

Consultation Paper on Review of the Regulatory Framework for Credit Rating Agencies (CRAs)

1. Objective

The objective of the consultation paper is to seek comments/ views from the public on the proposals that are expected to improve market efficiency by reducing the information asymmetry in the market and enhancing the governance, accountability and functioning of Credit Rating Agencies (CRAs) for carrying out the rating activities in an efficient and professional manner, thereby, yielding timely and accurate ratings.

2. Background

SEBI intends to review the regulatory framework for CRAs and put in place provisions pertaining to enhanced disclosures by issuer companies that shall augment the effectiveness of the rating process and outcomes and enable CRAs to be proactive and come out with fair, objective and unbiased ratings, mitigating the issues of conflict of interest. In pursuance of the same, the regulatory framework and practices prevalent in other jurisdictions were also referred. SEBI also held discussions with various market participants/ stakeholders to understand their concerns and suggestions. After taking into account these suggestions and practices abroad, this paper has been prepared where the proposals are listed for public comments, along with detailed rationale for the same.

3. Proposals

3.1. Enhanced net-worth requirement for CRAs:

Minimum net worth requirement to be eligible for grant of registration as a CRA to be increased to Rs. 50 Crores, from current requirement of Rs 5 crores.

Rationale:

Currently, as per SEBI (CRA) Regulations, 1999, an applicant is required to have a minimum net-worth of Rs. 5 Crores to be eligible for grant of registration as a CRA. This was stipulated by SEBI in 1999. The systemic importance of CRAs as well as the roles, responsibilities and business undertaken by them have since increased significantly as a result of evolution of the financial markets and change in market dynamics. Therefore, the present obligations of the CRAs warrant an increased networth requirement to ensure that CRAs have adequate financial capabilities that would enable them to invest in building intellectual capital, developing efficient systems and infrastructure and adopting better technology to ensure the highest standards of analytical rigour.

Accordingly, it is proposed that the minimum net worth requirement to be eligible for grant of registration as a CRA may be increased to Rs. 50 Crores. The existing registered CRAs having a net worth of less than rupees Rs. 50 crores, shall be provided a period of three years to meet the said network requirement.

3.2. Enhanced Eligibility criteria for Promoter of a CRA

If a CRA is promoted by a company or a body corporate (other than a public financial institution, scheduled commercial bank, foreign bank or foreign credit rating agency), then such promoter should also have a sound track record of carrying on business in financial services for a period of not less than five years.

Rationale:

Considering the important role played by CRAs, it is imperative that CRAs are promoted by experienced and financially robust entities, with long-term commitment and interest in the financial markets whose line of business is not misaligned with the activity of credit rating. Therefore the promoter being a body corporate should have a sound track record of carrying on business in financial services for a period of not less than five years.

3.3. Requirements of disclosure of financial results on the Exchange(s) for issuers of listed debt to be brought in line with the corresponding requirements for issuers of listed equity.

Rationale:

While issuers of listed equity are required to disclose financial results on a quarterly and year-to-date basis (as per Regulation 33 of SEBI (LODR) Regulations, 2015), issuers of listed debt are required to disclose financial results on a half-yearly basis (as per Regulation 52). This results in information regarding financial performance of issuers of listed debt not being available in a timely manner to the public at large. This constrains the ability of the CRA as well as the public at large to assess the creditworthiness and repayment ability of the Issuer in a timely manner.

Accordingly the requirement of disclosure of financial results for Issuers of listed debt needs to be brought in line with that of issuers of listed equity and, hence, it is proposed that issuers of listed debt shall disclose on the Exchange(s) the below mentioned financial results in the format as prescribed in Schedule III to the Companies Act, 2013 (excluding notes and detailed sub-classification):

- Statement of Profit and Loss on a quarterly and year-to-date basis
- Statement of Assets and Liabilities/ Balance Sheet on a half-yearly basis

3.4. Mandatory disclosure of annual consolidated financial results to the Exchange(s) in case of issuers having only listed debt.

Rationale:

Support from the holding/ parent company is a major consideration while rating instruments of subsidiaries. Hence, an analysis of the financials of the holding company and the group as a whole helps the public at large in getting a holistic picture about the creditworthiness of the entire group.

