

F/34
8/11/12

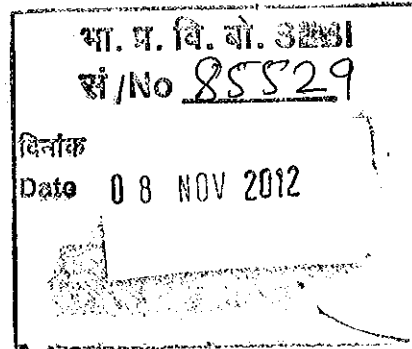


Sumer Plaza, Unit No. 102,
1st Floor, Marol Maroshi Road,
Marol, Andheri (East),
Tel. : +91 22 6714 1111
Fax : +91 22 6714 1142
Email: info@smera.in
www.smera.in

F&S/12-13/12366
November 7, 2012

9/11/12
AGM (AS)

Ms. Asha Shetty
General Manager
MIRSD - 4,
Securities & Exchange Board of India
SEBI Bhavan
Plot No. C-4A, 'G' Block,
Bandra Kurla Complex, Bandra (East),
Mumbai - 400 051



Dear Madam,

Sub.: Request for interpretative letter under the SEBI (Informal Guidance) Scheme, 2003, as amended ("the SEBI Scheme") in connection with Regulation 27 (1) of Chapter IV of Securities & Exchange Board of India (Credit Rating Agencies) Regulations, 1999

This is a request for an interpretative letter under clause 5(ii) of the SEBI Scheme on the basis of the factual background and details provided herein below in this letter:

Factual Background

1. SME Rating Agency of India Ltd. (SMERA) ("Company"), promoted by Small Industries Development Bank of India (SIDBI) and Dun & Bradstreet Information Services India Private Limited (D&B) in association with leading public, private sector and foreign banks, is a Credit Rating Agency (CRA) registered with SEBI under the SEBI (Credit Rating Agencies) Regulations, 1999 ("the said Regulations"), having a paid-up equity share capital of ₹ 14,87,50,000/- comprising of 1,48,75,000 equity shares of ₹ 10/- each. The existing shareholding pattern of the Company is enclosed herewith (*Annexure 1*).
2. Since its inception, SMERA has been engaged in assigning entity ratings such as the rating of SMEs under NSIC "Performance and Credit Rating Scheme", Green Field and Brown Field Ratings, Green Ratings, rating of Maritime Training Institutions (MTI) and Micro Finance Institutions (MFI). These entity ratings are purely private in nature. We would also like to mention that these entity ratings are non regulatory in nature and are not governed by any of the regulatory norms of SEBI, RBI and other regulators.
3. We also provide certain other services such as risk rating of industrial clusters, validation of rating models, code of conduct assessment for various institutions, due-diligence exercise etc. These services are in fact consultancy / advisory services and / or not credit rating of any security issued by any entity.
4. SMERA has formulated its own guidelines / internal procedures governing these above activities.



5. We have recently received accreditation from the Reserve Bank of India (RBI) to carry out rating of various facilities provided by the commercial banks to their borrowers such as loans, guarantees, cash credit limits, bill discounting facilities, pre and post-shipment facilities etc. These facilities provided by banks could be fund based and non-fund based facilities. Some of our SME clients have approached us for rating of these facilities provided to them by their respective banks.

Legal Framework

1. Clause 2 (1)(v) of the said Regulation, reads as follows:

"securities" has the same meaning assigned to it in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (Annexure 2)

2. Regulation 25 (b) of the said Regulation reads as follows:

"Promoter means a person who holds ten percent or more, of the shares of the credit rating agency".

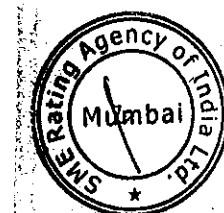
3. Regulation 27 (1) of Chapter IV of the said Regulations, reads as follows:

"No credit rating agency shall, rate a security issued by an entity, which is:

- a) *a borrower of its promoter; or*
- b) *a subsidiary of its promoter; or*
- c) *an associate of its promoter, if*
 - i) *there are common Chairman, Directors between credit rating agency and these entities.*
 - ii) *there are common employees.*
 - iii) *there are common Chairman, Directors, Employees on the rating committee."*

4. Circular (CIR.MIRSD/3/2012) dated March 01, 2012 inter alia states that:

- a) *It is observed that the CRAs registered with SEBI also carry out rating of other securities / instruments and loans / facilities provided by banks which are not regulated by SEBI. Such ratings are being used by other regulators or their regulated entities for the specified purposes.*
- b) *Therefore, it is desirable that in addition to the review / accreditation process put in place by these regulators, if any, such ratings should also be governed by the same stringent norms as applicable for rating of securities issued by way of public or rights issue.*
- c) *In view of the above, it has been decided in consultation with the CRAs and also with other regulators that for the above mentioned ratings, CRAs shall follow the applicable requirements pertaining to rating process and methodology and its records, transparency and disclosures, avoidance of conflict of interest, code of conduct, etc, as prescribed in the Regulations and circulars issued by SEBI from time to time.*



Interpretation Sought

SIDBI holds more than 10% of the equity share capital of SMERA and therefore in terms of the provisions of Regulation 25 (b) of the said Regulations "SIDBI" is deemed to be a "Promoter" of SMERA. Whether Clause 27 (1) of the said Regulations is attracted in case of any of the above services (provided by SMERA) mentioned under paragraph 2, 3, & 5 and stated under the head Factual Background.

