in cases where parent has supported raise of funds through debt or equity for the subsidiary, or has favourable debt covenants supported by the parent, then financial linkages may be considered.

4. **Legal linkages**

Legal linkages can be seen in case of support in the payment mechanism or parent's support to a subsidiary in later meeting its obligations. Tangible support in the form of an unconditional and irrevocable corporate guarantee (pre-default), cross-default clauses that link the debt obligations of the parent and the subsidiary, dividend restrictions limiting the company to upstream cash to the parent, and consolidation of subsidiary in parent on the basis of pooling of interests are some key factors amongst others that establish legal linkages.

In case of a pre-default guarantee and a strong payment mechanism for the debt, the rating of the subsidiary is credit enhanced (CE) and the rating of the subsidiary may be notched up in line with the linkages with the parent company.

d. Notch-up Support under PSL

The extent of strategic, operational, financial and legal linkages is evaluated and accordingly notch-up of rating is done on the standalone rating of the subsidiary. The strategic, operational, financial and legal linkages are assessed from low to moderate to strong and notched accordingly in the ratings.

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A bottom-up approach can define the final rating of the subsidiary after factoring the operational, strategic, financial and legal linkages with the parent. The linkages would reflect the importance of the subsidiary to the parent and likely support from the parent in times of stress and will define the number of notches of rating uplift.

It may be noted that there is limited influence and no control over strategic decisions of the parent entity in case of a joint venture (JV) and associate companies. In such cases, the linkages are low and no clear parent-subsidiary relationship exists, hence, PSL criteria cannot be applied, and the final rating is the basis of the standalone credit profile of the entity. However, if ACER determines likelihood of parent support to the JV/ associate company in stress, then linkages may be assumed and accordingly factored in the rating.

e. Rating alignment in case of a stronger parent

When the parent is significantly stronger than the entity, and the entity holds substantial business, strategic, or reputational importance for the parent—supported by explicit intent, contractual commitments, or a proven track record of timely assistance—the entity's standalone rating may be favourably impacted and notched accordingly. Conversely, if the entity's operations lack strategic or reputational relevance, and there is no evidence or acknowledgement of parental support, the linkages likely to be weak, then standalone rating may see an unfavourable to neutral adjustment. For cases where the entity's importance to the parent falls in between, the standalone rating may see a neutral to favourable adjustment.

Linkage Strength	**Conditions**	**Rating Support**
Strong	Strong legal ties, high strategic importance, operational integration, pre-default corporate guarantee with defined payment mechanism, demonstrated track record of support	Favourable
Moderate	Some operational integration, shared branding, partial strategic importance	Neutral to favourable
Weak	Limited ties but reputational risk from shared name may warrant some uplift; limited strategic importance	Unfavourable to neutral

f. Rating alignment in case of a weaker parent

In case a weak parent is supporting a stronger subsidiary, the subsidiary's rating is generally capped at the parent's rating. However, if such support is unlikely—due to regulatory restrictions, there is adequate ring-fencing of cash flows, or structural constraints such as the

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presence of institutional or minority shareholders and restrictive debt covenants—the subsidiary's rating will typically reflect its standalone credit strength, which may be higher than that of the parent. In these situations, the parent's rating also does not benefit from the stronger subsidiary's profile, and only cash inflows such as dividends are considered in assessing the parent's creditworthiness. The notching guidance in case of a weaker parent is captured in the table below.

Ability to Access Funds	**Conditions**	**Rating Support**
High	Strong linkages, no ring-fencing, history of upstream transfers, parent in distress	Favourable
Moderate	Some ability to access funds but partial restrictions in place	Neutral to favourable
Low	Weak linkages but some potential for resource extraction; strict regulations, independent board	Unfavourable to neutral

g. Treatment of Guaranteed Debt

1. If the debt is guaranteed with clauses that are pre-default, unconditional, irrevocable and with a defined payment mechanism, then rating is equated with the parent and credit enhancement suffix as applicable is assigned accordingly.
2. If the guaranteed debt is without a defined payment structure, the standalone rating and the extent of rating uplift, if any, will be assessed based on linkages.

h. Some scenarios where parent-supported ratings may be applicable

Applicability of parent support in the standalone ratings of entities, may be considered in scenarios where the subsidiary falls under the wholly owned group structure where the operational integration and brand association is established, as seen in some entities from the automotive sector. In entities from sectors such as retail, where the group holds majority stake but has low integration, parent support in ratings may be considered. In other cases where the degree of parent support to the entity varies on the basis of regional presence, control over subsidiary, criticality to parent operations, etc., the same is accordingly factored in the ratings and analysed on a case-to-case basis.

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i. Key Takeaways

1. Parent support assessment is based on both ability and willingness to provide support.
2. Legal ties, particularly pre-default guarantees with payment mechanisms, provide favourable support to the standalone rating of the subsidiary.
3. Operational integration and strategic importance may provide support to ratings and will be analysed on a case-to-case basis.
4. Weaker parents may negatively influence the subsidiary ratings through cash extraction mechanisms.
5. Cross-border structures may face additional constraints from transfer and convertibility risks.
6. The actual impact of the ring-fencing of cash flows, etc, on infrastructure Special Purpose Vehicles (SPVs) will be assessed on a case-to-case basis.
7. Divestment plans may reduce support expectations from the parent to the entity and may accordingly influence changes in the ratings.

4. Criteria for Notching Standalone Ratings Basis Group Support

a. Overview

Group support is established when it provides financial assistance to the group entities in times of stress. A group is characterised by commonality of promoters, significant business dependence amongst group entities, intercompany holdings, common branding and established operational and financial interlinkages. Support may be implicit wherein there is understanding between group entities to help in times of financial and business stress. Explicit support on the other hand may be established by letter of comfort, corporate guarantees and credit enhanced structures/ payment mechanisms.