Vide Gazette Notification dated Feb 16, 2015, Companies (Indian Accounting Standards) Rules, 2015 and Ind AS 110, it has been made mandatory to prepare consolidated financial statements for companies (that control one or more entities) whose equity or debt securities are listed or are in the process of being listed.

While SEBI (LODR) Regulations, 2015 mandate submission of annual consolidated financial results for listed equity, the same is not mandated for issuers of listed debt. Mandating the same for entities having listed debt shall aid investors in factoring in possibility of parent support for servicing the debt obligations, in case company's cash/ cash instruments are insufficient to service forthcoming debt obligations, and put listed debt at par with listed equity in this respect and bring it in line with Indian accounting standards.

Therefore, it is proposed that submission of annual consolidated financial results may be mandated for issuers of listed debt.

3.5. Restriction on Crossholding in SEBI registered CRAs:

- a. No CRA shall, directly or indirectly, hold more than 10% of shareholding and/ or voting rights in another CRA and shall not have representation on the Board of the other CRA.
- b. Acquisition of shares and/ or voting rights in a CRA resulting in change in control may be permitted with the prior approval of SEBI.
- c. A shareholder holding 10% or more shares and/ or voting rights in a registered CRA shall not hold 10% or more shares and/ or voting rights, directly or indirectly, in any other CRA. However, it shall not apply to holdings by broad-based domestic financial institutions.

Rationale:

Currently, there is no restriction on a CRA acquiring shares/ voting rights in another CRA or a person acquiring shares/ voting rights in more than one CRA. However, significant crossholdings may give rise to conflict of interest wherein the independence of such a

CRA to function may get affected in terms of rating process followed, instruments having dual ratings from these CRAs.

Having some thresholds on cross-holding in CRAs may mitigate concerns regarding conflict of interest, independence of operations, etc.

A threshold of 10 per cent for acquisition of shares and/ or voting rights has been proposed keeping in view certain statutory rights and protections under the Companies Act, 2013 available to such shareholders. Further, a threshold of 10 per cent, subject to certain exemptions, is also applicable on cross-holdings in banks, as stipulated by RBI. The extant SEBI (CRA) Regulations also recognize the influence exercised by shareholders with 10 per cent or more holding and puts additional restrictions on CRAs for rating of securities issued by such entities, their associates, in order to mitigate the potential conflict of interest.

However, introducing restrictions on cross-holding in CRAs may limit consolidations within the industry. Some consolidations may lead to synergies/ economies of scale, diversification of business risks, transfer of technical know-how to the target entity, etc. Hence, in order to facilitate such scenarios, acquisition of shareholding and/or voting rights resulting in change in control may be permitted with the prior approval of SEBI.

In this regard, certain instances of restrictions on crossholding/ shareholding have been observed, the same are as under:

India:

As per the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012, a stock exchange shall not acquire or hold more than 15 per cent of equity paid up capital in another recognized stock exchange.

In the banking sector, it is seen that while there is a restriction of 10 per cent of equity capital/ voting rights on crossholding, consolidations can happen with the prior approval of RBI.

Internationally:

As per the CRA Regulations of the European Securities and Markets Authority (ESMA), a shareholder with at least 5 per cent of capital/ voting rights in a registered CRA cannot have more than 5 per cent of capital/ voting rights, directly or indirectly, in any other CRA.

3.6. Appeal by Issuers against ratings provided by CRAs

Appeal by Issuers against the rating(s) provided to its instrument(s) by the CRA, shall be reviewed by a Rating Committee of the CRA that shall be different from the rating committee that had initially assigned the rating to the instrument(s) and shall consist of a majority of independent members.

Rationale:

As per the Rating Process followed by the CRAs, the issuers have an opportunity to appeal against the rating assigned to its instruments by the CRA, which is thereafter considered for a review by a Rating Committee of the CRA which, as per the present practice, may be the same or different from the Committee that had initially assigned the rating to the instrument(s).

It is felt that in the interest of transparency and fairness, issuers should get a just opportunity of review by an independent Rating Committee of the CRA so that the facts presented by the issuers can be reviewed impartially. In this regard, it is proposed that all cases of appeal by issuers against the rating assigned to their instruments by the CRA shall be reviewed by a separate Appeal Committee of the CRA. Such Appeal Committee shall be different from the Rating Committee that had initially assigned the rating (that the issuer is appealing against) and shall consist of a majority of independent members.

