POLICY ON DEFAULT RECOGNITION

This document describes Infomerics policy on default recognition when an entity fails to meet its debt servicing obligations in a timely manner. This document outlines Infomerics default recognition principles for ratings assigned to all financial instruments, long-term and short-term debt, bank loan ratings, fixed deposits, structured finance instruments, and corporate credit ratings. This document also specifies Infomerics policy on upgrading the rating once the default is cured. The policy draws from the various guidelines issued by the Securities and Exchange Board of India (SEBI) on this subject in the past, including the most recent circular (SEBI/ HO/ MIRSD/ CRADT/ CIR/ P/ 2020/ 87) dated May 21, 2020. The policy also incorporates the past guidelines issued by the Reserve Bank of India (RBI) on this subject, prescribing a uniform default definition for bank loan facilities.

This policy update supersedes Infomerics earlier document on this subject, approved in the BM dated 03rd July, 2020.

RECOGNITION OF DEFAULT

Infomerics considers the first instance of a missed payment as an 'event of default' for instruments with pre-defined repayments such as Debentures, Bonds, Commercial Paper or Term Loans. Default is recognised irrespective of the magnitude and period of delay and can be summarized as not meeting the 'one-day-one-rupee' condition. Default recognition on working capital bank loan facilities without a pre-defined repayment schedule, such as Cash Credit or Overdraft, is after the facility remains continuously overdrawn for more than 30 days. A similar default definition of 30 days of the facilities being overdue is considered for other working capital facilities such as Packing Credit and Letter of Credit. Instrument-wise definition of default is provided at **Annexure I.**

Upon recognition of a default, as determined by Infomerics policy, the outstanding ratings will be downgraded to 'IVR D'.

The default recognition policy is consistent with the regulatory guidelines/prescriptions i.e.

a) SEBI guidelines (CIR/MIRSD/CRA/6/2010) dated May 03, 2010 has specified that default be recognized at the first instance of delayed payment.
b) SEBI guidelines (SEBI/HO/MIRSD/MIRSD4/CIR/P/2016/119 dated 01 November, 2016 - Enhanced Standards for Credit Rating Agencies) lays down the principal and has provided instrument-wise default recognition to be adhered to by all credit rating agencies.
c) Standard Operating Procedure for CRAs for Monitoring and Recognition of Defaults as prescribed by SEBI Master Circular SEBI/HO/MIRSD/DOP2/CIR/P/2018/76, dated May 2, 2018.
d) RBI circular (DBR.No.BP.BC.4./21.06.001/2015-16 dated 01 July 2015- Master Circular - Prudential Guidelines on Capital Adequacy and Market Discipline-New Capital Adequacy Framework (NCAF)) states that external credit "assessment must fully take into account and reflect the credit risk associated with timely repayment of both principal and interest"
e) RBI has prescribed uniform default definition for bank loan ratings as below:
    a. For bank facilities having a predefined repayment date/due date, the definition of 'one day one rupee' may be adhered to;
    b. For revolving facilities like cash credit, CRAs may allow, as of now, grace period upto the maximum of 30 days from the date of overdraw, beyond which an activity would be considered as 'default';

