

Standard Operating Procedure for CRAs for monitoring and recognition of default

In order to standardise the operating process for monitoring and recognition of default, SEBI's circular, 'Guidelines for Enhanced Disclosures by Credit Rating Agencies (CRAs)' dated June 13, 2019, requires 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 noted that "CRAs have to be proactive in early detection of defaults/delays in making payments." SEBI had 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, all CRAs together have formulated an SOP for tracking and timely recognition of default. Recognition of default in a timely and consistent manner helps achieve the following objectives:

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

CRISIL shall adopt the following procedures as part of its SOP for monitoring and recognition of defaults, going forward.

1. **Communication with bankers:** The CRA shall write to the bankers for feedback at the time of the initial rating and at periodic intervals (at least once every quarter) to ascertain timeliness of debt servicing. If the bankers do not respond in writing, the discussions shall be documented (through email/letter to the banker).
2. **No default statement (NDS)** will be sought on a monthly basis from the issuer in line with SEBI regulations.
3. **Tracking confirmation from the 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on timely debt servicing on specific ISINs rated by the CRA in line with SEBI regulations:** For securities, the withdrawn rating shall be included in the computation of default rates till the completion of the 3-year cohort or the maturity of the instrument, whichever is earlier.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 CRA shall continue to track the confirmation received from the debenture trustee on the status of debt servicing on securities even after rating withdrawal, where applicable.
4. **Monitoring of stock exchange websites:** The CRA shall monitor the websites of stock exchanges 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 debt servicing, the CRA will publish a press release within the timeline prescribed under regulations.
6. **Disclosure in case of non-confirmation of timely debt servicing:** If no confirmation regarding servicing of the listed security is received by the CRA from the debenture trustee within 1 day after the due date, the CRA shall immediately follow up with the issuer for confirmation of payment. If no response is received from the issuer within 2 days of such communication, the CRA shall publish a

press release as per the SEBI prescribed format on its website and send it to all stock exchanges where the security is listed.

7. Rating agreements shall be suitably modified to incorporate the issuer's 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 default: In rare circumstances, if a CRA becomes aware of any delay that occurred in the past and has not been recognised 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 and the SOP on the curing period (mentioned below).

9. Default on instruments not rated by the CRA:

If an issuer defaults on an unrated instrument which has the same seniority as the instrument rated 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 clarity, we seek to highlight 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 if there is a structure around the cash flow.
- c. The CRA, in its annual default studies, shall list all companies where ratings may not have been downgraded to 'D' but the issuer has been included in the default study for that year due to default on unrated debt.

10. Curing period post default:

- a. The curing period principle for default category ratings should apply to a fresh rating assignment as well as surveillance assignments and usually at an issuer level. To emphasise, 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, as a default on such instruments may not necessarily imply a default by the issuer on senior instruments, the curing period should apply at the instrument level. In case of default on subordinated or hybrid instruments, the rating on a senior instrument may not be upgraded during the curing period.
- c. If a rated instrument is credit enhanced or if there is a structure around the cash flow, the curing period will apply at the instrument level, as default by the issuer on other instruments may not imply or lead to default on such instrument.