



Criteria – Credit Enhanced Ratings

The ratings assigned by Brickwork Ratings (BWR) for various instruments and facilities are derived based on the fundamentals of the entity that is rated and criteria based on standard Industry Risk, Business Risk, Management Risk and Financial Risk of the entity. However, it is possible that such an entity derives support from another entity or support mechanism to enhance the credit quality of its debt obligations, which results in 'Credit Enhancement' (CE) and hence, the Probability of Default of the rated entity decreases.

Ratings assigned by BWR which are based on explicit, external credit enhancement carry the suffix 'CE'. In such cases, in compliance with extant regulatory guidelines, BWR shall also carry out a standalone credit assessment of the rated entity and the unsupported rating (rating without factoring the explicit credit enhancement) is disclosed as a part of the press release disseminating the rating.

This criteria document has been updated on the basis of the guidelines issued by the Reserve Bank of India (RBI) vide its Guidance Note (GN)DOR. CRG(STR). No. S408/21.06.008/2022-23 dated 22 Apr 2022 on 'Bank Loan – Credit Enhancement (CE) Ratings' read with FAQs issued vide its communication DOR.CRG (STR). No. S2617/21.06.008/2022-23 dated 26 July 2022 and SEBI Master circular SEBI/HO/DDHS/DDHS- POD3/P/CIR/2024/ 47 dated 16 May 2024 setting out guidelines on 'Credit Ratings supported by Credit Enhancement (CE)'.

Scope of the Criteria:

This criteria document defines the broad principles of assessing ratings for Credit Enhanced Debt through various support mechanisms for instruments/facilities, as per guidance issued by SEBI and RBI.

This document does not cover the methodology for rating partially credit enhanced debt. For details in this regard, refer "BWR Rating Criteria for Credit enhancement based on Partial Credit Enhancement".

Credit Enhancement Rationale

The underlying spirit of the above-mentioned directives / guidance from SEBI and RBI are as follows:

- The support should be unconditional, irrevocable, and legally enforceable till all the obligations of the rated security have been paid to the investors / Stakeholders.
- An independent examination of financial strength of the support provider to ascertain the ability to honor the obligations guaranteed by the support provider.
- The support provider should have a lower probability of default on a continuous basis, compared with the rated issuer, till the time such ratings are outstanding.

Credit Enhancement Mechanism:

Evaluation of support for credit enhancement:

Based on the above-mentioned guidance from RBI and directions from SEBI, the following broad principles have been adopted by BWR:

Nature of Support and their acceptance for various instrument / rating types

Type of Support	Bank Loan/ Commercial Papers (CPs) / Fixed Deposits (FDs)	Securities – Non-Convertible Debentures (NCDs) / Bonds / Other Capital Market Instruments
Guarantee (legally enforceable, unconditional and irrevocable) and adheres to the evaluation criteria set out by RBI (applicable for Bank Loans and other credit ratings also)	Yes	Yes
Letter of Comfort provided by Central/State Governments (legally enforceable, unconditional and irrevocable)	Yes	Yes
Shortfall Undertaking provided by Central/State Governments (legally enforceable, unconditional and irrevocable)	Yes	Yes
Standby Letter of Credit	Yes	Yes
Debt backed by Payment Waterfall /Escrow, or DSRA etc., but with Full Guarantee or DSRA Replenishment Guarantee from a third party	No	Yes
Obligor-Co-Obligor Structure	BWR does not consider this type of support to derive Credit Enhancement	
Pledge of Shares ¹	BWR will not consider this type of support to derive Credit Enhancement	

Criteria for deriving credit enhancement based on Guarantee:

Corporate Guarantees offered by a higher rated (stronger credit profile) parent/group company, government or any external entity can be considered by BWR for assigning CE ratings ¹. Based on an executed guaranteed deed, lenders and bondholders can seek recourse to the guarantor if the borrower/issuer defaults on obligations on the guaranteed instrument.

The pre-requisite for such guarantees is that they are “legally enforceable, irrevocable and unconditional” and the guarantor assures timely payment on demand.

The guaranteed deed is evaluated for its adherence to the 12-point principle² outlined in the table below before the strength of the guarantee is factored into the rating.

¹ Outstanding CE ratings for securities assigned by BWR based on the Pledge of Shares as a support mechanism shall continue till the maturity of such rated instruments only - review of such ratings shall be based on our criteria prior to the 2022 issuance of the RBI and SEBI guidelines for CE ratings. Fresh CE ratings for both bank loans and securities based on the pledge of shares as a support mechanism shall not be assigned

