Policy on Default Recognition

[Issued in December 2022]

Background

CARE Ratings Limited's (CARE Ratings') 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 Ratings' default recognition policy is updated in line with the Securities and Exchange Board of India (SEBI) guidelines issued from time to time[1], wherein, in respect of ratings for instruments/bank facilities with a pre-determined repayment schedule, a 'one-day one-rupee' delay in debt servicing is considered as default, whereas for facilities with no pre-determined repayment schedule, a 30 days 'grace period' is considered prior to categorising it as a default. This apart, there are specific guidelines on default recognition in case the rated instrument/facility is rescheduled and the 'curing' period post which a rating may be revised upwards from 'Default grade' (CARE D). Changes concerning these have been carried out in CARE Ratings' policy on default recognition.

This document explains in detail the definition of default followed by CARE Ratings and the criteria for the treatment of defaults while assigning initial ratings and reviewing outstanding ratings.

1. Instrument-wise/Facility-wise definition of Default

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		
Debentures/Bonds		
Certificate of Deposits/ Fixed Deposits	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	Short Term	Overdue for more than 30 days from the day of devolvement.
Bank Guarantee (Performance/ Financial)	Short Term	The amount remaining unpaid for more than 30 days from the invocation of the facility.

[1] SEBI Circular no. SEBI/ HO/ MIRSD/ CRADT/ CIR/ P/ 2020/ 87 dated May 21, 2020 incorporated

Facilities *	Rating Scale	Definition of Default
Other Scenarios		
When the rated instrument/facility is rescheduled:		Non-servicing of the debt (principal or interest or both) as per the existing repayment terms in anticipation of a favourable response from the banks/investors of accepting their restructuring application/ proposal shall be considered a default. Rescheduling of the debt instrument by the lenders/investors before the due date of payment will not be treated as default unless the same is done to avoid default or bankruptcy.
When debt servicing of an instrument/facility backed by a guarantee is not done on the due date		In such cases, the recognition of default is generally dependent upon the nature of the structured payment mechanism (SPM) mentioned in the guarantee document. The SPM generally contains a 'T-' structure, where 'T' is the due date. In case the payment mechanism is not adhered to and there is a missed payment on such due date, default is recognised on the said facility/ instrument. In some cases, the payment mechanism mentioned in the guarantee document may be a 'T+x' structure, where 'x' is the number of days for making the payment after the due date. In case of such 'T+x' structures, CARE Ratings would recognise default on the facility/instrument if payment mechanism is not adhered to and debt servicing is not done by the 'T+x'th day, with 'T+x'th day being very close to the 'T'th day. In cases where there is no structured payment mechanism mentioned in the guarantee document, notwithstanding whether the guarantee is invoked or otherwise, if there is a missed payment on the due date, CARE Ratings would recognise default on the said facility/instrument.
Curing Period@		90 Days – for revision from Default to Speculative Grade.
		Generally 365 Days for revision from 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 a grace period for payment after the due date, CARE Ratings considers the due date after taking into account the grace period

@ CARE Ratings may deviate from the stipulated curing period as elaborated in CARE Ratings' policy on the curing period available at www.careedge.in.

2. Treatment of default in initial ratings

In the 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 (a facility in default). A non-default rating will 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, the curing period will apply on the instrument level.

Rating action

- In the 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 will take into account the extent, frequency and severity of the delay, as also how recently 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 Ratings may deviate from the stipulated curing period as elaborated in CARE Ratings' policy on the curing period available at www.careedge.in.

3. Treatment of Default in review of outstanding ratings

Whenever CARE Ratings becomes aware of any missed payment on a rated instrument, the rating of that instrument is brought down to 'CARE D'. The rating of all other instruments rated by CARE Ratings, which have the same seniority as the instrument that has defaulted will move to near default grade, as the circumstances that caused a delay in debt servicing on one instrument may also affect the debt servicing of other instruments. However, CARE Ratings may, in certain situations, not move the ratings on all other instruments to near-default grade if strong instrument-specific mitigating factors exist to conclude that instances of delinquencies/defaults on other instruments are unlikely to lead to a default on the rated instrument. After curing the delay, the default grade rating can be moved within the sub-investment category based on the extent, frequency, severity and the date of occurrence of the 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. CARE Ratings may deviate from the stipulated curing period as elaborated in the policy on the curing period available at www.careedge.in.

4. Default on instruments not rated by CARE Ratings

In case an issuer with an outstanding rating from CARE Ratings defaults on any instrument (other than the rated one), which has the same seniority as the instrument rated by CARE Ratings, the rating of the instrument rated by CARE Ratings (which is not in default) will move to near default grade. This is because the factors that caused the delinquency/default on other instruments may also affect the debt servicing on the rated instrument. However, CARE Ratings, in certain situations may not move the ratings on all other instruments to CARE D/near default grade, if strong instrument-specific risk-mitigating factors exist to conclude/believe that instances of delinquencies/defaults on other instruments are unlikely to lead to a default on the rated instrument.

5. Treatment of Default in case of hybrid instrument ratings

The terms of the hybrid instruments 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 Ratings' 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 Ratings examines the reasons for default from the rated entity, duly corroborated by the investor/lender. If as per CARE Ratings' assessment, the delay was not caused by liquidity stress at the issuer level but due to some technical problem, then the 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 to above is a procedural issue which may result in a delay in payment and not a credit issue related to the ability of the entity to meet the debt obligations. The technical problem will typically be concerning the transfer of funds or mechanism of transfer of funds by the issuer/obligor and is not related to the availability of funds and willingness of the issuer/obligor to meet obligations on time.

[For the previous version, please refer to ‘CARE Ratings’ Policy on Default Recognition’ issued in September 2021]

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About:

CareEdge is a knowledge-based analytical group that aims to provide superior insights based on technology, data analytics and detailed research. CARE Ratings Ltd, the parent company in the group, is one of the leading credit rating agencies in India. Established in 1993, it has a credible track record of rating companies across multiple sectors and has played a pivotal role in developing the corporate debt market in India. The wholly-owned subsidiaries of CARE Ratings are (I) CARE Advisory, Research & Training Ltd, which offers customised advisory services, credible business research and analytical services (II) CARE Risk Solutions Private Ltd, which provides risk management solutions.