CRISIL Ratings

Meaning and applicability of ‘SO’, ‘CE’ symbols

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Criteria contacts

Somasekhar Vemuri
Senior Director and Head
Rating Criteria, Regulatory Affairs and Operations
somasekhar.vemuri@crisil.com

Ramesh Karunakaran
Director
Rating Criteria and Product Development
ramesh.karunakaran@crisil.com

Mayank Devpura
Associate Director
Rating Criteria and Product Development
mayank.devpura@crisil.com

Shawn Lopes
Management Trainee
Rating Criteria and Product Development
shawn.lopes@crisil.com

In case of any feedback or queries, you may write to us at criteria.feedback@crisil.com

Executive summary

CRISIL Ratings used to apply an ‘SO’ suffix (indicating Structured Obligation) for instruments that were backed by credit enhancement structures or mechanisms. The ‘SO’ suffix was used to highlight the credit uplift enjoyed by the instrument over and above the rating of the issuer, due to the presence of the credit enhancement structure. Such credit enhancement supporting the payment of interest and principal on the instrument may have been internal, emanating from structural covenants inbuilt in specific transaction structures, or external, emanating from explicit contractual commitments for support from third parties.

However, the SEBI guidelines in June 2019 restrict the use of ‘SO’ suffix to instruments having credit enhancement/structure around cash flows that leads to the instrument being bankruptcy remote from the issuer/originator. SEBI guidelines mandate the use of ‘CE’ suffix (indicating Credit Enhancement), for the rating of an instrument backed by credit enhancement mechanism that is external (or from a third party / parent / group company), but the instrument is not bankruptcy remote from the issuer / originator.

The SEBI guidelines also stipulate the following:

- Disclosure of unsupported rating, without factoring the explicit credit enhancement, along with the supported rating, after factoring the explicit credit enhancement, to enable investors understand the extent of credit enhancement provided by third party/parent/group company.
- Development of models for assessment of adequacy of credit enhancement structures under various scenarios, including stress scenarios. Such an assessment should be articulated in the rating rationale.

In line with the SEBI guidelines, CRISIL Ratings applies the ‘CE’ suffix to the rating of an instrument backed by explicit external credit enhancement from a third party / parent / group where the instrument is not bankruptcy remote from the issuer / originator. However, the ‘CE’ suffix has been applied only if the credit enhancement mechanism results in a credit uplift for the instrument over and above the unsupported rating of the issuer.

In April 2022, the RBI issued a guidance note (GN) to the credit rating agencies (CRAs) on assigning CE ratings for bank loan facilities. This was followed by a set of FAQs on CE ratings for bank loan facilities that the RBI shared with CRAs in July 2022.

The GN and FAQs have laid down certain conditions based on which CRAs can draw credit enhancement comfort. These are as follows:

- CRAs can rely only on explicit guarantees extended by rated external entities (including parent/group companies or by financial institutions like banks and NBFCs).
- CRAs shall not rely on other forms of diluted and non-prudent structures, viz, letter of comfort (LOC), letter of support/undertaking/responsibility/acknowledgement, obligor-co-obligor structure, etc for deriving rating comfort while assigning CE Ratings.
  - However, LoCs issued by Central/State Governments and “shortfall undertakings”, which are legally enforceable, irrevocable, and unconditional in nature may be treated as valid supporting structure.
- CE Ratings shall not be assigned on the basis of credit enhancement derived through pledging of shares.
- Going forward, new CE ratings can be assigned to guaranteed bank loan facilities only when they are backed by a guarantee that is in compliance with a 12-point framework[1] as prescribed in the RBI GN. For existing bank loan ratings backed by guarantee, RBI has permitted grandfathering the rating approach until the residual tenure of the rated instrument.

[1] Please see the Annexure-1 for the 12 points specified in the RBI guidance note dated April 22, 2022

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Scope

This document[2] outlines the guiding principles behind the application of 'CE', 'SO' suffixes, the types of instruments which may be assigned 'CE' or 'SO' ratings. In case of 'CE' ratings, the distinction between supported and unsupported ratings are outlined in the document.