In our understanding, based on the definition of securities [as per Securities Contracts (Regulation) Act, 1956], the above mentioned services, bank facilities and advisory services may not fall under the category of securities and may not attract the provisions of Regulation 27 (1) of the said Regulations. Similarly, the guidelines issued vide circular dated March 01, 2012 may not be applicable for the services mentioned under paragraph 2, 3, & 5 and stated under the head Factual Background provided by SMERA.

SIDBI also provides resources support through re-finance / bill discounting and re-discounting facilities to Banks. For similar reasons, as stated in the earlier paragraph, these facilities from SIDBI, we feel, may not attract provisions of Regulation 27 (1) of the said Regulations. We shall be glad if SEBI could kindly arrange to get our interpretations examined.

We are enclosing herewith a Demand Draft dated November 6, 2012 bearing no. 018574 for ₹ 25,000/- drawn on ICICI Bank, Mumbai.

We would be grateful for receiving the confirmation and interpretations sought above at your earliest convenience. For any further information or clarifications, we shall request you to please contact the undersigned.

Thanking you,

Yours faithfully,
For SME Rating Agency of India Ltd.


Parag Patki
Chief Executive Officer

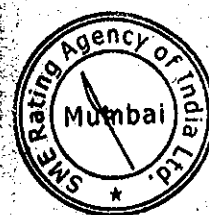


Encl.:

1. Annexure 1 - Shareholding pattern
2. Definition of "securities" as per Section 2 (h) of Securities Contracts (Regulation) Act, 1956

Annexure 1**SME RATING AGENCY OF INDIA LTD.****Shareholding Pattern as on November 07, 2012**

Sr. No.	Name of shareholder	Shareholding (no. of shares)	Percentage of holding
1	Small Industries Development Bank of India (SIDBI)	5100000	34.29%
2	Dun & Bradstreet Information Services India Pvt. Ltd. (D&B)	5100000	34.29%
3	ICICI Bank	1100000	7.39%
4	State Bank of India	950000	6.39%
5	Bank of Baroda	400000	2.69%
6	Bank of India	400000	2.69%
7	Canara Bank	400000	2.69%
8	Oriental Bank of Commerce	400000	2.69%
9	Union Bank of India	400000	2.69%
10	Standard Chartered Bank	225000	1.51%
11	Indian Bank	200000	1.34%
12	Punjab National Bank	200000	1.34%



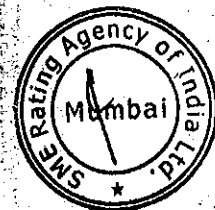
Annexure 2

Section 2 (h) of Securities Contracts (Regulation) Act, 1956

Definition of "securities"

"securities" include-

- (i) Shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;
 - (ia) derivative;
 - (ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes;
 - (ic) security receipt as defined in clause (zg) of Section 2 of SARFAESI Act, 2002;
 - (id) units or any other such instrument issued to the investors under any mutual fund scheme.
 - (ie) any certificate or instrument (by whatever name called), issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be;
- (ii) Government securities;
 - (ia) such other instruments as may be declared by the Central Government to be securities; and
- (iii) Rights or interest in securities;





SMERA RATINGS

Impact of SEBI Guidelines

January 2013

Contents

• SMERA's Introduction	2
• Extant SEBI (Credit Rating Agencies) Regulations, 1999/Circulars and Guidelines issued there under for CRAs	2
• Impact of the above regulations on SMERA	2
• Specific Instances of regulations impacting SMERA.....	2
• Steps taken by SMERA to avoid conflict of interest with respect to above regulations.....	2
• Why is SMERA's case is different from other rating agencies	2

SMERA's Introduction

SME Rating Agency of India Ltd (SMERA) was launched in 2005 as a Credit Rating Agency (CRA) for the Micro, Small and Medium Enterprise sector in India. SMERA is registered as a CRA with the Securities and Exchange Board of India (SEBI) and is accredited by the Reserve Bank of India (RBI) as an eligible external credit assessment institution (ECAI) to rate bank loans under the Basel II guidelines. SMERA is promoted by leading domestic as well as international institutions of repute. SMERA's promoters include: Small Industries Development Bank of India (SIDBI), Dun & Bradstreet Information Services India Pvt. Ltd (D&B) and various leading Govt., Public, Private and MNC banks in the country.