3.7. Withdrawal of ratings permitted after a specified minimum period.

A CRA may be allowed to withdraw the ratings subject to the CRA having rated that instrument continuously for 5 years or 50% of tenure of instrument, whichever is higher. At the time of withdrawal the CRA shall assign a rating to such security and issue a press release also stating the reasons for withdrawal.

Rationale:

Currently, the CRA regulations, do not allow withdrawal of ratings by CRAs and require CRAs to continuously monitor the rating of securities during the lifetime of securities. However, vide SEBI Circular dated March 31, 2017, it was clarified that withdrawal of ratings is permitted for bank loans/ facilities and open-ended mutual fund schemes, subject to certain conditions and disclosure of reason(s) for withdrawal in the Press Release.

SEBI has received representations from Issuers requesting permission for withdrawing ratings as Issuers at times might not be satisfied with the services being offered by the current CRA and might want to seek services of another CRA in rating its instruments. It

has also been observed that internationally, there is no such requirement of a CRA rating an instrument throughout its lifetime.

It is thereby proposed that on receipt of request for withdrawal from the issuer, a CRA may withdraw the rating subject to the CRA having rated that instrument continuously for 5 years or 50% of the tenure whichever is higher. The CRA would assign a rating to such security at the time of withdrawal and issue a press release mentioning the reason(s) for withdrawal.

3.8. Any activity, other than the rating of financial instruments and economic/ financial research, shall be hived off by the CRA to a separate entity.

Rationale:

As per the SEBI (CRA) Regulations, 1999, CRAs can undertake the ratings of securities. However, CRAs are, currently, also additionally undertaking rating/ grading of non-financial instruments/ facilities/ projects/ entities, providing advisory services, etc.

It is pertinent to mention that undertaking such activities may pose regulatory and systemic risks as such activities are outside the jurisdiction of SEBI and, hence, are not being monitored. In order to address these concerns, it is proposed that CRAs may segregate the activities, other than the rating of financial instruments and economic/ financial research, and hive off the same to a separate entity.

A similar provision was also brought in SEBI (Depositories and Participants) Regulations, 1996, wherein assignments, not incidental to the activity of depository, are required to be segregated and hived off to a separate entity.

3.9. Disclosure of non-accepted ratings only for a period of 6 months of non-acceptance

Details of non-accepted ratings, disclosed on the website of the CRAs, may be made available only for a period of 6 months of such disclosure.

Rationale:

As per extant requirements, ratings not accepted by the issuer shall be disclosed as non-accepted rating on the CRA's website. The details to be disclosed include the name of the issuer, name/ type of instrument, size of the issue, rating and outlook assigned, etc.

Since non-accepted ratings are not monitored and reviewed by the CRA, post the initial rating exercise, they cease to accurately reflect the creditworthiness of the issuer/ borrower and, therefore, do not remain meaningful after a period. Further, the instrument may subsequently be rated by other CRA(s) and, post acceptance by the issuer/ borrower, be continuously monitored by these CRA(s) in line with the regulatory requirements. In the above situations, availability of non-accepted ratings on a CRA's website may be confusing or misleading for the investors. In view of the same, it is proposed that details of non-accepted ratings be made available on the website of the CRAs only for a period of 6 months of such non-acceptance.

3.10. Enhanced disclosure norms for CRAs

An Annual Rating Summary Sheet presenting a snapshot of rating action carried out during the year, shall be uploaded by the CRAs on their websites on an annual basis, separately for securities and financial instruments other than securities.

Rationale:

Currently, CRAs disclose detailed information about the rating actions carried out by CRAs on a half-yearly/ annual basis, however the information is quite detailed and exhaustive. In order to have a summarized view of the ratings/ actions taken by a CRA, for ease of perusal by the investors in seeing the performance of the CRA, a summary sheet presenting a snapshot of the rating actions (new ratings, upgrades, downgrades, default cases, etc.) shall be uploaded by the CRAs on their website on an annual basis, separately for securities and financial instruments other than securities.

The format of the same is presented at **Annexure A**.

