CARE's Policy on Default Recognition

[In supersession of CARE's Policy on Default Recognition issued in Sept2019]

1. Background

CARE's ratings are an opinion on the relative ability and willingness of an issuer to repay debt (including interest and other obligations) in a timely manner. CARE follows a concept of 'one-day-one rupee' delay for default recognition in respect of all debt instruments and CARE has made this stance public through its various communications in the past.

CARE Ratings had earlier published its detailed policy on default recognition vide press release dated November 26, 2012 which was amended on May 9, 2013 to incorporate the changes in the RBI guidelines to CRAs. Further, the policy was updated in line with SEBI guidelines dated November 1, 2016 for default recognition and post-default curing period. CARE Ratings had last reviewed its policy on default recognition in September, 2019. CARE's default recognition policy is in line with the SEBI guidelines, wherein, in respect of ratings for instruments/bank facilities with a pre-determined repayment schedule, 'one-day-one-rupee' delay is considered, whereas for facilities with no pre-determined repayment schedule, a 30 day 'grace period' is considered. This apart, SEBI has stipulated default recognition criteria in case the rated instrument is rescheduled as also specific timelines when a rating can be revised upwards from 'Default grade' (CARE D). These changes have been carried out in CARE's policy on default recognition.

This document explains in detail the instrument-wise definition of default followed by CARE, and the criteria for treatment of defaults while assigning initial ratings and review of outstanding ratings.

2. Instrument-wise definition of default followed by CARE

Facilities *	Rating Scale	Definition of Default
Fund-based facilities & Facilities with pre-defined repayment schedule #		
Term Loan	Long Term	A delay of 1 day even of 1 rupee (of principal or interest) from the scheduled repayment date.
Working Capital Term Loan		
Working Capital Demand Loan (WCDL)		
Debentures/Bonds		
Certificate of Deposits (CD)/ Fixed Deposits (FD)	Short Term/ Long term	
Commercial Paper	Short term	
Packing Credit (pre-shipment credit)	Short Term	Overdue/unpaid for more than 30 days.
Buyer's Credit	Short Term	Continuously overdrawn for more than 30 days.
Bill Purchase/ Bill discounting/ Foreign bill discounting / Negotiation (BP/BD/FBP/FBDN)	Short Term	Overdue/unpaid for more than 30 days.
Fund-based facilities & No Pre Defined Repayment Schedule		
Cash Credit	Long Term	Continuously overdrawn for more than 30 days.
Overdraft	Short Term	Continuously overdrawn for more than 30 days.
Non fund-based facilities		
Letter of credit (LC)	Short Term	Overdue for more than 30 days from the day of devolvement.
Bank Guarantee (BG) (Performance/ Financial)	Short Term	Amount remaining unpaid from 30 days from invocation of the facility.
Other Scenarios		
When rated instrument is rescheduled:		Non-servicing of the debt (principal as well as interest) as per the existing repayment terms in anticipation of a favourable response from the banks of accepting their restructuring application/ proposal shall be considered as a default. Rescheduling of the debt instrument by the lenders prior to the due date of payment will not be treated as default, unless the same is done to avoid default or bankruptcy.
When instrument backed by a guarantee is in default		CARE rates instruments backed by the guarantor on the strength of the guarantor in case the entire debt is backed by a guarantee. The recognition of a default on such instrument is based on the guarantor becoming aware of his obligation to pay on invocation and his ability to make the payment within the stipulated time once the guarantee is invoked. Hence, post invocation of the guarantee by the trustee / banker/ investor, failure by the guarantor in servicing the debt obligation (principal as well as interest) of issuer within the stipulated time shall be construed as default.
Curing Period	A	90 Days – for Default to Speculative Grade
	B@	Generally 365 Days@ for Default to Investment Grade

**For bank loan ratings, default recognition will need to be in line with the RBI guidance*

 # If the sanctioned terms allow grace period for payment after due date, CARE also considers the due date considering the grace period

@ CARE may deviate from the stipulated curing period (under B in table above) for upgrading rating to investment grade in certain situations (after 90 days), where it believes that the underlying credit profile of the entity has altered significantly following specific events like change in ownership and significant infusion of long-term funds or certain forms of refinancing which lead to complete replacement of the facilities/instruments in default.

3. Treatment of default in Initial Ratings

In case of **initial ratings**, a rating of 'CARE D' is assigned in case of ongoing delays in debt repayment of the rated instrument. In case of instances of past delays in repayment of any debt instrument, the following four dimensions of delay are analysed: a) the extent of delay (number of days of delay), b) frequency of delay (number of times the delay occurred in the past one year), c) severity of delay (amount not paid vis-à-vis amount due) and d) status of an ongoing delay (facility in default). 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. For subordinate instruments and structured instruments, curing period will apply on instrument level.

Rating Action

- In case of (d) above, a rating of 'CARE D' is assigned if the delay is in respect of the rated instrument.
- In other cases, the rating would take into account the extent, frequency and severity of the delay as also how recent the delay has occurred. A default free track record of 90 days is required to assign ratings in the speculative grade other than CARE D [i.e. from CARE BB+ to CARE C- (long term rating) and CARE A4+ or CARE A4 (short term rating)], and generally a default free track record of 365 days[1] is required to assign an investment grade rating.

4. Treatment of default in review of outstanding ratings

Whenever CARE becomes aware of any missed payment, the rating is brought down to 'CARE D' and in case the delay has been cured, the rating can be moved within the sub-investment category based on extent, frequency, severity and the date of occurrence of delay. A default free track record of 90 days is required to move an instrument/facility's rating from CARE D to other ratings in the speculative grade and generally a default free track record of 365 days[1] is required to move an instrument/facility's rating from CARE D to investment grade.

[1] *CARE may deviate from the stipulated curing period (under B in table on page 2) for upgrading rating to investment grade in certain situations (after 90 days) where it believes that the underlying credit profile of the entity has altered significantly following specific events like change in ownership and significant infusion of long-term funds or certain forms of refinancing which lead to complete replacement of the facilities/instruments in default.*

5. Treatment of default in case of hybrid instrument ratings

The terms of the hybrid instrument may allow deferment of principal and / or interest payment in case of invocations of certain pre agreed clauses. Any delay in payment of interest/principal (as the case may be) following the invocation of the lock-in clause, is considered an event of default as per CARE's definition of default and as such, these instruments may exhibit a somewhat sharper migration of the rating compared with conventional subordinated debt instruments.

6. Treatment of default in case of technical delay / dispute

CARE examines the reasons for default from the rated entity, duly corroborated by the investor / lender. If as per CARE's assessment, the delay was not caused by liquidity stress at the issuer level but due to some technical problem, then default is not recognised. However, based on the assessment, severity and frequency of such incidences, the credit rating of the issuer may be reviewed.

'Technical problem' referred above is a procedural issue which may result into delay in payment and not a credit issue related to the ability of the entity to meet the debt obligations. Technical problem would typically be with respect to transfer of funds or mechanism of transfer of funds and not related to availability of funds and willingness of the issuer to meet obligations on time.

[Reviewed in February 2020. Next review due in February 2021]

CARE Ratings Limited
4th Floor, Godrej Coliseum, Somaiya Hospital Road,
Off Eastern Express Highway, Sion (East), Mumbai - 400 022.
Tel: +91-22-6754 3456, Fax: +91-22- 6754 3457, E-mail: care@careratings.com