



Default Recognition and Post Default Curing Period

Brickwork's Policy for Default Recognition

Brickwork Ratings (BWR) emphasizes on the timely recognition of default for the rated debt instruments and Bank loans as part of its rating process. BWR's default recognition policy is updated in-line with the guidelines of The Securities and Exchange Board of India (SEBI) and Reserve Bank of India (RBI) issued from time to time and is consistent with the Standard Operating Procedures for CRAs for Monitoring and Recognition of Defaults.

Scope of the Criteria

The document outlines the default recognition policy of Brickwork Ratings (BWR). The criteria applies to all financial instruments including capital market instruments, long-term and short-term debt, bank loan facilities, fixed deposits, issuer ratings and structured finance instruments.

Default Recognition Policy

a. Instruments/Facilities that have a pre-defined repayment schedule

BWR recognizes default on the first instance of missed payment on a rated instrument. A "default" is defined as a delay in payment, as per the payment schedule provided in the agreements/documents executed between the issuer/borrower and the investor/lender. BWR recognizes even a single rupee of missed payment, or delay by a single day as default. BWR considers non-payment of financial obligations on the due-date/or as per specified terms of the agreement between the lender and the borrower as default and accordingly downgrades the rating assigned to the instrument/Bank Loan to "BWR D", based on authentic information. Financial obligations refer to both principal and interest payments.

b. Facilities without a pre-defined repayment schedule

Default recognition on working capital bank loan facilities, which do not have a pre-defined payment schedule (like cash credit, packing credit, overdraft, letter of credit etc), is recognized if such facilities remain continuously overdrawn for more than 30 days or overdue for more than 30 days from invocation of the facility. Please refer to Item 5 for the instrument-wise definition of default.

c. Cases where grace period for debt servicing beyond the scheduled payment date is allowed by the lenders or investors

If the terms of sanction of the facility/instrument provide for a grace period to the issuer/borrower to service the debt obligations post the due date, BWR shall consider the due date for payment taking into account such grace period. This is subject to inclusion of such provision in the sanction letter/loan agreement or a written communication from the lender/investor prior to the scheduled due date. A

missed or delayed payment by the issuer beyond the allowable grace period shall be treated by BWR as a default.

d. Technical Delays

In some instances, there may be delays or missed payments due to operational/technical/administrative issues and not attributable to credit issues with the issuer/borrower. These instances typically include operational issues at the lenders' side like failure to debit the CC account on the due date, system/human errors or non-credit factors. In such instances, BWR evaluates if the delay is solely attributable to operational/technical/administrative issues and not credit related issues and whether the issuer had sufficient funds to make the payment on the due date. If BWR assesses that there is an intent, willingness and ability of the issuer to make the payment on the due date and that the delay is purely due to non-credit reasons, the missed/delayed payment will not be regarded as a default.

Default on Debt Obligations not rated by BWR:

When the issuer with an outstanding BWR rating defaults on any of its other financial obligations (not rated by BWR), there could be a probability that the issuer would default on the BWR rated instrument/Bank Loan. Under normal circumstances, a default in one instrument of an issuer will lead to a default rating "BWR D" or a near default rating "BWR C" of all instruments of that issuer. In such cases, BWR shall evaluate the availability of instrument-specific risk mitigants (like external credit enhancements) or if the defaulted instrument is of different seniority from the other instruments. BWR may, based on the existence of such risk mitigating factors, conclude that instances of default on other instruments are not likely to occur in the rated instrument and hence, may not move the ratings on such instrument to BWR D/near default grade.

How is a Default recognized?

BWR follows the guidelines prescribed by SEBI for Instrument wise definition of default as given below:

Facilities	Rating Scale	Definition of Default
<i>Fund-based facilities & Facilities with pre-defined repayment schedule</i>		
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	Long Term	
Working Capital Demand Loan (WC DL)	Long Term	
Debentures/Bonds	Long Term	
Certificate of Deposits (CD)/ Fixed Deposits (FD)	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
<i>Fund-based facilities & No Pre-Defined Repayment Schedule</i>		
Cash Credit	Long Term	Continuously overdrawn for more than 30 days.
Overdraft	Short Term	Continuously overdrawn for more than 30 days.
<i>Non fund-based facilities</i>		
Letter of credit (LC)	Short Term	Overdue for more than 30 days from the day of devolvement.
Bank Guarantee (BG) (Performance/ Financial)	Short Term	Amount remaining unpaid from 30 days from invocation of the facility
<i>Other Scenarios</i>		
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 a default unless the same is done to avoid default or bankruptcy.
Curing Period #		90 days for default to speculative grade and generally 365 days for default to investment grade

BWR may deviate from the stipulated curing period in cases where the fundamental credit profile of the defaulting entity undergoes a material improvement, while being within the curing period window. Such instances are elaborated later in this document.