Guiding principles behind application of 'SO', 'CE' suffixes

The application of 'CE' or 'SO' suffix to a rated instrument will be driven by the following principles:

Sr. No.	Instrument type	Application of suffix to rating
1	Instrument having no explicit credit enhancement or payment mechanism / structure	No 'CE' or 'SO' suffix
2	Instrument having internal credit enhancement mechanism (due to payment mechanism/structure around cash flows), but the instrument is not bankruptcy remote from the issuer/originator	No 'CE' or 'SO' suffix
3	Instrument having credit enhancement / structure that leads to the instrument being bankruptcy remote from the issuer / originator	'SO' suffix
4	Instrument having credit enhancement that is external (or from third party), but the rated instrument is not bankruptcy remote from the issuer / originator	'CE' suffix
5	Instrument having external credit enhancement through guarantees or other structures, but the CRA believes that the structure does not enhance the rating of the instrument (over and above the issuer's credit profile)	No suffix

Typical application of 'SO' or 'CE' suffix for bank loan facilities, commercial papers and instruments backed by securitisation

SO suffix – securitised, asset backed transactions with credit enhancement structures that lead to the instrument being bankruptcy remote from the issuer/originator	CE suffix – instruments backed by external credit enhancement from third party / parent / group company, but instrument not bankruptcy remote from the issuer/originator
• Asset Backed Securitisation (ABS) • Mortgage-Backed Securitisation (MBS) • Collateralised Debt Obligations (CDO)	• Guaranteed loan facilities complying with 12-point framework • Loans backed by LOC, Shortfall undertakings issued by Central/State Governments provided these are legally enforceable, irrevocable and unconditional • SBLC backed CPs or other instruments/facilities • Guaranteed pooled loans issuance (PLI), not through a trust • Debt backed by Payment Waterfall /Escrow, DSRA etc., but with Full Guarantee or DSRA Replenishment Guarantee from a third party

[2] For accessing the previous version of this article, please refer to the below link: https://www.crisilratings.com/content/dam/crisil/criteria_methodology/structured-finance/archive/meaning-and-applicability-of-so-ce-symbols-external-sep2022.pdf

Typical application of 'SO' or 'CE' suffix for bonds and other capital market instruments

SO suffix –credit enhancement structures that lead to the instrument being bankruptcy remote from the issuer/originator	CE suffix – instruments backed by external credit enhancement from third party / parent / group company, but instrument not bankruptcy remote from the issuer/originator
• Covered bonds where primary recourse to pool of loans housed in a trust, with secondary recourse to issuer • Capital protection-oriented funds	• Guaranteed bond, Shortfall undertaking backed bond or other such third-party credit enhancement • Covered bonds which have to be serviced primarily by the issuer (i.e., primary recourse to issuer), with secondary recourse to the cash flows from the pool of loans housed in a trust • Partially guaranteed bond • Commercial Mortgage-Backed Securities (CMBS)-like structures • Standby Letter of Credit (SBLC) backed securities • Debt backed by pledge of shares or other assets • Guaranteed Pooled bond issuance (PBI), not through a trust • Obligor/Co-obligor structures or Cross-default guarantee structures • Debt backed by Payment Waterfall /Escrow, or DSRA etc., but with Full Guarantee or DSRA Replenishment Guarantee from a third party • Letter of comfort

