Frequently Asked Questions (FAQs) on Credit Ratings

I. Definition, Scope, and Limitations of a Credit Rating

1. What exactly is a credit rating?

A credit rating is a qualitative & quantitative assessment of the probability of default on payment of interest and principal on a debt instrument. It is not a recommendation to buy, sell or hold a debt instrument. Credit rating only provides an additional input to the investor, and the investor is required to make their own independent and objective analysis before arriving at an investment decision.

2. What is a Credit Rating Agency (CRA)?

SEBI (Credit Rating Agencies) Regulations, 1999 define 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.

3. Who regulates CRAs?

Credit ratings of securities that are listed, or proposed to be listed, on a recognized stock exchange, and other credit ratings that are required under various SEBI Regulations or circulars thereunder are regulated by SEBI. CRAs also undertake rating of financial instruments under the respective guidelines of other financial sector regulators or authorities such as the Reserve Bank of India (RBI). Illustratively, RBI accredits CRAs for credit ratings of bank loans / facilities, authorizes CRAs for independent credit evaluation of resolution plans and approves CRAs for rating of public deposits raised by NBFCs.

4. Is a credit rating a recommendation for investors to buy, sell, or hold a debt instrument?

No. A credit rating is strictly an opinion and is not a recommendation to buy, sell, or hold a specified rated security. It does not offer any guarantee against future losses or protection against default. A rating serves only as an additional input, and investors must carry out their own independent and objective analysis before making any investment decision, in addition to the credit rating.

5. What critical financial aspects does a credit rating NOT measure?

Credit ratings focus solely on credit risk (probability of default). They do not account for other risks, such as market or liquidity risks or LGD, which can significantly impact a security's value. Furthermore, ACER's opinion does not take into account factors like the reasonableness of the issue price, the coupon

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Regional Off.: Unit 1513-1514, C Wing, One BKC, Bandra Kurla Complex, Mumbai 400051
+91 124 460 7887
contact@acerratings.com
www.acerratings.com

rate, secondary market liquidity, or pre-payment risk.

6. **How does a CRA like ACER differ from a credit bureau?**

A key difference is the focus on time frame: a credit rating agency provides an opinion related to future debt/Interest repayments by borrowers. Conversely, a credit bureau focuses on providing information regarding past debt repayment behaviour exhibited by borrowers.

7. **How does the function of a credit rating differ from a financial audit?**

A financial audit verifies the accuracy of historical financial statements, whereas a credit rating is a forward-looking opinion about future repayment capability. ACER does not perform an 'audit' in connection with the rating exercise, nor does it undertake a forensic exercise to detect fraud.

II. Process and Methodology

1. **How are ACER's Credit Ratings generally arrived at?**

ACER's ratings are based on a comprehensive evaluation process. This involves an in-depth study of the industry, an evaluation of the issuer's strengths and weaknesses, analysis of published financial information, visits to the issuer's offices, and intensive discussions with the senior management, auditors, and bankers. We also consider the macroeconomic, regulatory, and political environment.

2. **Are ratings primarily based on historical performance or are they forward-looking?**

While historical financial and qualitative data are considered in the analysis, credit ratings are ultimately forward-looking opinions. They require an evaluation of the entity's past performance alongside its future repayment capability.

3. **What is the typical time taken by ACER to complete a rating assignment?**

The time required depends on the complexity of the assignment and the timely availability of all necessary information and management discussions. Generally, a new rating assignment typically takes about three to four weeks from the date ACER receives the required information.

4. **What role do Rating Criteria play in the assessment process?**

Rating Criteria outline ACER's methodology for assessing factors that influence ratings within a given sector. They detail the analytical approach, framework, assumptions, and expectations used to evaluate these factors for assigning and

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maintaining credit ratings.

5. **How does ACER ensure the credibility and professional objectivity of its ratings?**

ACER ensures its credibility by maintaining absolute independence from market participants to provide unbiased opinions. Ratings are based on the collective judgment of the Rating Committee members, and the rating process is strictly insulated from any possible conflicts of interest.

III. Symbols and Classification

1. **Why does ACER use standardised symbols rather than descriptive credit opinions or marks?**

Standard Symbols are used because they are easy to understand and have been standardised across all Credit Rating Agencies (CRAs). ACER publishes the definitions and rationale for these symbols to facilitate greater market understanding.

