

# CARE's Policy on Default Recognition

(Issued on July 27, 2018)

[In supersession of CARE's Policy on Default Recognition issued on [August 17, 2017](#)]

## 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. SEBI had on November 1, 2016 issued guidelines to CRAs for default recognition and post-default curing period. Accordingly CARE Ratings had last published its policy on default recognition on August 17, 2017. CARE's default recognition policy is more or less 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
<b>Fund-based facilities &amp; Facilities with pre-defined repayment schedule</b>		
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.
<b>Fund-based facilities &amp; No Pre Defined Repayment Schedule</b>		
Cash Credit	Long Term	Continuously overdrawn for more than 30 days.
Overdraft	Short Term	Continuously overdrawn for more than 30 days.
<b>Non fund-based facilities</b>		
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.
<b>Other Scenarios</b>		
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

@ CARE may deviate from the stipulated curing period (under B in table above) for upgrading rating to investment grade in certain situations 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 (no. of days of delay),
- (b) frequency of delay (no. of times the delay occurred in the past one year),
- (c) severity of delay (amount not paid vis-à-vis amount due)
- (d) status of an ongoing delay (facility in default)

### **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@ is required to assign an investment grade rating.

*@ CARE may deviate from the stipulated curing period (under B in table in page 2) for upgrading rating to investment grade in certain situations 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.*

## 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@ is required to move an instrument/facility's rating from CARE D to investment grade.

*<sup>@</sup> CARE may deviate from the stipulated curing period (under B in table in page 2) for upgrading rating to investment grade in certain situations 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.*

**Disclaimer**

*CARE's ratings are opinions on credit quality and are not recommendations to sanction, renew, disburse or recall the concerned bank facilities or to buy, sell or hold any security. CARE has based its ratings/outlooks on information obtained from sources believed by it to be accurate and reliable.*

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