ANNEXURE I

Instrument/Facility wise Default Recognition & Post-Default Curing Period

<table>
<tr><th>Facilities/Debt Instruments</th><th>Rating Scale</th><th>Definition of Default</th></tr>
<tr><td colspan="3">Fund-based facilities & Facilities with pre-defined repayment schedule</td></tr>
<tr><td>Term Loan</td><td rowspan="4">Long Term</td><td rowspan="6">A delay of 1 day even of 1 rupee (of principal or interest) from the scheduled repayment date.</td></tr>
<tr><td>Working Capital Term Loan</td></tr>
<tr><td>Working Capital Demand Loan (WCDL)</td></tr>
<tr><td>Debentures/Bonds</td></tr>
<tr><td>Certificate of Deposits (CD)/Fixed Deposits (FD)</td><td>Short Term/Long Term</td></tr>
<tr><td>Commercial Paper</td><td>Short Term</td></tr>
<tr><td>Packing Credit (pre-shipment credit)</td><td>Short Term</td><td>Overdue/unpaid for more than 30 days.</td></tr>
<tr><td>Buyer’s Credit</td><td>Short Term</td><td>Continuously overdrawn for more than 30 days.</td></tr>
<tr><td>Bill Purchase/Bill discounting/Foreign bill discounting/Negotiation (BP/BD/FBP/FBDN)</td><td>Short Term</td><td>Overdue/unpaid for more than 30 days.</td></tr>
<tr><td colspan="3"></td></tr>
<tr><td colspan="3">Fund-based facilities & No Pre Defined Repayment Schedule</td></tr>
<tr><td>Cash Credit</td><td>Long Term</td><td>Continuously overdrawn for more than 30 days.</td></tr>
<tr><td>Overdraft</td><td>Short Term</td><td>Continuously overdrawn for more than 30 days.</td></tr>
<tr><td colspan="3">Non fund-based facilities</td></tr>
<tr><td>Letter of credit (LC)</td><td>Short Term</td><td>Overdue for more than 30 days from the day of devolvement</td></tr>
</table>

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.
Curing Period		90 Days for Default to Speculative Grade and 365 days for Default to Investment Grade.

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

Default on Instruments not rated by Infomerics:

When issuers with outstanding Infomerics rated instruments default on external debt/ loan facilities rated by other CRA's (not rated by Infomerics), it is very likely that the outstanding Infomerics Rating will be lowered to near-default status. The severity of the rating action would be based on Infomerics assessment of the information received regarding reasons of default and the credit quality of the issuer.

However, if strong reasons exist for differentiating among the rating of the debt instrument that is in default and that of the other debt instruments that aren't, the reasons and protective factors for such instruments (that are not in default), as assessed by Infomerics, would have a critical bearing on the rating of the other debt instruments. In such cases, the rating of the other instruments may not be revised to 'IVR D', but suitably reviewed. The above described rating action could be taken in the following cases, among others:

-The other debt instruments on which there is no default are senior to the debt in default and the default probability of the senior debt is distinctly lower than that of the debt in default.

-The cash flows meant for servicing the other debt instruments (that are not in default) are ring fenced and no cross-default clauses apply

-The other debt instruments on which there is no default are supported by a third-party explicit support such as a corporate guarantee.

Default recognition in case of rescheduling of debt:

Re-schedulement of debt is generally perceived as step taken by the issuer and investors to escape the label of default. However considering the current scenario of stress on account of pandemic, Infomerics would take cognizance of the factors that necessitated the obligor to reschedule its debt and the circumstances that led the investor to provide its consent.

Further Infomerics will not treat re-schedulement of debt obligation as default, provided the investors in the instrument grant a formal consent for revision in the terms of repayment sufficiently prior to the repayment due date. Infomerics would consider the new repayment schedule for its assessment of credit risk.

Default recognition for retrospective defaults:

Infomerics monitors the credit quality of all its outstanding ratings on a periodic basis. However, there might be a rare instance where there has been a delayed payment on a rated instrument in the past, without CRA getting to know about it, but the account has since been regularised and demonstrates a sufficiently long track record of timely repayment. In such cases, Infomerics shall downgrade the rating of the entity to default category while simultaneously upgrading the rating to a level that takes into account the track record of timely repayments.

When the instruments backed by guarantee are in default:

In case of instruments backed by guarantee from a third party, there should exist a clear payment mechanism. The documents should state that in case the issuer is unable to make the payment as per the terms outlined in the payment mechanism, the guarantor will clear all the dues on the guaranteed instrument, within the time stipulated in the payment mechanism when the trustee/ banker invokes the guarantee. In case the instrument is not serviced within the timelines mentioned in the payment mechanism, Infomerics will downgrade the rating on the guaranteed instrument to the default category.

Default recognition in case of hybrid instruments

Infomerics rates hybrid instruments on the same scale as conventional debt instruments. Infomerics ratings on hybrid instruments reflect the likelihood of timely servicing on the instrument. Hence, if the issuer skips or defers the payment on the instrument, the rating on the hybrid instrument will be downgraded to 'IVR D', even though it may be permitted as per the terms of the instrument.