Reschedulement of Debt:

BWR does not treat reschedulement of a debt obligation with investor consent prior to the upcoming scheduled payment/maturity date as default provided the debt servicing had been timely till the time the lenders provide the consent to the rescheduling and that the reschedulement was not done to avoid a default/bankruptcy. Under such a scenario, BWR would consider the new payment schedule for its assessment of credit risk and review the ratings appropriately. BWR would also take cognizance of the factors that necessitated the obligor to reschedule its debt and the circumstances that led the investor to provide its consent.

Factoring in past defaults

In rare circumstances, if BWR becomes aware of the delays that have occurred in the past and have not been recognized by way of a 'BWR D' rating, the delay shall be recognized by downgrading the rating to 'BWR D'. If the default has been subsequently cured, the rating may be simultaneously upgraded to a non- BWR D rating, in line with the curing period guidelines.

Instrument backed by guarantee

Default recognition is generally based on the structured payment mechanism mentioned in the guarantee document. In case of instruments backed by guarantee from a third party and where there is a clearly defined payment mechanism post invocation of the guarantee, BWR shall recognise default upon non-payment of the obligations within the timelines mentioned in such payment mechanism.

In case of guarantees extended for bank facilities, normally no structured payment mechanism is defined. In such cases, irrespective of invocation of the guarantee, if there is a missed payment, BWR would recognise default on the said facility/instrument.

Hybrid Instruments

In case of hybrid instruments, any missed/deferred payments are recognised as default, even if such instances are permitted as per the terms of the hybrid instrument.

Post Default Curing Period Policy

The curing period principle for default category ratings will apply to fresh rating assignments as well as surveillance assignments and usually are at an issuer level. If BWR is rating an issuer afresh, a non-default rating would not be assigned if the curing period post an earlier default on any instrument of similar seniority has not been completed. For the successful completion of the curing period, the account should be regular and the issuer should have serviced the debt and interest for all instruments on a timely basis for at least 90 days post the regularization of the most recent default. Only post successful completion of the curing period, a non-default rating can be assigned.

In respect of facilities/ instruments downgraded to default category, post which the issuer's debt is restructured/ rescheduled such that a revised payment schedule becomes applicable, the curing period would be considered to have commenced from the date when the loan restructuring/ rescheduling is approved, and not from the cut off/ reference date from which the restructuring became effective.

However, for ratings on subordinated or hybrid bonds, since a default on such instruments may not necessarily imply a default by the issuer for senior instruments, the curing period will apply at the instrument level. In case of default on subordinated or hybrid instruments, ratings on senior instruments may not be upgraded during the curing period for subordinated and hybrid instruments.

If a rated instrument has credit enhancement or there is a structure around the cash flows, the curing period will apply at instrument level, as default by issuer on other instruments may not imply or lead to default on such an instrument.

On successful completion of the curing period of 90 days, generally a sub-investment grade rating will be assigned to the outstanding instruments / facilities of the issuer. For ratings to be upgraded to investment grade, typically the issuer should have been servicing the debt and interest for all instruments on a timely basis for 365 days and should have the credit profile of an investment grade entity.

The checks for completion of curing period will be:

- Clear statement of timely servicing of principal and payment of interest for 90 days from bankers (for bank loans) and debenture trustees or IPAs (for capital market instruments).
- A clear statement from the banker that the account continues to be standard for the preceding 3 months.
- 3 months NDS from the issuer
- 3 months bank statements (CC and term-loan statements) from all bankers of the entity showing timely payments and overdrawals in CC account, if any, being regularized within 30 days

An entity's rating may continue to be rated as BWR D even after completion of the minimum curing period if in BWR's assessment, the entity may slip to the default status over the short term after a temporary period of regularisation in debt servicing.

Exceptions to policy:

The general curing period of 90 days for a sub-investment grade rating and 365 days for an investment grade rating may be deviated from, if the issuer can establish that there is a structural improvement in the credit profile of the issuer from the time that it went into default. Some of the instances where such a deviation may be allowed are:

- Infusion of capital into the entity, substantially improving its liquidity profile
- Merger/takeover of the entity by a stronger entity or change in ownership of the entity
- Regulatory / government action, favorably impacting the entities cash flows
- Restructuring of facilities of the entity, substantially improving its liquidity position
- Removal of the circumstances that lead to the default of the entity (including force majeure events), thereby improving the visibility of cash flows
- Technical nature of defaults on account of procedural or system issues, human errors or non credit related factors

[Policy on Procedure to be followed for monitoring and recognition of defaults.](#)

The previous version of this document can be found in www.brickworkratings.com/download/Criteria-DefaultRecognitionDefaultCuringPeriod.pdf

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