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## Default on Obligations by Crescent Standard Investment Bank Ltd.

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### COMMENT

JCR-VIS Credit Rating Co. Ltd. (JCR-VIS) had been rating Crescent Standard Investment Bank Limited (CSIBL) till April 2006, when the assigned ratings were suspended due to the fact that in view of disclosures of concealment of material transactions, assets and liabilities in the books of account we reached the conclusion that sufficient reliable information was not available to us to be able to reach an opinion on the rating. At the time of the rating suspension, CSIBL's entity ratings were BBB+/A-2 and the rating of their TFC (originally issued by Pacific Leasing) stood at A-. Subsequent to the suspension of ratings, CSIBL defaulted on its TFC as well as failing to honour its money market commitments and depositor obligations.

JCR-VIS received many queries from regulators, market participants and the affectees of CSIBL on what was a perceived 'inability' to judge the problems faced by CSIBL. Some went as far as accusing us of actively colluding with the management of CSIBL. As part of our regular process, JCR-VIS carries out thorough reviews of all ratings in which unusual activity occurs i.e. suspensions, defaults or major downgrades (more than two notches from the originally assigned ratings)

in order to identify causes for such variations and to further strengthen our systems where necessary. Beginning with this paper, JCR-VIS intends to make its findings on all such events available in the public domain.

Our review of the circumstances surrounding the CSIBL event resulted in one clear conclusion; most users of ratings are not aware of the process behind assigning ratings and the nature of the responsibility of the rating agencies. This comment paper will first carry a general discussion regarding the above-mentioned issues followed by specific details of the CSIBL case.

As per international practice, the responsibility of rating agencies is to give an opinion on the creditworthiness on the basis of information publicly available information and any other information that may be requested by them from time to time from the client. The opinion of the rating agency is not an investment recommendation and is only an opinion on the probability of default of the rated entity. Following is the disclaimer attached to all our rating reports and press releases:

*Information herein was obtained from sources believed to be accurate and reliable; however, JCR-VIS Credit Rating Company Limited does not guarantee the*

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*accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. JCR-VIS Credit Rating Company Limited has been paid a fee for the rating assignment(s). This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.'*

The very fact that different rating bands reflect varying levels of probability of default means that defaults do occur in investment grade ratings even when no fraud or misrepresentation has taken place. Even the new Basel-II Accord for Capital Adequacy of Banks recognizes this phenomenon and includes the following table:

| Proposed long-run "reference" three-year CDRs |                    |          |              |            |          |
|---|--------------------|----------|--------------|------------|----------|
| S&P Assessment<br>(Moody's)                   | AAA-AA<br>(Aaa-Aa) | A<br>(A) | BBB<br>(Baa) | BB<br>(Ba) | B<br>(B) |
| 20-year average of<br>three-year CDR          | 0.10%              | 0.25%    | 1.00%        | 7.50%      | 20.00%   |

Rating agencies do not scrutinize the organisation's records on a regular basis as was the belief of some of the affectees that contacted us in the case of CSIBL. That is the responsibility of the external and internal auditors of the company. JCR-VIS Credit Rating Co Ltd.'s policy in this regard as clearly mentioned on our website is as follows:

*'JCR-VIS relies on the audited accounts as one of its basic sources of information, however, additional information is obtained where required. In addition, JCR-VIS rechecks the current position of areas where the auditors have shown concern in their reports or management letter etc.'*

All major rating agencies state that it is the obligation of the rated entity to provide accurate and timely information to the rating agency and

unless the rating agency has sufficient grounds to doubt the veracity of the submitted information, all management representations are considered as a reliable basis for developing an opinion on the company's creditworthiness. A standard clause in our rating agreements is re-produced below for our reference:

*'The Applicant agrees to promptly furnish to JCR-VIS all information relevant to an evaluation, to furnish additional information and notify JCR-VIS of material changes in the information furnished, from time to time after the Ratings are first made, so long as the Ratings continue in effect. JCR-VIS relies on the Applicant for the accuracy and completeness of the information supplied by it and assumes no responsibility to verify such information. The Ratings are exclusively based on the information and particulars supplied by the Applicant. The Applicant agrees to notify JCR-VIS when new debt issues are offered publicly or privately.'*

Even in cases where the rating agency is doubtful about the reliability of submitted information, it does not extend the scope of its work to encompass verifying the information provided through an audit of the rated entity's financial statements. Instead, the rating agency would in such cases either decline to issue a rating (in the case of a new assignment) or suspend/withdraw the ratings in cases where a rating is already outstanding.

