



ICRA Rating Feature

Approach for Default Recognition

This note describes ICRA's policy for default recognition when an entity fails to meet its debt servicing obligations in a timely manner. The note is prepared based on the circular dated November 1, 2016 issued by the Securities and Exchange Board of India (SEBI) prescribing enhanced standards for credit rating agencies; and also the letter dated April 26, 2013 issued by the Reserve Bank of India (RBI) prescribing a uniform default definition for bank loan facilities.

This note updates and supersedes ICRA's earlier note on this subject, published in 2012. While this revised version incorporates a few modifications, ICRA's overall approach to default recognition remains materially similar.

ICRA's Definition of Default

Default recognition in case of bank facilities or borrowing programmes that have a pre-defined repayment schedule

- » ICRA defines default as a missed or a delayed payment by an entity in breach of the agreed terms of the loan facility or the borrowing programme. Thus, even a 'single day single rupee' delay—in case of bank facilities or borrowing programmes having a pre-defined repayment schedule—is treated as a default. ICRA has been using this definition of default consistently for all its default-related studies, and the practise has remained unchanged over the years.

Default recognition in case of bank facilities that do not have a pre-defined repayment schedule

- » In the case of bank facilities that do not have any pre-defined repayment schedule (such as cash credit and overdraft facility), ICRA recognises default only on continuous and sustained overdrawals.

Refer to *Annexure-1* for the instrument-wise definition of default followed by ICRA.

Default recognition when the lenders or investors allow a grace period for debt servicing beyond the scheduled payment date

- » In case the lenders or investors allow for a grace period to the borrowing entity to service the debt obligations N days post the due date T, the deemed due date for debt servicing is construed as 'T+N' by ICRA. Such grace period should be specifically mentioned as part of the loan agreement or the sanctioned letter. A missed or a delayed payment by an entity beyond the allowable grace period is treated by ICRA as a default.

Default recognition in case of rescheduling of debt

- » The rescheduling of a debt obligation prior to the due date of repayment is not treated as a default by ICRA, provided there is no material Net Present Value (NPV) loss to the lenders or investors and the debt servicing had been timely before the rescheduling. However, in such cases, the ratings may be suitably revised downwards in case debt rescheduling was intended to provide a relief to the borrower owing to its extant or expected financial stress or if there is a fundamental impairment in the entity's credit quality.

- » In case an entity delays on debt servicing before its lenders give consent to the rescheduling, or there is a material NPV loss to the lender(s), the delay and/or loss is treated as a default.

Default recognition in case of commercial dispute

ICRA takes into consideration, on a case-by-case basis, the reasons that led to delays in debt servicing by an entity and its potential implications on the entity's willingness and ability to service its other debt obligations in a timely manner.

- » In case the delay is primarily because of the weak liquidity position of the entity, the delay in debt servicing is treated as a default.
- » In case the liquidity position of the rated entity is comfortable such that it was in a position to service all its debt obligations in a timely manner and the delay in debt servicing is on a specific instrument¹ on account of a bona-fide commercial dispute, as assessed by ICRA, the delay is not treated as a default. However, if such delay in debt servicing may impact the financial risk profile of the entity because of reasons such as invocation of certain covenants, the entity's rating may be suitably revised downwards.

Default recognition in case of hybrid instruments

- » A missed or deferred payment on the hybrid instrument is treated as a default, even if the terms and conditions of the hybrid instrument allow for payment deferral or skipping under certain conditions.

Impact of Default on Credit Ratings

Upon a default, ICRA downgrades the ratings for all the rated instruments to [ICRA]D, regardless of the magnitude or duration of the default. This policy is in accordance with the approach prescribed by both the RBI as well as SEBI i.e. a delay of one day even of one rupee (of principal or interest) from the scheduled payment date is to be construed as a default.

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 ICRA, 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 [ICRA]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

¹ The rating of the instrument on which default has occurred is put on watch to inform the lenders/ investors that ICRA has taken cognizance of the default and the reason for taking no rating action is, as per ICRA's assessment, a bona-fide commercial dispute. The rating watch is removed upon resolution of the dispute.

Annexure-1:

Facilities	Definition of Default
Fund-based facilities	
Term Loan	A delay of 1 day even of 1 rupee (of principal or interest) from the scheduled payment date
Working Capital Term Loan	
Working Capital Demand Loan (WCDL)	
Debentures/Bonds	
Certificates of Deposit (CD)/ Fixed Deposits (FD)	
Commercial Paper	
Packing Credit (pre-shipment credit)	Overdue or unpaid for more than 30 days
Buyer's Credit	Continuously overdrawn for more than 30 days
Bill Purchase/Bill discounting/Foreign bill discounting /Negotiation (BP/BD/FBP/FBDN)	Overdue or unpaid for more than 30 days
Cash Credit	Continuously overdrawn for more than 30 days
Overdraft	Continuously overdrawn for more than 30 days
Non-fund based facilities	
Letter of Credit (LC)	Overdue for more than 30 days from the day of devolvement
Bank Guarantee (BG) (Performance/ Financial)	Amount remaining unpaid for 30 days from invocation of the facility
Other scenarios	
When the rated instrument is rescheduled	<p>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 the restructuring application/ proposal should be considered as a default</p> <p>Rescheduling of the debt instrument by the lenders prior to the due date of payment will not be treated as a default, unless the same is done to avoid default or bankruptcy</p>
Curing Period	<p>90 days for movement of rating from the default category to the Non-Investment Grade and generally#</p> <p>365 days for movement of rating from the default category to the Investment Grade</p>

ICRA may make exceptions to the above in cases where the fundamental credit profile of the defaulting entity undergoes a significant change, while being within the curing period window. Such change may be by virtue of change in ownership, access to some form of explicit support from a strong third-party or any other such event that has a strong positive influence on the entity's credit quality.

Note: These default definitions are in accordance with the SEBI circular (SEBI/ HO/ MIRSD/ MIRSD4/ CIR/ P/ 2016/ 119) dated November 1, 2016 applicable to all credit rating agencies in India.

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