Dealing with technical delays

In case Infomerics can establish that the occurrence of a delay or a missed payment by an entity is solely because of technical reasons/ errors, beyond the control of that entity, and that such an occurrence is not a reflection of the lack of ability or willingness of the entity to pay its debt obligations, such occurrence is not treated as a default. Additionally, Infomerics would ascertain if the delay is expected to correct in few business days and whether the issuer has taken corrective measures to avoid such instances in future.

CURING PERIOD POST DEFAULT

A. Currently, CRAs recognize default based on the guidance issued vide SEBI circular dated May 3, 2010 and November 1, 2016.

B. In view of the nationwide lockdown and the three month moratorium/ deferment on payment permitted by RBI, a differentiation in treatment of default, on a case to case basis, needs to be made as to whether such default occurred solely due to the lockdown or loan moratorium.

C. Accordingly, based on its assessment, if the CRA is of the view that the delay in payment of interest/principle has arisen solely due to the lockdown conditions creating temporary operational challenges in servicing debt, including due to procedural delays in approval of moratorium on loans by the lending institutions, CRAs may not consider the same as a default event and/or recognize default. Appropriate disclosures in this regard shall be made in the Press Release.

D. The above shall also be applicable on any rescheduling in payment of debt obligation done by the issuer, prior to the due date, with the approval of the investors/lenders.

E. The above relaxation is extended till the period of moratorium by the RBI. in which SEBI instructed CRAs to evaluate each default on a case to case basis and observe whether it is on account of COVID 19 induced lockdown."

Further on May 21, 2020, SEBI released a circular SEBI/ HO/ MIRSD/ CRADT/ CIR/ P/ 2020/ 87 which directed CRAs to frame individual policies for movement of default rating into sub investment and investment grade and not necessarily abiding by the curing period of 90- days (default to sub investment grade) and 365- days (default to investment grade) criteria."

Keeping in view the regulatory directives and the need to have framework to review the existing downgrade in ratings, we propose the following policy for movement of ratings from default grade sub investment /investment grade under different scenarios:-

Situations where rating can be upgraded from 'Default' grade before the stipulated 90 days curing period.

	DEFAULT	To Investment Grade	To Sub Investment Grade
1.	**Delay due to technical reasons**	**Immediate**	**Immediate**
		i) Delay and default due to technical reasons shall be construed if the issuer is able to demonstrate with adequate proof to	

		INFOMERICS that the company had sufficient liquidity available in the bank accounts and there was willingness to pay the same on due date. However delay has occurred due to technical reason such as deficiency in the service on the part of the bank or intermediary to effect transfer of funds from one account to another or one bank to another Bank where the funds were required due to non-availability of staff or closure of Branch/offices due to lock down or placed in containment zone. This or any other reason which may be construed as technical reason by the INFOMERICS due to which the issuer was unable to remit the funds on due date for repayment of debt. ii)The issuer shall submit the documentary proof in connection with following:- ▪ Circumstances under which the delay/default occurred at the first place. ▪ No due certificate issued by the Bank/FI that the over dues are cleared after the technical issue is resolved. ▪ Bank statement to confirm regularization of the account. ▪ Letter/Email from the bank/investor clearly mentioning that the delay was due to technical reasons and the account is running satisfactorily with no delay/defaults.	
2.	**Change in Promoter/Management**	**Immediate /After at least one quarter of operation under the new promoter/management**	**Immediate**
		In order to protect the economic capital in the shape of investment in plant and machineries and business processes, the stakeholders are coming together to restructure the non-performing assets with merger and acquisition. The change in promoters with control over the management may have significant impact on the credit risk profile of the issuer. When	