In the case of CSIBL, there was a deliberate misstatement of the financial statements through concealments of a material level of borrowings and assets. Since this misstatement was not highlighted at any time by the auditors (in their audit report for the year ended December 31, 2004 or their review report for

the six months ended June 30, 2005) nor was there any other public information about this fact, there was no plausible manner in which JCR-VIS could have known about the existence of the misstatements and their materiality. However, taking into account the fact that there were certain rumours in the market regarding a regulatory investigation of the affairs of CSIBL (a fact that was not disclosed publicly by either the regulator or CSIBL), we did ask the management to clarify this situation and they categorically informed us that this was not the case. We then placed this fact in writing to the management.

Also, while placing CSIBL on 'Rating Watch' on account of its proposed merger with a modaraba, JCR-VIS clearly mentioned, in its press release dated February 17, 2006, that CSIBL was facing liquidity related issues and was preparing a restructuring plan.

The first public information regarding the financial misstatements by CSIBL was a news article in the daily 'Business Recorder' published on April 15, 2006. In response to this information JCR-VIS issued a press release on the same day stating that JCR-VIS believed that there was a need for authentication of information previously made available to us. Subsequently, on April 18, 2006, we announced the suspension of the assigned ratings.

At no time in the above sequence of events, did JCR-VIS deviate from the international best practices of credit ratings and at no time did we act in collusion with management. The main issue has arisen from the fact that, even though the Securities & Exchange Commission of Pakistan had begun probing the records of CSIBL as far back as September 2005, these pro-

ceedings were not public information till April 15, 2006, and therefore JCR-VIS had no way to know of their existence. As soon as JCR-VIS became aware of these developments we took the extreme action of suspending the ratings of CSIBL **JCR-VIS**

Jahangir Kothari Parade (Lady Lloyd Pier)  
Inspired by Her Excellency, The Honorable Lady Lloyd, this promenade pier and pavillion was constructed at a cost of 3 Lakhs and donated to the public of Karachi by Jahangir Kothari to whose generosity and public spirit the gift is due. Foundation stone laid on January 5, 1920. Opened by Her Excellency, The Honorable Lady Lloyd on March 21, 1921.

*Dome: A roof or vault, usually hemispherical in form. Until the 19th century, domes were constructed of masonry, of wood, or of combinations of the two, frequently reinforced with iron chains around the base to counteract the outward thrust of the structure.*

*Origins: The dome seems to have developed as roofing for circular mud-brick huts in ancient Mesopotamia about 6000 years ago. In the 14th century B.C. the Mycenaean Greeks built tombs roofed with steep corbeled domes in the shape of pointed beehives (tholos tombs). Otherwise, the dome was not important in ancient Greek architecture. The Romans developed the masonry dome in its purest form, culminating in a temple built by the emperor Hadrian. Set on a massive circular drum the coffered dome forms a perfect hemisphere on the interior, with a large oculus (eye) in its center to admit light.*



Jahangir Kothari  
Parade

## National Excellence, International Reach

JCR-VIS Credit Rating Company Limited is committed to the protection of investors and offers a blend of local expertise and international experience to serve the domestic financial markets. With its international reach, JCR-VIS is positioned to aim for an international mark. In this regard, the global experience of our principal, Japan Credit Rating Agency, Ltd. has been invaluable towards adding depth to our ongoing research endeavors, enriching us in ways, that enable us to deliver our responsibilities to the satisfaction of all investors.

The edifice of the Jahangir Kothari Parade has stood proudly through the years and is a symbol of our heritage. Its 'Dome' as the most stable of building structures, exemplifies architectural perfection. Committed to excellence, JCR-VIS continues its endeavor to remain an emblem of trust.

# JCR-VIS Credit Rating Company Limited

Affiliate of Japan Credit Rating Agency, Ltd.  
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