3.11. Rationalization of existing disclosures for CRAs

The disclosure requirements laid down in the Circular CIR/ MIRSD/ CRA/ 6/ 2010 dated May 3, 2010 need to be rationalized by segregating it for securities, and financial instruments other than securities.

Further, CRAs shall also specify the Instrument Type (e.g. NCD, Preference Shares, CP, CD, etc.), Sector of Issuer, Status of listing, trigger of the rating action, date of event/ intimation in cases of default.

Rationale:

The disclosures need to be such that are easily comprehensible to the investors. For ease of understanding by the investors, the current disclosures need to be segregated for ratings of securities and financial instruments other than securities.

The disclosures also need to reflect the promptness of the CRA in taking the rating action. It is, thereby, proposed to include the following additional information in the various disclosures mandated vide Circular dated May 03, 2010.

- Type of Instrument being rated (e.g. NCD/ Preference Shares/ CP/ CD, etc.) being rated and Issue Size
- Sector of the Issuer
- Whether the instrument is listed or not
- Separate tables for upgrades and downgrades in the disclosure pertaining to movement of ratings
- Trigger event that resulted in the rating movement
- Current Outstanding Rating in disclosure of History of Outstanding Ratings
- Date of event/date of intimation triggering change in rating in case of default cases
- Debt-weighted default rates in case of average default rates for last 5 financial years

With respect to disclosure of debt-weighted default rates, it may be noted that CRAs are required to disclose default rates in accordance with Point 2.2.3 of the said Circular, which is *the number of defaults among rated entities in the static pool as a percentage of the total number of entities in the static pool*. It is proposed that in addition to this, CRAs shall also disclose the debt-weighted default rate which shall be defined as *the amount of rated debt that defaulted in the static pool as a percentage of the total amount of rated debt in the static pool*. The averaging for debt-weighted default rate shall be based on *the weighted average method where weights shall be the amount of debt rated in each static period*. This will help reflect the significance of a default from an issuer with high quantum of rated debt on the overall default statistics.

Further, it is proposed to delete Annexure IV of the said Circular as the information in this Annexure has been incorporated in the proposed modified Annexure II.

In accordance with the above suggested modifications, the proposed formats of the modified disclosures, with the added columns highlighted in bold, are presented at **Annexure B**.

4. Public Comments:

Public comments are invited on the proposals contained in the Consultation Paper in the following format:

Name of entity/ person/ intermediary/ organization: _____			
Sr.No.	Pertains to Point No.	Comments/ suggestions	Rationale

Comments/ suggestions may be forwarded by email to cra@sebi.gov.in or may be sent by post to the following address latest by September 29, 2017.

Deputy General Manager

Market Intermediaries Regulation and Supervision Department- 4
 Securities and Exchange Board of India
 SEBI Bhavan, Plot No. C4-A, "G" Block, Bandra Kurla Complex
 Bandra (East), Mumbai - 400 051
 Ph: 022-26449315

Issued on: September 08, 2017

Annexure A: Proposed Format for Annual Rating Summary Sheet, segregated for securities and financial instruments other than securities

S.No.	Parameter	No. of ratings	Amount of debt rated (Rs. millions)
1.	New Ratings		
2.	Upgrades		
a.	Total Upgrades		
b.	Upgrades from Non-Investment to Investment Grade		
3.	Downgrades		
a.	Total Downgrades		
b.	Downgrades from Investment to Non - Investment Grade		
4.	Defaults		
a.	Total Defaults		
b.	Default from Non-Investment Grade		
c.	Default from Investment Grade:		
	AAA		
	AA		
	A		
	BBB		
5.	Rating Distribution for outstanding ratings as on 31st March		
a.	AAA		
b.	AA		
c.	A		
d.	BBB		
e.	BB		
f.	B		
g.	C		
h.	D		

Annexure B: Rationalization of Disclosures of Circular MIRSD/ CRA/ 6/ 2010 dated May 03, 2010, segregated for Securities and Financial Instruments other than Securities

Annexure I - Details of new credit ratings assigned during last six-months

New Ratings assigned between Apr – Sep/ Oct – Mar						
S. No	Name of the Issuer	Sector (Finance & Banking, Textiles, etc.)	Instrument Type (NCD, Preference Shares, CP, CD, etc.)	Issue Size (Rs. millions)	Listing Status (Listed/ Unlisted)	Rating

