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tions and interpretations

of India (SEBI) has not only tightened disclosure norms for Indian credit rating agencies, but has also shone a light on the lacunae of the existing norms. Investors relying on rating agencies to make their investment decisions were mainly concerned about the sharp downgrades which have hurt them in the past. Investors can now find comfort from the SEBI's diktat that requires rating agencies to put out detailed rating criteria on their websites, and subsequent revisions to them.

Of the various rating criteria that rating agencies need to be formulate, the one on default recognition and curing period is particularly important.

What constitutes default?

Rating agencies normal follow a rating scale that ranges from AAA (highest safety regarding timely servicing of debt) to D (in default or expected to be in default soon).

SEBI has now clearly laid down the definition of default across various instruments, removing any ambiguity. For instance, in case of term loans, working capital loans, bonds, fixed deposits, certificate of deposits and commercial paper, a default would said to have occurred if there has been a delay of even one day of even 1 rupee (of principal or interest) from the scheduled repayment date. For buyer's credit, packing credit and bill purchase, overdue of over 30 days is considered as default.

"Many of these definitions already existed but there was variation amongst rating agencies on interpretation of specific instruments. To bring consistency and standardisation in the definition of what constitutes default SEBI has now laid it down clearly the definition of default for various instruments," says Rajesh Mokashi, MD & CEO, CARE Ratings.

Buying time

SEBI has also gone ahead and clarified definitions of default recognition in the case of restructuring.

At times when the borrower approached the lender to reschedule the loan or debt instrument, it was unclear if rating agencies should consider the revised repayment date or go with the earlier stipulated due date. Now SEBI has clearly laid down two scenarios. If the borrower has approached the lender prior to the due date and sought more favourable terms, than rating agencies can consider such rescheduling and not treat the loan or debt instrument as default. If however, the borrower has not serviced the debt, hoping for favourable terms from the lender, it will be treated as default.

Putting the conditions down in black and white has removed some of the interpretative issues that existed earlier, Mokashi says.

Stability in ratings

Aside from the consistency in recognition of default across rating agencies, investors can also draw comfort from the stability in ratings.

Many a time, it has been found that rating agencies have re-rated instruments at short frequencies, leaving investors in a lurch.

SEBI has now stipulated that once an instrument is downgraded it cannot be upgraded soon, giving investors ample time to factor in revisions. Any revision upwards from default to speculative grade cannot happen before 90 days. Similarly ratings cannot move from default to investment grade, before a year (365 days).

BB and below rated instruments are speculative grading. BBB- and above are considered investment grade.

"While definitions of curing periods are provided by RBI, further elaboration of curing of default rating to speculative grade and investment grade ratings have been provided by SEBI," says Mokashi.

Different perspectives

For an investor, up until now, ratings by multiple agencies have not added much value; mostly all agencies give similar ratings to an instrument.

This was because of the non acceptance of ratings by issuers of debt instruments. Companies are not obliged to accept the initial ratings and could shop around for better ratings if need be. The rejection rates were about 20-odd per cent, according to market players.

Earlier ratings that were rejected were kept confidential, and what came out in the public domain were probably ratings that were to the issuers' liking and hence they were mostly similar. Now all ratings--accepted or not, similar or varied-- will be out in the public domain.

However while rating agencies will be obliged to disclose these ratings on their websites, investors usually go by the information put out by the issuer company. It is unclear as of now, particularly for unlisted companies outside the SEBI's purview, whether companies will also have to disclose all ratings in their offer document when they raise deposits or bonds.

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