The level of control over group companies identifies the ability of the promoters to take strategic decisions. Group integration is also established with crossholdings amongst group entities, creating financial interdependencies. Group reputation based on common branding and/ or shared name/ logo, form a part of key group linkage assessment parameters. A group company can be significant to the group if its standalone revenue is significant to the consolidated group revenue, the strategic interest of the entity is aligned well with the group, and there is demonstrated track record of the group supporting its entities in times of stress.

b. Criteria

ACER's criteria derive the standalone rating of the entity, followed by adjustments based on implicit or explicit support, and the group's overall credit quality. The flagship company's willingness and ability to support subsidiaries are few critical factors. This criterion applies primarily to large, diversified groups with complex holding structures and the ability to mobilize

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funds from capital markets or other sources. It is less relevant for small, family-owned groups with limited entities.

If an instrument carries an unconditional and irrevocable guarantee backed by a payment mechanism supported by the group, its rating is aligned with that of the guarantor and marked with the suffix CE (Credit Enhancement).

c. Group Credit Quality Assessment

Once the group entities as per the interlinkages and other factors mentioned above are ascertained, the overall group consolidated credit profile is assessed based on the evaluation of business risk, financial risk, cash flow linkages, common management, etc. Further, credit is given for geographical diversification and diverse but overlapping businesses of the group. Lastly, financial flexibility at group level and access to funds to support business growth for companies within the group drives the group credit profile.

d. Factors impacting Rating Support by/ to the Group

I. Strategic importance and business linkages

It plays a key role in deciding the assessing the notching on the basis of the group support. The importance of the entity to the group is attributable to a high share of revenue and profitability of the group, overlap in business activity, degree of integration in the group, amongst other factors. Additionally, strategic linkages and accordingly financial flexibility will influence notching of ratings of the entity. Further, effective oversight of the management of the group over the entity and cash flow fungibility amongst group companies, amongst other factors may influence the rating of the standalone entity basis group support.

2. Moral obligation and Reputational Risk for the Group

Moral obligations may influence group support when reputational risks are at stake. Deterioration in the business and financial risk profile of the entity can hamper the reputation of the group and may erode the investor confidence and may tarnish the brand image. Strong corporate governance practices and ethical business operations support the goodwill of the group and the entity and is accordingly factored in the ratings. Moreover, dependence of the entity on the group for raw material, financial flexibility with banks, common management, and operational and financial support, establishes linkages and likelihood of group support, if required.

e. Rating Support

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Given below are key factors guiding for notch-up and notch-down of ratings of the group entity based on the linkages with the group.

i. **Notch-up guidance**

Linkage Strength	Conditions	Rating Support
Strong	Significant crossholdings and cross-guarantees, integration, demonstrated track record, shared branding, and high integration.	Favourable
Moderate	Promoter control with management influence, and moderate contribution to group	Neutral to favourable
Weak	Limited ties, no clear flagship, emerging group structure	Unfavourable to neutral

ii. **Notch-down guidance**

Extraction Risk	Conditions	Rating Support
High	Distressed group, history of cash upstreaming, weak ring-fencing	Unfavourable to neutral
Moderate	Some extraction potential but partial restrictions	Neutral to Favourable
Low	Strong independent governance, regulatory protections	Favourable

The degree of notch-down is derived from the degree of cash flow ring fencing and history of cash upstreaming would lead to high extraction risk from the group company and hence the rating of the standalone entity will be notched accordingly. On the other end of the spectrum, if there are no cross holdings and the cash flows are ring fenced, then there may be no adjustment made to arrive at the standalone rating.

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Treatment of guaranteed debt is seen in cognisance with cross-guarantees from strong entities, and in such cases, ratings may be influenced by the guarantor rating, along with applicable suffix indicating support. In case of partial guarantees, the coverage of such guarantees is analysed and accordingly factored into the ratings. In cases of informal commitments, the guaranteed debt is assessed based on track record.

f. Some scenarios where group-supported ratings are applicable

Group-supported ratings may be seen in diversified conglomerates, such as in steel, cement, power, other sectors, where the group dynamics are perceived to be strong and there is high control and brand association of the entity with the group. In case of family-controlled businesses, the cross holdings are generally seen to be high as in the textile and retail sector and group-support may be factored accordingly. In emerging businesses such as IT-services and renewable energy, strategic importance of the entity, cash flow fungibility amongst group entities, amongst other factors may govern the strength of the linkages and support consideration. In conglomerates with centralised treasury, group support to the cash flows of the entity along with group complexity and legal ties and obligations are few factors that may be analysed to factor group support. In other scenarios including but not limited to groups with distressed flagship companies. Multi-sector groups with partial guarantees, group under restructuring, international group with cross-border entities may be assessed on diversification of operations, strategic importance of entity and track record of support are some factors that may be considered in factoring group support in rating of the entity.

g. Key Takeaways

I. Group support applies where no single parent is identifiable, focusing on promoter control and interdependencies.
II. Flagship or consolidated profile may serve as a credit surrogate.
III. Crossholdings and guarantees are some of the key parameters amongst others to consider notching.
IV. Strategic hierarchy and historical track record would drive willingness assessment.
V. Distressed groups may lead to downward notching for stronger entities.
VI. Cross-border groups face additional constraints from transfer risks to be considered while notching ratings.
VII. Restructuring or divestments at group may materially reduce support expectations for the entity and will be notched accordingly.

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