भारतीय प्रतिभूति और विनिमय बोर्ड
Securities and Exchange Board of India

CIRCULAR

SEBI/ HO/ MIRSD/ DOS3/ CIR/ P/ 2019/ 70 **June 13, 2019**

To

All Credit Rating Agencies (CRAs) registered with SEBI
All Debenture Trustees (DTs) registered with SEBI

Dear Sir/ Madam,

Sub: Guidelines for Enhanced Disclosures by Credit Rating Agencies (CRAs)

1. In order to further strengthen the disclosures made by CRAs and enhance the rating standards, it has been decided to prescribe the following disclosures:

I. Computation of Cumulative Default Rates (CDR)

A. With a view to aligning the methodology of calculation of default rates with that followed globally and in partial modification of SEBI Circular CIR/MIRSD/CRA/6/2010 dated May 3, 2010, the default rates shall be computed in the following manner:

a. CDR shall be calculated issuer-wise using the Marginal Default Rate (MDR) approach, using monthly static pools.
b. The above may be adjusted for rating withdrawals. For securities, the withdrawn rating shall be included in the computation of default rates till the completion of the cohort or the maturity of the instrument, whichever is earlier. Accordingly, all DTs shall continue to report any delays/ default in payment on debentures to the CRA(s) having rated the said debenture for the lifetime of the instrument, irrespective of the rating on that instrument being withdrawn.
c. Ratings of non-cooperative issuers shall be included in the cohort under the rating category in which the instrument is currently being rated.

B. Based on the above approach, a CRA shall disclose, on an annual basis, the average one-year, two-year and three-year cumulative default rates (based on weighted average) each for:

a. Last 10-financial years period (Long-run average default rates)
b. 24, 36 and 48 most recent cohorts, respectively (Short-run average default rates)

C. The format of the above disclosures is specified at **Annexure A**. Consequently, Annexure B. VII of SEBI Circular SEBI/HO/MIRSD/ DOP2/CIR/P/2018/86 dated May 30, 2018 stands deleted.

D. The above disclosures shall be made on a consolidated basis for all financial instruments rated by a CRA.

E. Further, the historical data on the default rates disclosed every year shall be archived and made available on the website of each CRA for last 10 years.

II. In order to achieve a consistent approach, CRAs, in consultation with SEBI, shall frame a uniform Standard Operating Procedure (SOP) in respect of tracking and timely recognition of default, which shall be disclosed on the website of each CRA.

III. Introducing Probability of Default (PD) benchmarks for CRAs

A. In order to enable investors to discern the performance of a CRA vis-à-vis a standardised PD benchmark scale, CRAs, in consultation with SEBI, shall prepare and disclose standardized and uniform PD benchmarks for each rating category on their website, for one-year, two-year and three-year cumulative default rates, both for short-run and long-run.

B. These benchmarks shall be prepared based on the following key principles:

a. Marginal Default Rate (MDR) approach, using monthly static pool, for last 10-year period.
b. The short-run benchmarks may account for spikes due to economic cycles or unforeseen events, and hence, may have a wider band. The same shall be computed based on a confidence interval of 99.7% over the weighted average of 1-year, 2-year and 3-year default rates pertaining to last 10-year period, making adjustments to achieve ordinality, wherever required.
c. The long-run benchmarks iron out economic cycles since these are over a longer tenure (10-year period) and may, therefore, be narrower. The same shall be computed based on a confidence interval of 95% over the weighted average default rates (1-year, 2-year and 3-year) pertaining to 10-year period, making adjustments to achieve ordinality, wherever required.
d. The same may be adjusted for rating withdrawals. For securities, the rating shall be included in the computation of default rates till the completion of the cohort or the maturity of the instrument, whichever is earlier.
e. Ratings of non-cooperative issuers shall be included in the cohort under the rating category in which the instrument is currently being rated.
f. The PD benchmark for the rating categories AAA, AA and A shall be as under, subject to any unexpected legal events/ mitigating circumstances impacting the default rates, with certain permitted tolerance levels:

i. **For AAA:**
- Zero for 1-year and 2-year default rate.
- Zero for 3-year default rate, with a tolerance level of 1%.

ii. **For AA:**
- Zero for 1-year default rate.
- Zero for 2-year default rate with a tolerance level of 2%.

iii. **For A:**
- Zero for 1-year default rate with a tolerance level of 3%.

g. For ratings on non-structured instruments, various instruments of an issuer with equal seniority level and having same rating shall not be included separately for default rate calculation. However, various instruments of an issuer having different seniority levels shall be included as separate instances, subject to a cap of three instances across all rating categories put together.

h. For ratings on structured instruments, various instruments, issued by a trust, with the same degree of seniority and hence having same rating shall not be included separately for default rate calculation. However, various instruments, issued by a trust, having different seniority levels shall be included as separate instances. Further, in order to avoid under-estimation of default rates in case of significantly higher number of tranches of differing seniority but same rating, a cap of three tranches per rating category per issuer may be applied.