SMERA offers a wide range of services in the debt market and banking domain; SMERA's product suite comprises of:

- Bank loan ratings
- SME Ratings
- SME/NSIC performance ratings
- Rating of Non-convertible debentures and bonds,
- Rating of Commercial papers and certificate of deposits,
- Rating of fixed deposits
- Grading of IPOs and Maritime Training Institutes
- Microfinance Institution ratings
- Greenfield and Brownfield Grading
- Green Ratings

The rating process and activities carried out under these products are available on www.smera.in. Detailed product activities are given in the links below:

Product	Information
Bank loan ratings	http://www.smera.in/bond.aspx#bondfeatures
Rating of Non-convertible debentures and bonds	http://www.smera.in/bond.aspx#bondfeatures
SME Ratings	http://www.smera.in/sme.aspx
SME/NSIC performance ratings	http://www.smera.in/smeransic.aspx#nsicfeatures
Grading of IPOs	http://www.smera.in/ipograting.aspx#ipofeatures
Maritime Training Institutes	http://www.smera.in/maritime.aspx#maritimeprocess
Microfinance Institution ratings	http://www.smera.in/ipograting.aspx#ipofeatures
Greenfield and Brownfield Grading	http://www.smera.in/Greenfield.aspx
Green Ratings	http://www.smera.in/GreenRating.aspx#greenratingfeatures

Extant SEBI (Credit Rating Agencies) Regulations, 1999/Circulars and Guidelines issued there under for CRAs

1. Clause 2 (1)(v) of the said Regulation, reads as follows:

"securities" has the same meaning assigned to it in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956

2. As per Section 2 (h) of Securities Contracts (Regulation) Act, 1956, "securities" include-

- (i) Shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;
 - (ia) derivative;
 - (ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes;
 - (ic) security receipt as defined in clause (zg) of Section 2 of SARFAESI Act, 2002;
 - (id) units or any other such instrument issued to the investors under any mutual fund scheme.
 - (ie) any certificate or instrument (by whatever name called), issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be;
- (ii) Government securities;
 - (iia) such other instruments as may be declared by the Central Government to be securities; and
- (iii) Rights or interest in securities.

3. Regulation 25 (b) of the said Regulation reads as follows:

"Promoter means a person who holds ten percent or more, of the shares of the credit rating agency".

4. Regulation 27 (1) of Chapter IV of the said Regulations, reads as follows:

"No credit rating agency shall, rate a security issued by an entity, which is:

- a) *a borrower of its promoter; or*
- b) *a subsidiary of its promoter; or*
- c) *an associate of its promoter, if*
 - i) *there are common Chairman, Directors between credit rating agency and these entities.*
 - ii) *there are common employees.*
 - iii) *there are common Chairman, Directors, Employees on the rating committee."*

5. Circular (CIR.MIRSD/3/2012) dated March 01, 2012 inter alia states that:

- a) It is observed that the CRAs registered with SEBI also carry out rating of other securities / instruments and loans / facilities provided by banks which are not regulated by SEBI. Such ratings are being used by other regulators or their regulated entities for the specified purposes.

- b) Therefore, it is desirable that in addition to the review / accreditation process put in place by these regulators, if any, such ratings should also be governed by the same stringent norms as applicable for rating of securities issued by way of public or rights issue.
- c) In view of the above, it has been decided in consultation with the CRAs and also with other regulators that for the above mentioned ratings, CRAs shall follow the applicable requirements pertaining to rating process and methodology and its records, transparency and disclosures, avoidance of conflict of interest, code of conduct, etc, as prescribed in the Regulations and circulars issued by SEBI from time to time.

