Policy for Default Recognition

1. Introduction and Objective

ACER is India's newest SEBI-registered credit rating agency, committed to delivering independent and transparent credit ratings. Our purpose is to empower investors, lenders, and businesses with ratings they can trust-enabling informed decisions and fostering confidence in India's financial markets. With a clear vision to support India's economic growth story, ACER upholds the highest ethical and analytical standards, combining deep domain expertise, advanced analytics, and rigorous processes to ensure every rating is objective, consistent, and insightful. At ACER, we are not just rating credit, we are fueling India's journey towards a stronger and more resilient economy.

This Policy for Default Recognition outlines ACER CRA's approach to identifying and addressing defaults, ensuring consistency with regulatory guidelines and industry best practices.

This policy adheres to the Securities and Exchange Board of India (Credit Rating Agencies) Regulations, 1999, and the latest SEBI Master Circular from time to time. Any exceptions to this policy and procedures shall be approved in writing by the CEO/Chairman of ACER.RSC will annually review this Policy.

2. Definitions

i **"Board" or "SEBI"** means the *Securities and Exchange Board of India* established under section 3 of the Act.

ii **ACER or "the Company":** means ACER Credit Rating Private Limited, a private limited company incorporated under the Companies Act, 2013, and a Credit Rating Agency registered with the Securities and Exchange Board of India.

iii **"Credit rating agency" or "CRA"** means a "credit rating agency" as a body corporate which is engaged in, or proposes to be engaged in, the business of rating of securities that are listed or proposed to be listed on a stock exchange recognized by the SEBI.

iv **"Credit Rating" or "Rating"** means the rating agency's opinion on the likelihood of a rated debt obligation being repaid in full and on time. Credit rating is therefore an assessment of the probability of default on payment of interest and principal on a debt instrument.

v **"Default"** means a non-payment of interest/dividend or principal amount in full on the pre-agreed date and shall be recognized at the first instance of delay in servicing of any interest/dividend or principal amount.

vi **"Debt Servicing"** means the payment of principal, interest, or any other dues by the issuer in accordance with the repayment schedule or contractual terms of the facility or instrument.

vii **"Overdue"** means any payment obligation that has not been honoured on or before its due date, and remains unpaid for the period specified under the CRA's recognition criteria.

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viii **“Working Capital Facilities”** means credit facilities such as cash credit, overdraft, packing credit, bill discounting, or buyer’s credit used to finance day-to-day operations of the borrower.

ix **“Non-Fund-Based Facilities”** means credit arrangements such as letters of credit (LCs), bank guarantees (BGs), Co-acceptance of bills, Partial Credit Enhancement (PCE) or other such instruments where the bank’s funds are not immediately disbursed but may become due upon invocation or devolvement.

x **“Invocation”** means the act of demanding payment under NFB Facilities due to the obligor’s failure to perform its obligations.

xi **“Restructuring”** means the act by which a lender, for economic or legal reasons relating to the borrower’s financial difficulty, grants concessions to the borrower.

xii **“Hybrid Instruments”** means instruments with both debt and equity features, such as preference shares or subordinated bonds, where missed payments or deferments are treated as defaults for rating purposes.

xiii **“Technical Default”** – means a situation where the issuer had sufficient funds and intended to make the payment, but the payment did not reach investors due to administrative, operational, or external technical reasons, not because of financial stress or unwillingness to pay.

xiv **“No-Default Statement (NDS)”** means the NDS shall require the Issuer to explicitly confirm to the CRA that it has not delayed on any payment of interest/ principal in the previous month. In case there have been delays in the payment of interest/ principal by the Issuer, the Issuer shall state the same in this statement, and the CRA shall promptly conduct a rating review and disseminate the rating action through a Press Release within 2 working days of receipt of such statement.

xv **“Debenture Trustee”** means a trustee of a trust deed for securing any issue of debentures of a body corporate.

2.1. General Principles of Default Recognition

- **First Instance of Missed Payment:** ACER recognises default at the first instance of a missed payment, irrespective of the magnitude of the overdue amount or the duration of the delay. This is commonly referred to as the 'one-day-one-rupee' principle for instruments with pre-defined repayment schedules.
- **Continuous Overdrawn/Overdue for Non-Scheduled Facilities:** For facilities without a pre-defined repayment schedule, such as cash credit or overdraft, a default is recognised if the facility remains continuously overdrawn for more than **30 days**. A similar 30-day overdue period applies to non-fund-based facilities and certain working capital facilities like packing credit, buyer's credit, and bill discounting from the day of devolvement or invocation.