2. **How is a credit rating denoted?**

SEBI circular dated June 15, 2011, captioned "Standardisation of Rating Symbols and Definitions" has standardised common rating symbols and their definitions. For instance, rating symbols and definitions for long-term debt securities (i.e. those with original maturity exceeding one year) have been standardised as under and as given earlier in the document.

Rating symbols should have ACER's first name as a prefix:
AAA - 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.
AA - 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.
A - Instruments with this rating are considered to have an adequate degree of safety regarding the timely servicing of financial obligations. Such instruments carry low credit risk.
BBB - Instruments with this rating are considered to have a moderate degree of safety regarding the timely servicing of financial obligations. Such instruments carry moderate credit risk.
BB - Instruments with this rating are considered to have a moderate risk of default regarding timely servicing of financial obligations.
B - Instruments with this rating are considered to have a high risk of default regarding the timely servicing of financial obligations.

C - Instruments with this rating are considered to have a very high risk of default regarding the timely servicing of financial obligations.
D - Instruments with this rating are in default or are expected to be in default soon.

3. **What do the modifiers, such as the plus (+) and minus (-) symbols, indicate in a rating?**

The modifiers, specifically plus (+) or minus (-), are used with rating symbols (typically AA to C) to reflect a finer distinction or comparative standing within a particular rating category. It is important to note that the minus sign does not carry an inherently negative connotation relating to the issuer's performance. For example, a rating of 'AA-' is stronger than a rating of 'A+'.

4. **What is the distinction between Investment Grade and Speculative Grade ratings?**

In the Indian context, instruments rated 'BBB-' and above are classified as Investment Grade, signifying ACER's opinion that the instrument is likely to meet its payment obligations/period. Conversely, instruments rated 'BB+' and below are classified as Speculative Grade. Speculative-grade instruments carry a materially higher risk and a significantly greater probability of default compared to investment-grade instruments.

5. **Does the size of the rated debt obligation affect its credit rating?**

The size of the rated debt obligation is a factor in the overall analysis but does not automatically determine the credit rating.

6. **Are rating symbols identical across all types of financial instruments?**

No. Rating symbols may vary depending on the type of financial instrument and its tenure, such as long-term versus short-term instruments. For details, please refer SEBI Master Circular, 2025.

IV. Types of Ratings and Enhancements

1. **Is the rating assigned for the specific instrument or for the issuer company overall?**

ACER assigns ratings to a specific security or instrument. However, ACER may also assign an issuer rating, which considers the overall debt management capability of the issuer over a medium-term perspective (typically three to five years). Instrument ratings factor in issue-specific characteristics like maturity or credit enhancements.

2. **Why is a rating necessary for Bank Loans?**

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Credit ratings are essential for Bank Loans because they are used for the determination of risk weights for calculating Capital Adequacy for banks, as mandated by Basel II guidelines in India. This process helps make the banking system more risk-sensitive in assigning lending margins, securities, and rates of interest to mitigate risk.

3. **What defines a Structured Obligation (SO) rating?**
The suffix '(SO)' is assigned to instruments (such as securitised or asset-backed transactions) that benefit from a structured payment mechanism and credit enhancement. The structure typically ensures that the rated instrument is largely bankruptcy-remote from the issuer/originator.

4. **What defines a Credit Enhancement (CE) rating?**
The suffix '(CE)' is used for instruments where the credit enhancement (like a guarantee) is provided by an external or third party. Crucially, in a CE rating, the instrument is not deemed bankruptcy-remote from the original issuer or originator.

5. **What is a Partial Credit Enhancement?**
Partial Credit Enhancement occurs when a credit rating is supported by only a partial guarantee or an Irrevocable Contingent Line of Credit (ICLC) from a higher-rated entity, rather than a full guarantee. The guarantor or ICLC provider is responsible for covering losses only up to a specified limit, as documented.

6. **What is the definition of a Provisional rating?**
Where a rating is prefixed as [Provisional], it indicates that a full rating has been assigned based upon the agency's expectations regarding final documentation or certain steps pending, typically based upon a review of the final draft documentation provided by the issuer. If such final documentation is received or steps pending are executed as expected, the provisional rating will typically be converted to a final rating. Provisional ratings are not conditional upon receipt of further analytical information. By the time a provisional rating is assigned to a transaction, no change is anticipated to that opinion other than in exceptional circumstances. While provisional ratings typically convert to final ratings within a short time, determined by the timing of transaction closure, in the period between assignment of a provisional rating and a final rating, provisional ratings may be raised, lowered or placed on Rating Watch or withdrawn, as with final ratings.