		such change is coupled with infusion of additional funds by the new Promoters/Management, it may strengthen the financial risk profile of the issuer and deserve a review of the existing "default" rating of the issuer. Infomerics shall review the existing rating only if the following if the following is complied with i) The new promoters are not closely related to the previous promoters /management. ii) The new promoters/management has infused fresh funds to improve the financial risk profile. iii) The delay and default has been cleared and the credit facilities are restored/being restored by the lenders. iv) After considering an impact analysis, rating may be upgraded to the appropriate scale based on the risk profile under the new promoters.	
3.	**Merger and Acquisition by another entity**	**Immediate**	**Immediate**
		In case of acquisition by way of merger, the credit risk and financial risk profile undergoes a change. INFOMERICS shall conduct a fresh credit risk assessment based on the Acquirer or on the merged entity. Hence a fresh rating can be assigned notwithstanding the delay/default in the now defunct entity subject to the following:- i) The merger of the defunct unit is with entities owned by new promoters which not closely related to the previous promoters /management. ii) The new promoters/management has infused fresh funds to improve the financial risk profile of the merged entity. iii) The delay and default has been cleared and the credit facilities are restored/being restored by the lenders. After considering an impact analysis, rating may be upgraded to the appropriate scale based on the credit risk profile of the merged entity.	

4.	**Sizable inflow of long term funds**	**Immediate**	**Immediate**
		If inflow of long term fund reduces the immediate liabilities and/or defers/ease off/reduce the debt repayment obligations the rating may be assigned/revised based on the revised credit risk profile of the issuer/borrower. However, the inflow amount should be material and we may consider various other factors while assigning the rating. Most importantly all dues needs to be cleared.	
5.	**Benefit arising out of regulatory action**	**After 90 days**	**After 30 days**
		Keeping in view the lock down situation, RBI has advised lenders to extend moratorium on loan instalments and interest payment for a period of three months which was later extended by another three months. It has come to our notice that there was delay in extending moratorium by some of the lenders to their clients which resulted in delay and default in the repayment and attracted downgrade by the CRAs. INFOMERICS shall deem such a delay/default as technical in nature and take rating action appropriately subject to submission of the following documentary evidence by the issuers:- 1. Letter/Email from the bank/investor that the moratorium was allowed albeit with delay 2. Prior to application for moratorium there was no ongoing delay/default at least for 1 month and the account was standard and was running satisfactorily. (Banker letter/mail)	

Relaxation from Default recognition due to restructuring of debt due to COVID-19 related stress

SEBI vide its circular **SEBI/ HO/ MIRSD/ CRADT/ CIR/ P/ 2020/ 160, dated August 31, 2020** has issued guidance to CRAs to provide relaxation from default recognition due to restructuring of debt and as per the RBI notification no. **RBI/2020-21/16 DOR.No.BP.BC/3/21.04.048/2020-21 dated August 6, 2020** towards resolution framework for COVID-19 related stress. The said relaxation is extended till December 31, 2020.

Based on the aforementioned SEBI / RBI circulars, Infomerics Ratings shall adopt the following approach in case of entities witnessing stress due to the COVID-19 pandemic subject to the entity was not in default as on 1st March 2020 as per RBI guidelines on the subject.

A. For Bank loans/ capital market related instruments:

Entity has applied to lenders for resolution under COVID-19 framework	**Default Recognition**
I. Before due date of payment (a) Application accepted and framework being implemented within 180 days of invocation. (b) Application pending with lenders (period between application & implementation). Plan is likely to be implemented within 180 days	No Default.
II. After due date of payment.	Default to be recognised. Rating will migrate to IVR D.
III. Application rejected by lenders (resolution not implemented) – Entity has not made the payment within stipulated timeline.	Default to be recognised. Rating will migrate to IVR D.
IV. Application rejected by lenders (resolution not implemented) – Entity has made the overdue payment within stipulated timeline.	NO default

B. For Capital Market related listed or unlisted Instruments:

I. Before due date of payment (a) Application accepted and framework being implemented within 180 days of invocation. (b) Application pending with lenders (period between application & implementation). Plan is likely to be implemented within 180 days	No Default.
II. After due date of payment.	Default to be recognised. Rating will migrate to IVR D.

However keeping in view the above framework, a default is not recognised or rating is not migrated to IVR D, Infomerics Ratings may take an appropriate rating action including change in outlook based on its assessment of the resolution plan and its efficacy, to reflect the credit quality of the issuer/borrower.

As approved by the Board Members through circulation on 6th November, 2020.