² Evaluation criteria are as per RBI guidance

SI No	Principle	Assessment
i.	It should be unconditional	The support extended should be unconditional in nature in honoring the obligations under the guarantee.
ii.	It should be irrevocable	The support provider should not revoke the guarantee till all the obligations of the borrower are fully paid to the lender
iii.	It should be enforceable	The extended support should be legally enforceable at any time during the tenure of rated facility.
iv.	The support should be for the facility in its entirety	The support should cover the entire facility being rated as applicable, including principal, interest or any other amounts payable as per the terms of the facility. In case of partial guarantees, the rating comfort derived shall be restricted to the extent of partial guarantee provided.
v.	Guarantee for payment	The obligation of the support provider should be to pay the guaranteed amount without demur as per the sanctioning terms in case of default by the borrower and not merely ensure repayment by the borrower.
vi.	Payment mechanism	The guaranteed deed should specify timelines for invocation of the guarantee by the lender, and for subsequent payment by the support provider.
vii.	Payment on first demand	The support provider should make payment under the guarantee on receipt of the first demand or notice from the lender as per the terms of the guarantee.
viii.	Payment without deduction	All guaranteed payments are to be made by the guarantor without any deductions.
ix.	Rights of Support provider to be waived	The Indian Contract Act, 1872 provides certain rights to the guarantors, including automatic termination of the guarantor's obligations under certain situations (such as change in the terms of contract without the guarantor's consent as per Section 133). Hence, in case of any change in the terms of the contract, the guarantee needs to be reaffirmed by the guarantor for it to be treated eligible as valid support for deriving the CE rating.
x.	Guarantor is primary obligor	The lender is entitled to proceed against the support provider without waiting to exercise all its remedies.
xi.	Payment should happen in the event of insolvency	The support provider should agree to make payments even in case of any insolvency, liquidation, dissolution or any other analogous proceedings against the rated entity.

xii.	Overseas guarantors	If the guarantee is extended by an overseas support provider (foreign parent) in respect of subsidiaries/ group entities/ affiliates operating in India, the foreign guarantor should continuously hold a rating from at least one of the international rating agencies (S&P, Fitch Ratings and Moody's Ratings), which corresponds to a lower risk weight than the standalone rating of the borrower. Further, the CRAs shall assess all the features of the guarantee and also ensure if there are no regulatory or legal issues in the guarantor making remittances under the guarantee as per the existing legal/ regulatory framework in the jurisdiction of the guarantor.
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Standalone Rating

Stand-alone rating of both the borrower and guarantor is worked out before deriving the credit enhancement using the applicable rating criteria for the borrower.

Guarantor Rating

The rating of the Guarantor is to be factored in, either based on BWR rating, or by assessing the Guarantor's creditworthiness independently. Wherever BWR has not rated the guarantor, the implicit/shadow rating of the guarantor is arrived at based on an analysis of its credit profile also duly factoring the external rating assigned by other Credit Rating Agencies (if available). Continuous surveillance of the support provider's rating is undertaken till the tenure of the rating.

Generally, the 'CE' rating assigned will be in between the standalone rating of instrument and that of the guarantor. A 'CE' rating equated to the rating of the guarantor is assigned only if the guarantee meets the evaluation framework laid out in RBI's guidance note, and if the invocation and payment mechanism is strong. For example, if the stand-alone rating of the issuer is BBB and that of the guarantor A+, then rating of the specific instrument/facility can be capped at A+ (CE), provided all the evaluation criteria are satisfied.

Criteria for deriving credit enhancement based on 'Letter of Comfort' (LOC) and 'Shortfall Undertaking' (SU)

A 'Letter of Comfort' (LOC) is a document wherein the LOC provider declares that they will ensure that the business affairs of the borrower/issuer are managed in such a way that the issuer is always in a position to meet all its debt obligations in a timely manner, and in case of necessity, will provide required support. In such cases, the external support (LOC) provider offers to support the borrower/issuer by facilitating the debt repayment and not guaranteeing the debt repayment.

A SU provider undertakes to make good any shortfall in debt repayment, in case the funds brought in by the issuer are insufficient to meet the maturing term obligations in full. Such undertakings are a part of the legal documentation taken by the lenders/investors and hence are generally legally enforceable. SUs shall be examined for the availability of payment mechanism ensuring payment before the due date.

For Bank loan ratings and other capital market instruments, BWR shall only consider LOC/SU issued by the Central / State Government as valid support structures provided, they meet the evaluation criteria stipulated in the RBI guidance note.

BWR shall obtain a legal opinion to determine whether the LOC/ SU is legally enforceable, irrevocable, unconditional in nature, covers the entire tenure of the debt and whether the payment mechanism is

adequate. The assignment of CE ratings in case of LOC/SU shall take into consideration the credit profile of the support provider, the relevance of the issuer to the support provider, extent of the moral obligation of the LOC provider to support the issuer/borrower, availability of a board resolution of the support provider for issuance of the LOC and the legal opinion on the strength of the support mechanism and its adherence to the applicable regulatory guidelines. CE rating assigned in such cases may lie somewhere in between the standalone rating of the issuer and that of the LOC/SU provider and will generally be lower than that of the support provider's rating.

Criteria for deriving credit enhancement based on Standby Letter of Credit

A Standby Letter of Credit (SBLC) which is a support that is extended typically by a financial institution to the issuer based on commercial terms. In this type of support the financial institution takes on the obligation of payment to the lender/investor in case of non-payment by the issuer. Since these are standardized structures, they are mostly legally enforceable in nature. BWR shall consider such SBLC as a valid support mechanism provided it meets the evaluation criteria stipulated by the regulators. CE rating assigned in such cases may lie somewhere in between the standalone rating of the issuer and that of the SBLC provider (Bank/FIs rating).

