

# CARE's Policy on Default Recognition

(Issued on February 1, 2017)

[In supersession of CARE's Policy on Defaults issued on May 9, 2013 & January 2, 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 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 has recently issued guidelines to CRAs for default recognition and post-default curing period. 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 now 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  |                       | 90 Days – for Default to Speculative Grade and generally 365 Days for Default to Investment Grade  |

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

### 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.

### 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.

#### **Disclaimer**

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