



Press Release
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Why should you know Credit Rating?

Before you decide to invest your hard earned money in bank deposits, finance company deposits or in debt securities, you must be convinced that the entity will be able to pay you back at the maturity date. Thus providing independent objective assessments of the credit worthiness of companies, a credit rating helps investors decide how risky it is to invest money in a certain institution and/or institutions' securities.

Credit in the Investment World

The diverse range of investment opportunities available creates difficulty in differentiating between financial strengths underlying the investments. Even though it's important to invest in a mix of securities, it is equally important to be aware of the risk exposure of these securities. By measuring the ability and willingness of an entity - which could be a corporation, a security or a country - to keep its financial commitments, credit ratings are essential tools for helping you make better-quality investment decisions.

Sovereign Credit Ratings

A sovereign credit rating provides the latter as it signifies a country's overall ability to provide a secure investment environment. This rating reflects factors such as a country's economic status, transparency in the capital market, levels of public and private investment flows, foreign direct investment, foreign currency reserves, political stability, or the ability for a country's economy to remain stable despite political change.

Because it is the doorway into a country's investment atmosphere, the sovereign rating is the first thing most institutional investors will look at when making a decision to invest money abroad. This rating gives the investor an immediate understanding of the level of risk associated with investing in the country. A country with a sovereign rating will therefore get more attention than one without. So to attract foreign money, most countries will strive to obtain a sovereign rating and they will strive even more so to reach investment grade. In most circumstances, a country's sovereign credit rating will be its upper limit of credit ratings.

Credit Rating Agencies

There are two domestic credit rating agencies operating in Sri Lanka. Each of these agencies aims to provide a rating system to help investors determine the risk associated with investing in a specific Bank, Finance Company, Insurance Company or Investment Instrument.

Ratings can be assigned to short-term and long-term debt obligations as well as securities, loans, preferred stock and insurance companies. Long-term credit ratings tend to be more indicative of a company's ability to honor its debt responsibilities.

It is important to note that ratings are not equal to or the same as buy or sell recommendations nor a guarantee against default. Ratings are rather a measure of an entity's ability and willingness to repay debt and hence it's a relative ranking.

The Rating Scale

The ratings lie on a spectrum ranging from highest safety or highest credit quality on one end and default or "junk" on the other. Long term credit ratings are denoted with an alpha numeric symbol (Refer graph).

Within this spectrum there are different degrees of each rating, which are --depending on the agency-- sometimes denoted by a number (1,2,3) or plus(+) or negative(-) sign.

Conclusion

Hence, a credit rating is a useful tool not only for the investor, but also for the entities looking for investors. An investment grade rating can put a security, company or country on the global radar, attracting foreign money and boosting a nation's economy. Indeed, for emerging market economies, the credit rating is the key to showing their worthiness to foreign investors. Since the credit ratings act to facilitate investments, many countries and companies will strive to maintain and improve their ratings, hence ensuring a stable environment and a more transparent capital market.