Criteria for deriving credit enhancement based on DSRA Replenishment Guarantee:

Some support structures have a Debt Service Reserve Account (DSRA) funded to the extent of the debt repayment scheduled for the next one or two quarters (interest payment and principal repayment) throughout the tenure of the debt. External support in such cases will be utilised in the event of inadequacy of cash flows of the issuer/borrower to meet the scheduled debt servicing obligations. In the case of a DSRA replenishment guarantee that covers full payment of the debt including an acceleration event arising from any breach of covenants and which meets all the other standard evaluation criteria, the CE rating is likely to be equated to the DSRA guarantor's rating. In other cases, BWR shall assess the benefit of credit enhancement in the rating based on the support structure features and the credit profile of the entity.

Additional consideration for CE Ratings for determining the adequacy of valid support structures

- **Assessment of legal risk:** BWR shall obtain an independent legal opinion to ascertain whether the support mechanism meets the evaluation criteria stipulated as per RBI/SEBI guidance, prior to assigning any CE ratings.
- **Invocation and Payment mechanism:** Generally, the support mechanism - CE structure specifies a 'T-d' days clause, wherein the funding required for meeting the debt repayment obligations is brought in 'd' days before the due date (T), failing which the CE structure can be invoked, so that the shortfall is brought in within the 'd' days. The objective of such a clause is that funds are available in time to meet the debt obligations and not after default. However, an exception may be made in respect of Government guarantees, where the guarantees are issued in their own format, with or without 'T-d' type of clauses. In respect of guarantees already executed without the 'T-d' clause, the guarantor can provide a suitable undertaking addressed to the lender/investor incorporating the above requirement, which shall be accepted/ acknowledged by the lender/investor. In the case of bank loans / facilities, it is generally observed that the credit enhancement structures do not stipulate a 'T minus' structure but specify a period after the due date in which the guarantee must be invoked and paid by the guarantor. These structures will be considered as valid support structures, based on assessment of the reasonability of the response time of the guarantor in making payments on invocation as stipulated in the support mechanism.
- **Ability of guarantor to support the borrower for varying levels of debt:** Scenarios of ability of guarantor to pay on devolvement is checked. All the on and off-balance sheet liabilities of the guarantor are taken into consideration for determining the impact of such devolvement on the

liquidity, repayment capacity and rating of the guarantor under stressed conditions.

- **Relationship between the Guarantor and the borrower:** The level of strategic importance of the borrower to the guarantor / guarantor group and other relational importance provides a view on the likelihood of the guarantor honoring its commitment on devolvement.

The Press Release disseminating CE ratings shall contain a detailed explanation of all the covenants of the security and brief details about the adequacy of the CE structure.

The long term and short-term CE rating scales are presented below:

Long Term Rating scale symbol	Descriptor
BWR AAA (CE) (BWR Triple A (CE))	Instruments with this rating are considered to have the highest degree of safety regarding timely servicing of financial obligations. Such instruments carry the lowest credit risk.
BWR AA (CE) (BWR Double A (CE))	Instruments with this rating are considered to have a high degree of safety regarding timely servicing of financial obligations. Such instruments carry very low credit risk.
BWR A (CE)	Instruments with this rating are considered to have an adequate degree of safety regarding timely servicing of financial obligations. Such instruments carry low credit risk.
BWR BBB (CE) (BWR Triple B (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.
BWR BB (CE) (BWR Double B (CE))	Instruments with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations.
BWR B (CE)	Instruments with this rating are considered to have a high risk of default regarding timely servicing of financial obligations.
BWR C (CE)	Instruments with this rating are considered to have a very high likelihood of default regarding timely payment of financial obligations.
BWR D (CE)	Instruments with this rating are in default or are expected to be in default soon.
BWR may apply '+' (plus) or '-' (minus) signs for ratings from 'BWR' AA (CE)' to 'BWR' C (CE)' to reflect comparative standing within the scale.	

Short Term Rating scale Symbol	Descriptor
BWR A1 (CE)	Instruments with this rating are considered to have a very strong degree of safety regarding timely payment of financial obligation. Such instruments carry the lowest credit risk.
BWR A2 (CE)	Instruments with this rating are considered to have a strong degree of safety regarding timely payment of financial obligation. Such instruments carry low credit risk.
BWR 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.
BWR A4 (CE)	Instruments with this rating are considered to have a minimal degree of safety regarding timely payment of financial obligation. Such instruments carry very high credit risk and are susceptible to default.
BWR D (CE)	Instruments with this rating are in default or expected to be in default on maturity.
BWR may apply '+' (plus) sign for ratings from 'BWR' A1 (CE)' to 'BWR' A4 (CE)' to reflect comparative standing within the category.	

The previous version of this document can be found in

<https://www.brickworkratings.com/download/Criteria - Credit Enhancement v1.6 - Final p>

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