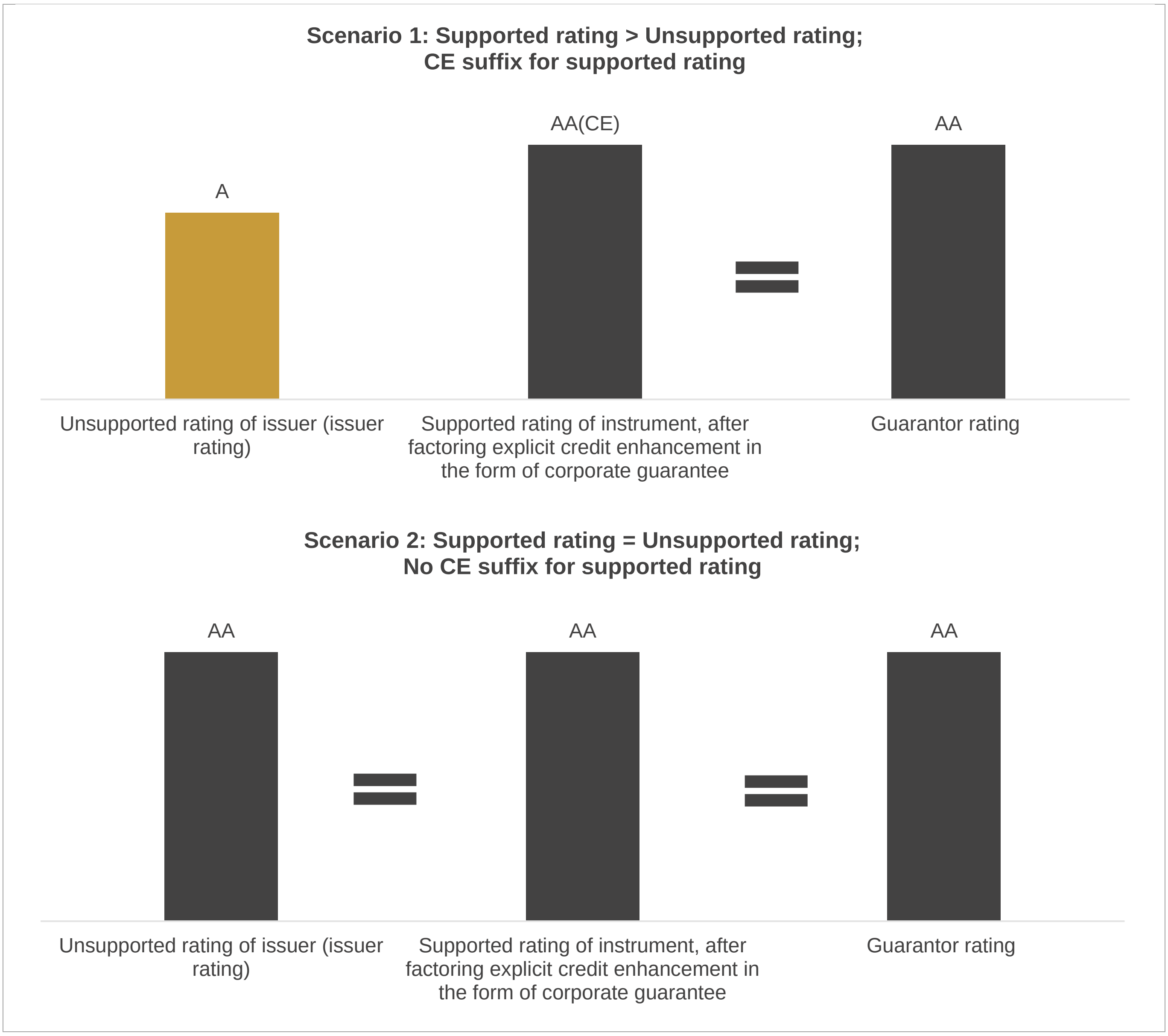
The 'CE' suffix is used only if the presence of the credit enhancement structure or mechanism results in a credit uplift for the instrument over and above the unsupported rating of the issuer.

Supported vs unsupported ratings for 'CE' structures

Supported ratings factor in the explicit credit enhancement. Unsupported ratings do not factor the credit enhancement from third party. Though explicit external credit enhancement is not factored in the unsupported rating, any implicit support from, say, a parent or group company, will be factored in.

The supported rating on a credit-enhanced instrument will be assigned the 'CE' suffix only if it is higher than the unsupported rating of the issuer. In other words, 'CE' suffix will be applied only if the external credit enhancement structure provides a credit uplift over and above the unsupported issuer rating. In the absence of any credit uplift, the credit enhancement structure does not add any enhancement to the instrument's rating.