C. The above standardised and uniform PD benchmarks shall be disclosed on the website of each CRA for ratings of long-term and short-term instruments, on a consolidated basis for all financial instruments rated by a CRA, by December 31, 2019.

D. CRAs may review their rating methodologies in order to align the same with the proposed PD benchmarks.

E. The above PD benchmarks and tolerance levels may be re-indexed from time to time.

IV. Rating symbol for Instruments having explicit Credit Enhancement feature

A. SEBI, vide circulars dated May 03, 2010 and June 15, 2011, had mandated certain disclosures and standardised the rating symbols in respect of rating of structured finance products, namely, instruments/ pay-outs resulting from securitization transactions, by using suffix ‘SO’.

B. It is observed that CRAs are also assigning 'SO' suffix to ratings of instruments other than securitized or asset backed transactions. The 'SO' rating to such instruments is based on some form of explicit credit enhancement from a third party/ parent/ group company, in the form of corporate guarantee/ letter of comfort/ pledge of shares, etc. There is a need to differentiate ratings of such instruments from the ratings of securitized debt and asset backed transactions. It has therefore been decided that:

a. CRAs shall now assign the suffix 'CE' (Credit Enhancement) to rating of instruments having explicit credit enhancement. In this regard, the standardised symbols and definitions, annexed as **Annexure B,** shall henceforth be used for new ratings/ reviews by the CRAs. For existing outstanding ratings, the CRAs shall:

i. disclose new rating symbols and definitions on their websites;
ii. update their rating lists on their websites; and
iii. inform their clients about the change in the rating symbols and definitions and specifying that this should not be construed as a change in the ratings.

b. Disclosure of unsupported and supported ratings - To bring more transparency and to enable investors to understand the extent of credit enhancement provided by third party/ parent/ Group Company, disclosures of both the ratings i.e. unsupported ratings without factoring in the explicit credit enhancement and supported rating after factoring in the explicit credit enhancement shall be disclosed in the Press release. Further, the Press Release shall also contain a detailed explanation of all the covenants of the instrument.

c. The CRAs shall devise a model to assess the adequacy of credit enhancement structure under various scenarios including stress scenarios. Such assessment shall also be disclosed in the press release regarding the rating action.

V. Disclosure of rating sensitivities in press release

A. The disclosure of factors to which the rating is sensitive, is critical for the end-users to understand the factors that would have the potential to impact the credit worthiness of the entity. Accordingly, in order to improve transparency, the CRA shall have a specific section on 'Rating Sensitivities' in the Press Release which shall explain the broad level of operating and/ or financial performance levels that could trigger a rating change, upward and downward. Such factors shall be disclosed in quantitative terms to the extent possible, discernible to the investors, and should not read like a general risk factor.

VI. Disclosure on liquidity indicators

A. SEBI Circular SEBI/ HO/ MIRSD/ DOS3/CIR/P/2018/140 dated November 13, 2018, inter-alia, mandated inclusion of a specific section on Liquidity in the Press Release, highlighting parameters such as liquid investments, access to unutilised credit lines, liquidity coverage ratio, adequacy of cash flows for servicing maturing debt obligation, etc.

B. In order to make the disclosures meaningful to the end users, it has been decided to mandate disclosure of liquidity indicators using standardised terminology. Accordingly, CRAs shall, in addition to the disclosures mandated vide aforesaid circular, shall also disclose the liquidity indictors using one of the following indicators and give an explanation thereon:

a. Superior / Strong
b. Adequate
c. Stretched
d. Poor

An indicative description for these liquidity indicators is enclosed as **Annexure C**.

VII. Tracking deviations in bond spreads

A. SEBI circular No. SEBI/ HO/ MIRSD/ DOS3/CIR/P/2018/140 dated November 13, 2018, inter-alia, provided that CRAs may treat sharp deviations in bond spreads of debt instruments vis-à-vis relevant benchmark yield as a material event, while reviewing material events. It is reiterated that CRAs shall devise a model to track deviations in bond spreads in line with the said circular.

2. This circular is issued in exercise of the powers conferred by Section 11 (1) of Securities and Exchange Board of India Act, 1992 read with the provisions of Regulation 20 of SEBI (Credit Rating Agencies) Regulations, 1999, to protect the interest of investors in securities and to promote the development of, and to regulate, the securities market.