V. Regulation and Independence

1. **Which regulatory body oversees ACER Credit Rating Private Limited?**
All Credit Rating Agencies (CRAs) in India, including ACER, are regulated by the

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Securities and Exchange Board of India (SEBI) under the SEBI (Credit Rating Agencies) Regulations, 1999. These regulations govern registration, monitoring of ratings, disclosure requirements, and the ethical conduct of CRAs, ensuring uniform compliance across all agencies. CRAs must maintain independence, avoid conflicts of interest, and provide transparent ratings based on accurate financial and operational information. CRAs are also expected to align with international best practices, such as those prescribed by IOSCO, to promote transparency, credibility, and investor confidence in the rating process.

2. **Does the regulator influence ACER's final rating decisions?**

No. The Securities and Exchange Board of India (SEBI) does not influence or participate in the credit assessment conducted by ACER. The rating is intended to be the independent, unbiased, and professional opinion provided solely by the Credit Rating Agency, within regulatory guidelines.

3. **What are the measures taken by SEBI to strengthen credit rating?**

SEBI has, from time to time, taken several steps to strengthen the process of credit rating. SEBI directives inter alia require the credit rating agencies to be transparent and disclose to the public the information which may have a material bearing on the ratings, any sources of conflicts of interest while undertaking the rating exercise, rating methodology, rationale of the ratings, etc.

4. **If the issuer pays for the rating, how does ACER maintain its independence and objectivity?**

Although the issuer provides the remuneration, the investor is the primary user, and the "value" of the rating depends entirely on the investor's perception. Investor perception is built on the stability and reliability of past opinions. Additionally, CRAs are expected to follow a stringent Code of Conduct and Ethics to insulate the rating process from conflicts of interest.

VI. Monitoring and Changes

1. **What is the validity period of a credit rating?**

A rating is expected to remain valid until the rated debt obligation is fully paid or the rating is formally withdrawn. However, long-term debt instrument ratings are typically subjected to annual or periodic review.

2. **Is the rating a one-time exercise, or is it monitored?**

A rating is not a one-time exercise. To protect investor interests, ACER continuously monitors all outstanding rated debt issues throughout the instrument's life, a process known as surveillance. ACER adjusts the rating as needed in response to changes in the issuer's creditworthiness or any material

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changes.

3. **Why do credit ratings change over time?**

A rating is an opinion based on the information and expectations available at a specific point in time. However, information, expectations, and the issuer's circumstances can change significantly over time, affecting the issuer's future repayment abilities. Consequently, ratings may be altered (upgraded or downgraded), or outlooks may be changed, to accurately reflect these changes.

4. **What is a rating outlook and rating watch?**

A Rating Outlook reflects the likely movement of a rating over the medium term, generally within one to two years. It indicates potential future rating actions based on emerging financial, business, or industry trends that have not yet fully materialised to warrant an immediate change.

Most ratings carry a Stable Outlook, suggesting that no significant rating movement is anticipated in the near future.

A Positive Outlook indicates that an upgrade is possible if favourable trends continue, while a Negative Outlook suggests potential for a downgrade should adverse factors persist. However, an Outlook does not guarantee a rating action; a Stable Outlook may still see a change if warranted by evolving circumstances.

A Rating Watch, on the other hand, signals an elevated likelihood of a near-term rating action and specifies the expected direction of change.

5. **What is "Issuer Not Cooperating (INC)"?**

In case the rated entity does not cooperate with the CRA (for instance, does not provide information required for rating, non-payment of fees for conducting surveillance, etc.), that entity may be classified as Issuer Not Cooperating (INC). Majority of such non-cooperating clients are unlisted entities or borrowers. For entities classified as INC, CRAs will continue to review the ratings on an ongoing basis throughout the instrument/facility's lifetime, on the basis of best available information.

6. **What kind of responsibility or accountability does a rating agency have if an investor makes their investment decision based on ACER's rating, and incurs a loss on the investment?**

ACER's credit rating is a professional opinion given after studying all available information at a particular point in time. Nevertheless, such opinions may prove wrong in the context of subsequent events. There is no contract between an investor and a rating agency. The investor is free to accept or reject the opinion

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of the agency.