Illustration: Supported and unsupported ratings for debt backed by corporate guarantee from the parent



Assessment of adequacy of ‘CE’ structures

The financial position of the third party providing the credit enhancement, and the impact of extending payment support to the issuer are assessed to determine the ability of the structure to ensure full debt repayment. Several scenarios, including stress scenarios, are considered.

For instance, in the case of corporate guarantees, the impact of the guaranteed liabilities on the guarantor’s credit profile, which, in turn, determines the supported rating of the guaranteed instrument, is considered. Stress scenarios correspond to varying levels of guaranteed debt that are assumed to devolve on the guarantor, and their impact on the guarantor rating. The results of such stress testing are articulated in the rating rationale.

CRISIL Ratings also scrutinises contractual agreements underpinning the structure to assess the legal risks involved. Legal opinions are obtained, wherever required, in order to confirm the adequacy of the legal provisions in the transaction documents.

For more details, please refer CRISIL Ratings’ criteria for “Criteria for rating instruments backed by guarantees”.

Conclusion

CRISIL Ratings applies ‘SO’ suffix to securitization or asset backed transactions backed by credit enhancement structures that lead to the instrument being bankruptcy remote from the issuer/originator. On the other hand, ‘CE’ suffix is applied to the ratings of instruments backed by explicit credit enhancements that are external, or from third parties / parents / group companies, but the instrument is not bankruptcy remote from the issuer/originator. The ‘CE’ suffix is applied only if the supported rating after factoring the explicit credit enhancement structure is higher than the unsupported rating without factoring the structure, thereby implying a credit uplift provided by the structure. The adequacy of the ‘CE’ structure to ensure full and timely debt repayment is evaluated under various scenarios, including stress scenarios.

Annexure I: 12-point framework to assess the strength of the guarantee

It should be unconditional: The support extended should be unconditional in nature in honouring the obligations under the guarantee.

It should be irrevocable: The support provider should not revoke the guarantee till all the obligations of the borrower are fully paid to the lender.

It should be enforceable: The support extended should be legally enforceable at any time during the tenure of rated facility.

The support should be for the facility in its entirety: The support should cover the entire facility being rated as applicable, including principal, interest or any other amounts payable as per the terms of the facility. In case of partial guarantees, the rating comfort derived shall be restricted to the extent of partial guarantee provided.

Guarantee for payment: The obligation of the support provider should be to pay the guaranteed amount without demur as per the sanctioning terms in case of default by the borrower and not merely ensure repayment by the borrower.

Payment mechanism: The guarantee deed should specify timelines for invocation of the guarantee by the lender, and for subsequent payment by the support provider.

Payment on first demand: The support provider should make payment under the guarantee on receipt of the first demand or notice from the lender as per the terms of the guarantee.

Payment without deduction: All guaranteed payments are to be made by the guarantor without any deductions.

Rights of Support provider to be Waived: The Indian Contract Act, 1872 provides certain rights to the guarantors, including automatic termination of the guarantor's obligations under certain situations (such as change in the terms of contract without the guarantor's consent as per Section 133). Hence, in case of any change in the terms of the contract, the guarantee needs to be reaffirmed by the guarantor for it to be treated eligible as a valid support for deriving the CE rating.

Guarantor is primary obligor: The lender is entitled to proceed against the support provider without waiting to exercise all its remedies.

Payment should happen in the event of insolvency: The support provider should agree to make payments even in case of any insolvency, liquidation, dissolution or any other analogous proceedings against the rated entity.

Overseas guarantors: If the guarantee is extended by an overseas support provider (foreign parent) in respect of subsidiaries/ group entities/ affiliates operating in India, the foreign guarantor should continuously hold a rating from at least one of the international rating agencies (S&P, Fitch Ratings and Moody's Ratings), which corresponds to a lower risk weight than the standalone rating of the borrower. Further, the CRAs shall assess all the aforementioned features of the guarantee and also ensure if there are no regulatory or legal issues in the guarantor making remittances under the guarantee as per the existing legal/ regulatory framework in the jurisdiction of the guarantor.

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