Yours faithfully,

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ANNEXURE A

ANNEXURE A.1. – Long-run average default rates for long term instruments

Rating Category	1-Year Default Rate	2-year Cumulative Default Rate	3-year Cumulative Default Rate
AAA			
AA			
A			
BBB			
BB			
B			
C			

ANNEXURE A.2. – Long-run average default rates for short term instruments

Rating Category	1-Year Default Rate
A1+	
A1	
A2	
A3	
A4	

ANNEXURE A.3. – Short-run average default rates for long term instruments

Rating Category	1-Year Default Rate	2-year Cumulative Default Rate	3-year Cumulative Default Rate
AAA			
AA			
A			
BBB			
BB			
B			
C			

ANNEXURE A.4. – Short-run average default rates for short term instruments

Rating Category	1-Year Default Rate
A1+	
A1	
A2	
A3	
A4	

ANNEXURE B

Rating Symbols and Definitions for Long Term Credit Enhanced Instruments

Long term Credit Enhancement instruments: The instruments with original maturity exceeding one year

Rating symbols should have CRA's first name as prefix.

AAA (CE) - Instruments with this rating are considered to have the highest degree of safety regarding timely servicing of financial obligations. Such instruments carry lowest credit risk.

AA (CE) - Instruments with this rating are considered to have high degree of safety regarding timely servicing of financial obligations. Such instruments carry very low credit risk.

A (CE) - Instruments with this rating are considered to have adequate degree of safety regarding timely servicing of financial obligations. Such instruments carry low credit risk.

BBB (CE) - Instruments with this rating are considered to have moderate degree of safety regarding timely servicing of financial obligations. Such instruments carry moderate credit risk.

BB (CE) - Instruments with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations.

B (CE) - Instruments with this rating are considered to have high risk of default regarding timely servicing of financial obligations.

C (CE) - Instruments with this rating are considered to have very high likelihood of default regarding timely payment of financial obligations.

D (CE) - Instruments with this rating are in default or are expected to be in default soon.

Modifiers {"+" (plus) / "-"(minus)} can be used with the rating symbols for the categories AA (CE) to C (CE). The modifiers reflect the comparative standing within the category.

Rating Symbols and Definitions for Short Term Credit Enhanced Instruments

Short term Credit Enhanced Instruments: The instruments with original maturity of up to one year

Rating symbols should have CRA's first name as prefix.

A1 (CE) – Instruments with this rating are considered to have very strong degree of safety regarding timely payment of financial obligation. Such instruments carry lowest credit risk.

A2 (CE) - Instruments with this rating are considered to have strong degree of safety regarding timely payment of financial obligation. Such instruments carry low credit risk.

A3 (CE) - Instruments with this rating are considered to have moderate degree of safety regarding timely payment of financial obligation. Such instruments carry higher credit risk as compared to instruments rated in the two higher categories.

A4 (CE) - Instruments with this rating are considered to have minimal degree of safety regarding timely payment of financial obligation. Such instruments carry very high credit risk and are susceptible to default.

D (CE) - Instruments with this rating are in default or expected to be in default on maturity.

Modifier {"+" (plus)} can be used with the rating symbols for the categories A1 (CE) to A4 (CE). The modifier reflects the comparative standing within the category.

ANNEXURE C

Indicative illustration of usage of descriptors for liquidity assessment

1. **Liquidity: Superior/ Strong** - Liquidity is marked by strong accruals against negligible repayment obligations and liquid investments to the tune of Rs.xxx Crore. With a gearing of xx times as of March 31, xxxx, the issuer has sufficient gearing headroom, to raise additional debt for its capex. Its unutilized bank lines are more than adequate to meet its incremental working capital needs over the next one year.

2. **Liquidity: Adequate** - Adequate liquidity characterized by sufficient cushion in accruals vis-à-vis repayment obligations and moderate cash balance of Rs.xx Crore. Its capex requirements are modular and expected to be funded using debt of Rs.xx Crore for which it has sufficient headroom. Its bank limits are utilized to the extent of 80% and has sought enhancement in bank lines, supported by above unity current ratio.

3. **Liquidity: Stretched** - Liquidity is marked by tightly matched accruals to repayment obligations, highly utilized bank limits and modest cash balance.

4. **Liquidity: Poor** - Poor liquidity marked by lower accruals when compared to repayment obligations, fully utilized bank limits and modest cash balance. This could constrain the ability of the company to repay is debt obligations on a timely basis.