

## Standard Operating Procedure for CRAs for Monitoring and Recognition of Defaults

In order to standardize the operating process for monitoring and recognition of defaults, SEBI's Circular "Guidelines for Enhanced Disclosures by Credit Rating Agencies (CRAs)" dated June 13, 2019 has required that "CRAs, in consultation with SEBI, shall frame a uniform Standard Operating Procedure (SOP) in respect of tracking and timely recognition of default, which shall be disclosed on the website of each CRA".

SEBI in its Circular dated June 30, 2017 on "Monitoring and Review of Ratings by Credit Rating Agencies (CRAs)", had also noted that "CRAs have to be proactive in early detection of defaults/ delays in making payments." SEBI had further stated, "As responsible institutions, CRAs are expected to proactively track all important changes relating to the client companies in order to yield timely and accurate ratings. It is reiterated that CRAs are required to ensure prompt and accurate rating action".

In line with these regulatory guidelines, we have put together an SOP for tracking and timely recognition of default. Recognition of defaults in a timely and consistent manner helps achieve the following objectives:

1. Present accurate performance statistics like default rates
2. Help investors and other stakeholders compare performance of CRAs using objective metrics and consistent default monitoring/recognition practices

Following practices shall be consistently adopted by all CRAs towards ensuring consistency and uniformity in tracking and recognition of defaults.

1. **Communication with bankers:** Every CRA shall write to the bankers to take feedback at the time of initial rating and at periodic intervals (at least once every quarter) to ascertain timeliness in debt servicing. In cases where bankers do not respond in writing, the discussions shall be documented (through email/ letter to the banker).
2. **No default statement (NDS)** to be sought on a monthly basis from the Issuer in line with SEBI regulations.
3. **Tracking confirmation from debenture trustee** on timely debt servicing on specific ISINs rated by the CRA in line with SEBI regulations. For securities, the withdrawn rating shall be included in the computation of default rates till the completion of the 3-year cohort or the maturity of the instrument, whichever is earlier. Accordingly, the CRAs shall continue to track the confirmation received from the debenture trustees on the status of debt servicing on securities even after rating withdrawal, where applicable.

4. **Monitoring of Exchange website:** The CRA shall also monitor the Exchange website for disclosures made by issuers with listed securities (either debt or equity) in respect of timely debt servicing.
5. **Publishing of press release in case of payment default:** In case of confirmation of any delay in servicing of the debt obligation, press release shall be published within timelines as prescribed under regulations.
6. **Disclosure in case of non-confirmation of timely debt servicing:** In case no confirmation regarding servicing of debt obligation on the listed security is received by the CRA from the Debenture Trustee within 1 day post the due date, the CRA shall immediately follow up with the Issuer for confirmation of payment. In case no response is received from the Issuer within 2 days of such communication, the CRA shall publish a Press Release as per SEBI prescribed format on its website and send to all stock exchanges where the security is listed.
7. **Rating agreements shall be suitably modified** to incorporate Issuers responsibility to provide consent to the CRA to obtain details of the existing and/ or future borrowing of the issuer, its repayment and any delay or default in servicing of such borrowing, either from the lender or any other statutory/non - statutory organisation maintaining any such information. Such right to access to information shall be made clear to the said external parties while seeking information.
8. **Factoring in past defaults:** In rare circumstances, if a CRA becomes aware of the delays that have occurred in the past and have not been recognized by way of a 'D' rating, the delay shall be recognised by downgrading the rating to 'D'. The rating can be simultaneously upgraded to a non-D rating, in line with the SEBI guidelines on curing period and the SOP on curing period mentioned below.
9. **Default on instruments not rated by CRA:**

In case an issuer defaults on an unrated instrument which has same seniority as the rated instrument by the CRA,

- a. The CRA shall recognise the default in its default statistics from the rating level of the rated instrument. The rating of the rated instrument which has not defaulted may be appropriately reviewed by the CRA.
- b. For the sake of ample clarity, it is highlighted that a default on an unrated instrument may not mean and shall not be construed as a default for computation of default statistics, if the rated instrument is credit enhanced or there is a structure around the cash flows .
- c. The CRA in its default studies shall also give out a list of all companies where ratings may not have been downgraded 'D', but issuer has been included in the default study due to default on unrated debt.

## **10. Curing period post defaults:**

- a. The curing period principle for default category ratings should apply to fresh rating assignment as well as surveillance assignments and usually at an issuer level. For the sake of ample clarity, if a CRA is rating an issuer afresh, a non-default rating would not be assigned if the curing period post an earlier default on any instrument of similar seniority has not lapsed.
- b. However, for ratings on subordinated or hybrid bonds, since a default on such instruments may not necessarily imply a default by the issuer for senior instruments, curing period should apply at instrument level. In case of default on subordinated or hybrid instruments, ratings on senior instruments may not be upgraded during the curing period for subordinated and hybrid instruments.
- c. If rated instruments is credit enhanced or there is a structure around the cash flows, the curing period will apply at instrument level, as default by issuer on other instruments may not imply or lead to default on such instrument.