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2.2. Instrument-wise Definition of Default

ACER CRA adopts the instrument-wise definition of default as prescribed by SEBI:

Facilities & Rating Scale	**Definition of Default**
Fund-based facilities & facilities with a pre-defined repayment schedule:	
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)	A delay of 1 day, even of 1 rupee (of principal or interest) from the scheduled repayment date.
Working Capital Demand Loan (WCDL) (Long Term)	A delay of 1 day, even of 1 rupee (of principal or interest) from the scheduled repayment date.
Debentures/Bonds (Long Term)	A delay of 1 day, even of 1 rupee (of principal or interest) from the scheduled repayment date.
Certificate of Deposits (CD)/ Fixed Deposits (FD) (Short Term/Long Term)	A delay of 1 day, even of 1 rupee (of principal or interest) from the scheduled repayment date.
Commercial Paper (Short Term)	A delay of 1 day, even of 1 rupee (of principal or interest) from the scheduled repayment date.
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 (Short Term)	Overdue/unpaid for more than 30 days.
Fund-based facilities & no pre-defined repayment schedule:	
Cash Credit (Long Term)	Continuously overdrawn for more than 30 days.
Overdraft (Short Term)	Continuously overdrawn for more than 30 days.
Non-fund-based facilities:	
Letter of Credit (LC) (Short Term)	Overdue for more than 30 days from the day of devolvement.

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Bank Guarantee (BG) (Performance/ Financial) (Short Term)	Amount remaining unpaid for 30 days from the invocation of the facility.
Partial Credit Enhancement (PCE)	If unpaid/unrecovered**> 30 days** from the invocation date.
Co-acceptance of Bills	30 days after payment, if not recovered from the customer.

2.3. Specific Scenarios

A. **Rescheduled Instruments:**

- Non-servicing of debt (principal or interest) as per **existing repayment terms** in anticipation of a favourable response to a restructuring application/proposal shall be considered a default.
- Rescheduling of a debt instrument prior to its due date shall be considered a default where such modification is intended or results in the avoidance of an imminent default, downgrade, or bankruptcy.
- However, if lenders formally consent to revised repayment terms sufficiently before the original due date, and such rescheduling is not an attempt to avoid default, it will not be treated as a default.

B. **Hybrid Instruments:** Any missed or deferred payment of principal and/or interest on hybrid instruments will be recognised as a default, even if such deferment is permissible under the terms of the instrument. Ratings for hybrid instruments may experience sharper migrations than conventional debt instruments.

C. **Default on Unrated Instruments:** If an issuer with an outstanding ACER CRA rating defaults on any other external debt or loan facilities not rated by ACER CRA, especially those of similar seniority, the rating on ACER CRA's rated instrument(s) is likely to be lowered to near-default or default status. This is because a default on one instrument indicates a high probability of distress across other obligations. Strong instrument-specific mitigating factors, such as external credit enhancements, may lead to an exception, which will be explicitly justified. ACER CRA will disclose a list of companies where ratings were not downgraded to 'D' but were included in default studies due to defaults on unrated debt.

D. **Guaranteed Instruments:** For instruments backed by a third-party guarantee, a default will be recognised if the guarantor fails to service the debt obligation (principal or interest) within the stipulated timelines after the guarantee has been invoked.

E. **Technical/Operational Default:** The following scenarios of non-payment of debt (principal and/ or interest) may arise due to reasons beyond the control of the issuer, namely, failure to remit payment due to absence of correct information or due to incorrect or dormant investor account furnished by the investor(s) or due to notice/ instruction received from a government authority to freeze the account of investor(s). In the aforesaid scenario, ACER shall confirm and verify the availability of adequate funds with the issuer and also confirm and verify:

- The proof of failure of the required payment of debt (principal and/ or interest),

- The reasons for failure being as specified above
- The required amounts being duly paid into a separate escrow account maintained with a scheduled commercial bank by the issuer on the due date of payment.

ACER shall sensitise their clients, i.e. the issuers, to avail of the penny-drop verification facility offered by banks to avoid occurrence of failure to remit the required payments of debt (principal and/ or interest) and/or other suitable measures to prevent such occurrence.

F. **Past Defaults:** If ACER CRA becomes aware of a past delayed payment on a rated instrument that was not previously recognised, but has since been regularised with a sufficient track record of timely repayment, ACER CRA shall downgrade the rating to the default category ('ACER D') and may upgrade it in line with the curing period guidelines.

Considerations for a coercive debt exchange (CDE)

An exchange offer will be considered a CDE and recorded as a 'ACER D' if there is a material reduction in terms in relation to the original contractual terms, and is accepted by creditors, and causes diminished financial obligation non distress exchange will not be treated as default, the exchange is necessary to avoid bankruptcy, similar insolvency or intervention proceedings, or a traditional payment default.

A material reduction in terms could be any one or a combination of the following:

- Reduction in principal amount
- Reduction in interest or fees; unless it is improvement in credit profile or lower interest in market
- Extension of maturity date; unless it is project debt and project scheduled commercial operation date has been extended by the lender as per regulatory guidelines
- Swapping of debt for equity, hybrid or other instruments

How NPA recognition by banks is different from the recognition of default by CRAs

Any failure to honour debt obligations as per the terms of the facility is construed as default on the rated facility. This is distinct from banking norms, where an account is recognised as an NPA when it remains unpaid for over 90 days after the due date. All facilities in default will carry a rating in the default category, which will continue until the arrears are cleared and a track record as per the Post-Default Curing Policy is complied.

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