7. **From where can the credit ratings of instruments be obtained? How can an investor know if a credit rating agency has changed its rating?**

Credit ratings assigned by the credit rating agencies to various instruments are made available by the agencies through press releases and on their respective websites. The same are also available in the prospectus or the offer document of the issuer company and in media advertisements.

The credit rating agencies are required to continuously monitor the ratings assigned by them to a particular instrument. In case of any changes in the ratings so assigned, the agencies are required to disclose the same through press releases on their respective websites.

8. **What action does ACER take when an issuer stops cooperating or providing necessary information?**

In case an issuer stops cooperating or does not share information to carry out a rating, ACER will try to carry out the process based on the best available information in the public domain. Such ratings will be marked with a suffix "ISSUER NOT COOPERATING*". This will be followed by an asterisk mark. The asterisk mark shall be explained and shall read as 'Issuer did not cooperate; based on best available information'. ACER will communicate such ratings through its usual communication channels, such as press releases, websites, etc. In line with regulatory requirements, investment-grade ratings in Issuer Not Cooperating status, outstanding for more than six months with ACER, will necessarily be downgraded to the non-investment grade, while maintaining the Issuer Not Cooperating status. This action will be taken regardless of whether the issuer is cooperating or not cooperating with any other CRA.

9. **Can an issuer appeal a rating decision made by ACER?**

Yes. If an issuer is not satisfied with an assigned, reaffirmed, or revised rating, they have the right to submit a written appeal requesting a review. The appeal must include any relevant additional information and supporting documents. This appeal is reviewed by an Appeal Committee, which consists of a majority of senior members (external/Internal) who were not involved in the original rating decision.

10. **What is the purpose of a Default Recognition Policy?**

The Default Recognition Policy outlines the criteria and processes used by the CRA to identify, recognise, and record a default by an issuer or borrower. It ensures uniformity, transparency, and consistency in how defaults are treated across all rated entities and instruments.

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11. **What can be the potential conflict of interest arising from a CRA's relationship with a rated entity?**

Potential conflict of interest may arise in various scenarios, including where a KMP of a CRA has any relationship with or interest in the rated entity or any affiliate of the rated entity or any entity that may cause or may be perceived as causing a conflict of interest.

To illustrate, considering the supervisory responsibilities to be discharged by certain entities as per regulatory requirements, potential conflict of interest may arise where a KMP of a CRA has any relationship with or interest in any of the following entities:

I. Debenture trustee for a debenture being rated by the CRA, or
II. Trustee/ sponsor of a mutual fund whose scheme is being rated by the CRA, or
III. Trustee/ sponsor of REIT/ InvIT where such investment trust is being rated by the CRA, etc.

12. **Where can an investor look out for more information on CRAs registered with SEBI?**

For more information on CRAs, one can refer to the following:

a) SEBI website (www.sebi.gov.in)
   1. Regulatory framework, including CRA Regulations, circulars issued thereunder
   2. List of registered CRAs
b) RBI website (www.rbi.org.in)
   1. List of RBI-accredited or eligible CRAs for risk weighting of banks' claims for capital adequacy purposes
   2. RBI-approved credit ratings and minimum investment grade ratings for public deposits by NBFCs
   3. Independent credit evaluation (ICE) of the residual debt by credit rating agencies (CRAs) specifically authorised by the Reserve Bank
c) Stock Exchanges and Depositories website
   1. Disclosures made by CRAs
d) Website of the respective CRA
   1. Information about the CRA
   2. Disclosures made by the CRA, including FAQs on ratings, disclosures on rating process and methodologies, etc.

13. **How can investors redress their complaints against CRAs?**

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Investors should first approach the concerned CRAs with their complaint.
If the complaint remains unresolved, the investors may approach the respective regulator or authority, for instance:

- RBI – for complaints pertaining to rating of bank loans/ facilities, independent credit evaluations of residual debt or ratings of Resolution Plans (RPs), and deposits raised by NBFCs, etc.
- MCA – for complaints pertaining to ratings of public deposits raised by corporates, etc.
- SEBI – for complaints pertaining to ratings of securities that are listed or proposed to be listed on a recognised stock exchange. SEBI has a web based centralized grievance redress system called SEBI Complaint Redress System (SCORES) available at http://scores.gov.in where investors can lodge their complaints against CRAs.

14. **Is there a need to appoint a compliance officer?**

CRA Regulations require a compliance officer to be appointed by the CRA. Every CRA shall appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions, etc. issued by SEBI or the Central Government. (Regulation 20A of CRA Regulations).

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