Approach For Calculating
Average Rating Transition Rates For Long-Term Instruments

As per SEBI circular No. SEBI/HO/MIRSD/DOS3/CIR/P/2018/140 dated November 13, 2018, all Credit Rating Agencies (CRAs) must publish their average one-year rating transition rates over a five-year period on their websites. These transition rates for long-term instruments must be computed as the weighted average of rating movements across all rating categories and across all static pools formed during the five-year window.

Accordingly, ACER calculates and publishes the Average Rating Transition Rates for the previous five years on its website.

ACER reserves the right to amend this methodology from time to time in accordance with the applicable regulations, circulars, and directives issued by the regulators. This disclosure will be reviewed annually.

A. Approach

a. Static Pool Formation

ACER uses the Static Pool Method to compute rating transition rates. For each financial year, a static pool is created consisting of all long-term ratings that are outstanding at the beginning of the year.

- Ratings withdrawn during the year, as well as ratings of non-cooperative issuers, are excluded.
- Each financial year forms a separate static pool.
- Any rating downgraded to "D" is treated as a default for the remainder of the period.
- If a rating is later upgraded from "D," it is treated as a new rating and included in the relevant subsequent static pool.

b. Transition Rate Calculation

ACER tracks how ratings change during the following year.
The one-year transition matrix reflects the movement of each rating category by the end of the financial year.

Transition rates represent the proportion of ratings that migrate from one category to another relative to the total number of ratings in that static pool at the start of the year.

c. Averaging Across Years

Transition data from all static pools over the five-year period is combined. Weighted averages are used, where each static pool is weighted by its number of issuers. This results in issuer-weighted average one-year transition rates for each rating grade across all five years. Only long-term ratings that have been assigned and accepted by issuers are included.

Data is issuer-level; not instrument-level. so if an issuer has multiple long-term rated instruments, it is counted only once. In such cases, the highest rating among the issuer's instruments is considered.

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The resulting five-year average one-year transition rates are then published on ACER's website. A rating transition matrix shows how ratings evolve over time. The diagonal values represent the stability of ratings. As stated earlier, withdrawn ratings and ratings of non-cooperative issuers are excluded from the calculation.

d. Average Rating Transition Rates for Listed or To-Be-Listed Securities

SEBI circular No. SEBI/HO/DDHS/DDHS-RACPOD2/P/CIR/2022/113 dated August 25, 2022, introduced revised requirements for publishing average transition rates specifically for long-term credit ratings of securities that are listed or proposed to be listed on a recognized stock exchange.

From FY 2022–23 onward, CRAs are also required to publish two additional transition matrices for listed/to-be-listed securities, based on the following definitions of static pools:

i. Static Pool Definition - Excluding Withdrawn & Non-Cooperative Ratings

- Ratings outstanding at the start of the financial year.
- Excludes ratings withdrawn during the year and ratings of non-cooperative issuers.
- Ratings downgraded to "D" are treated as defaults for the rest of the year.
- Ratings upgraded from "D" are treated as new ratings for subsequent pools.

ii. Static Pool Definition – Including Withdrawn & Non-Cooperative Ratings

- Ratings outstanding at the start of the financial year.
- Includes ratings withdrawn during the year and ratings of non-cooperative issuers.
- Ratings downgraded to "D" are treated as defaults for the remainder of the year.
- Ratings upgraded from "D" are treated as new ratings for future pools.
- CRAs must additionally disclose the proportion of ratings withdrawn during the year.

Based on these requirements, ACER prepares and discloses the two additional Average Rating Transition Rates each year for all relevant listed or to-be-listed securities.

Disclosure

All the above transition-rate-related disclosures- including the standard transition rates and the two additional matrices required for listed instruments- are regularly published on ACER's website.

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