Annexure II–Movement* of Each Credit Rating

Annexure II A - Upgrades

Rating Upgrades between Apr – Sep/ Oct – Mar									
S. No	Name of the Issuer	Sector (Finance & Banking, Textiles, etc.)	Type of Instrument being rated (NCD/ Preference Shares/ CP/ CD, etc.)	Listing Status (Listed/ Unlisted)	Rating prior to Revision	Rating post Revision	Date of Press Release for Rating Upgrade	Notch Difference	Trigger Event (Quarterly Results, Exchange Disclosures, Annual Surveillance etc.)

Annexure II B – Downgrades

Rating Upgrades between Apr – Sep/ Oct – Mar									
S. No	Name of the Issuer	Sector (Finance & Banking, Textiles, etc.)	Type of Instrument being rated (NCD/ Preference Shares/ CP/ CD, etc.)	Listing Status (Listed / Unlisted)	Rating prior to Revision	Rating post Revision	Date of Press Release for Rating downgrade	Notch Difference	Trigger Event (Quarterly Results, Exchange Disclosures, Annual Surveillance etc.)

**Will cover only rating changes. Reaffirmations shall be excluded*

Annexure III - Movement of each credit rating from investment grade to non-investment grade and vice versa

Rating Movement from Investment Grade and Non-Investment Grade between Apr – Sep/ Oct – Mar						
From Investment Grade to Non-Investment Grade						
S. No	Name of the Issuer	Sector (Finance & Banking, Textiles, etc.)	Type of Instrument being rated (NCD/ Preference Shares/ CP/ CD, etc.)	Listing Status (Listed/ Unlisted)	Rating prior to Revision	Rating post Revision
From Non- Investment Grade to Investment Grade						
S. No	Name of the Issuer	Sector (Finance & Banking, Textiles, etc.)	Type of Instrument being rated (NCD/ Preference Shares/ CP/ CD, etc.)	Listing Status (Listed/ Unlisted)	Rating prior to Revision	Rating post Revision

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Annexure V – History of Credit Rating of all Outstanding Securities

History of Credit Rating of all Outstanding Securities															
S . No	Name of the Issuer	Sector (Finance & Banking, Textiles etc)	Instrument Type (NC D, Preference Shares, CP, CD etc)	Outstanding Issue Size (Rs. millions)	Listing Status (Listed/Unlisted)	Initial Rating	Date of Initial Rating	Rating after 1 st Revision	Date of 1 st Revision	Rating after 2 nd Revision	Date of 2 nd Revision	Rating after 3 rd Revision	Date of 3 rd Revision	Current Outstanding Rating

Annexure VI – List of Defaults Separately for Each Rating Category

Annexure VI A – Long Term Scale

Category-wise List of Defaults in a Financial year – Long Term Scale											
S. No	Name of the Issuer	Sector	Instrument Type	Issue Size (Rs. millions)	Listing Status (Listed/Unlisted)			Rating prior to Default	Trigger Event	Date of trigger of event/ receiving intimation	Date of Default Recognition
Rating prior to default - AAA category											
1											
2											
Rating prior to default - AA category											
1											

[illegible]

Annexure VI B – Short Term Scale

[illegible]

Rating prior to default - A4 category										
1										
2										

Annexure VII – Average Default Rates for the last 5-Financial Year Period

Annexure VII A- STRUCTURED INSTRUMENTS

Rating Category	Weighted by No. of Issuers in Static Pool		Weighted by Amount of Debt in Static Pool	
	1-Year Default Rate	3-Year Cumulative Default Rate	1-Year Default Rate	3-Year Cumulative Default Rate
AAA				
AA				
A				
BBB				
BB				
B				
C				

Annexure VII B- NON - STRUCTURED INSTRUMENTS

Rating Category	Weighted by No. of Issuers in Static Pool		Weighted by Amount of Debt in Static Pool	
	1-Year Default Rate	3-Year Cumulative Default Rate	1-Year Default Rate	3-Year Cumulative Default Rate
AAA				
AA				
A				
BBB				
BB				
B				
C				