Impact of the above regulations on SMERA

Sr. No.	Regulation	Business Line Affected	Impact on SMERA
1	a) Regulation 25 (b) & Regulation 27 (1) b) Circular (CIR.MIRSD/3/2012) dated March 01, 2012	SMERA's SME/NSIC Business Line	SMERA cannot rate any MSMEs which are borrowers of SIDBI. This would have an adverse impact on SMERA's ability to rate MSMEs since a large number of MSMEs are direct borrowers of SIDBI or would be covered under the indirect financing schemes of SIDBI.
2	a) Regulation 25 (b) & Regulation 27 (1) b) Circular (CIR.MIRSD/3/2012) dated March 01, 2012	SMERA's NCD/Bond Ratings	SMERA cannot rate any issue which is made by the borrowers of SIDBI. <ul style="list-style-type: none"> From a debt market perspective, banks and financial institutions are the primary issuers in this market accounting for a lion's share in the primary issuances Most of the banks and financial institutions have a refinance line from SIDBI thus accounting for a large portion of its revenues As a result of the regulations even refinance would come under the ambit of the SEBI regulations which would prevent SMERA from rating the Tier 1, Tier 2, IPDI and other such instruments of most of the scheduled commercial banks in India. This exclusion will impact SMERA's revenues from financial sector ratings business. The financial sector ratings comprise of major revenues of other rating agencies.
3	a) Regulation 25 (b) & Regulation 27 (1) b) Circular (CIR.MIRSD/3/2012) dated March 01, 2012	SMERA's BLR Ratings	SMERA cannot rate any issue/facility of the borrowers of SIDBI. <ul style="list-style-type: none"> From a Bank Loan Rating (BLR) perspective, SMERA's promoter, SIDBI, is a diversified financial lender and a refinancing agency. SIDBI has extended its facilities to a large cross-section of MSMEs-directly as well as through refinance scheme. Considering the number of entities SIDBI has lent to, most of the entities in the BLR space have a high possibility of having borrowings from SIDBI, thus limiting SMERA's role in this space as well. This will also result in a large revenue loss as BLR business is the growth driver across rating agencies today.
4	a) Regulation 25 (b) & Regulation	Micro-Finance	As many of the MFIs /NBFC are borrowers of

	27 (1) b) Circular (CIR.MIRSD/3/2012) dated March 01, 2012	Institutions / NBFC ratings	SIDBI the impact of loss of business from this sector to SMERA would be substantial.
5	a) Regulation 25 (b) & Regulation 27 (1) b) Circular (CIR.MIRSD/3/2012) dated March 01, 2012	Loan Facilitation Services	Loan Facilitation Services for MSMEs is proposed to be launched by SIDBI under the guidance of Department of financial Services (DFS), GOI. This would involve rating / limited due diligence of the loan proposals from the MSMEs to SIDBI for consideration of assistance. The regulations would prohibit SMERA from undertaking this line of activity.

In addition, SMERA would not be able to undertake the surveillance/renewals of its initial ratings in case the rated clients avail of direct / indirect financing from SIDBI, thus impacting the future revenues.

Specific Instances of regulations impacting SMERA

Regulation 25 (b) & Regulation 27 (1) of the said Regulations read together with SEBI Circular (CIR.MIRSD/3/2012) dated March 01, 2012 would adversely impact almost all the business lines of SMERA such as:

- SME Ratings
- SME/NSIC performance ratings
- Bank loan ratings
- Rating of Non-convertible debentures and Bonds
- Micro-finance Institution ratings

Specific instances wherein the regulations would adversely impact SMERA's business are as follows:

- Direct loans from SIDBI to MSMEs
- Direct and indirect loans to 40 (public and private sector) banks, 7 State Bank of India associate banks and other major lenders such as co-operative banks, state level financial institutions, non-banking finance companies, micro-finance institutions etc which account for almost entire credit flow to MSME/ other sectors of the economy.

The number of financial intermediaries and others covered under the ambit of lending by SIDBI is enclosed for reference.

Steps taken by SMERA to avoid conflict of interest with respect to above regulations

- In compliance with SEBI regulations for CRAs, SMERA's Board has been reconstituted by substitution of SIDBI's Chairman and SIDBI's Deputy Managing Director by nominees who are not employees, Directors or Chairman of SIDBI.
- SMERA has put in place processes for assigning of ratings through the Rating Committee. The Rating Committee comprises of senior members within the organization as well as external experts from the field of banking, finance and economics who bring with them extensive industry experience. The Rating Committee is the final authority for assigning Ratings. It may be noted here that none of the Directors of the SMERA Board (excluding Chief Executive Officer of SMERA) are members of the Rating Committee of SMERA. Also, the Board is not involved in the selection / nomination of members in the Rating Committee nor does it involve itself in the rating committee meeting process.
- None of our promoter' employees / Directors are either connected with rating or are members of the Rating Committee.

It may observed from the above that -

- i) the rating process is carried by the executives of SMERA and rating is assigned by the rating committee comprising senior executives of SMERA and independent professionals and
- ii) the Board of SMERA and the Promoter (SIDBI) is not in any way connected with/involved in the rating process/decisions.

Why is SMERA's case different from other rating agencies

Sr. No.	Rating Agency	Financial Institution Shareholding	Greater than ten percent shareholding pre-regulation	Greater than ten percent during the inception of regulations (1999)	Greater than ten per cent at present
1	CRISIL	Yes	Yes	No	No
2	CARE	Yes	Yes	Yes	Yes
3	Brickworks	No	No	No	No
4	India Ratings and Research (Formerly Fitch India)	No	No	No	No
5	ICRA	Yes	Yes	Yes	No (shareholding underwent change in 2006 post the IPO, but pre bank loan rating)
6	SMERA	Yes	NA	NA	Yes