Default Recognition Policy

1. Background

Ratings are an opinion on the relative ability and willingness of an issuer to repay debt (including interest and other obligations) in a timely manner.

CARE Ratings South Africa (Pty) Limited (CARE SA) default recognition policy is updated in line with the FSCA guidelines issued from time to time , wherein, in respect of ratings for instruments/bank facilities with a pre-determined repayment schedule, 'one-day-one-rand' delay is considered as default, whereas for facilities with no pre-determined repayment schedule, a 30 day 'grace period' is considered prior to categorising as default. This apart, there are specific guidelines on default recognition in case the rated instrument is rescheduled and 'curing' period post which a rating may be revised upwards from 'Default grade' (CARE (za) D). Changes with respect to these have been carried out in CARE SA's policy on default recognition.

This document explains in detail the definition of default followed by CARE SA, and the criteria for treatment of defaults while assigning initial ratings and reviewing outstanding ratings.

2. Instrument-wise/facility-wise definition of default followed by CRAF SA

Facilities *	Rating Scale	Definition of Default
Fund-based facilities & Facilities with pre-defined repayment schedule #		
Term Loan	Long Term	A delay of 1 day even of 1 ZAR (of principal or interest) from the scheduled repayment date.
Working Capital Term Loan		
Working Capital Demand Loan (WCDL)		
Debentures/Bonds		
Certificate of Deposits (CD)/ Fixed Deposits (FD)	Short Term/ Long term	
Commercial Paper	Short term	
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 (BP/BD/FBP/FBDN)	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.
Bank Guarantee (BG) (Performance/ Financial)	Short Term	Amount remaining unpaid for more than 30 days from invocation of the facility.
Other Scenarios		
When rated instrument is rescheduled:		Non-servicing of the debt (principal or interest or both) as per the existing repayment terms in anticipation of a favourable response from the

		banks of accepting their restructuring application/ proposal shall be considered as a default. Rescheduling of the debt instrument by the lenders prior to the due date of payment will not be treated as default, unless the same is done to avoid default or bankruptcy.
When instrument backed by a guarantee is in default		The recognition of default is generally based on the structured payment mechanism mentioned in the guarantee document. In case the payment mechanism is not adhered to and there is a missed payment, default is recognised on the said facility/ instrument. It has been observed that in case of guarantees given for bank facilities, there is generally no structured payment mechanism. In such cases, notwithstanding whether the guarantee is invoked or otherwise, if there is a missed payment CRSA would recognise default on the said facility/instrument.
Curing Period@		90 Days – for revision from Default to Speculative Grade
		Generally 365 Days for revision from Default to Investment Grade

*For bank loan ratings, default recognition will need to be in line with the SARB guidance
If the sanctioned terms allow grace period for payment after due date, CARE SA considers the due date taking into account the grace period
@ CARE SA may deviate from the stipulated curing period as elaborated in CARE SA's policy on curing period available at www.careedgesouthafrica.com

3. Treatment of default in Initial Ratings

In case of **initial ratings**, a rating of 'CARE (za) D' is assigned in case of ongoing delays in debt repayment of the rated instrument. In case of instances of past delays in repayment of any debt instrument, the following four dimensions of delay are analysed: a) the extent of delay (number of days of delay), b) frequency of delay (number of times the delay occurred in the past one year), c) severity of delay (amount not paid vis-à-vis amount due) and d) status of an ongoing delay (facility in default). A non-default rating would not be assigned if the curing period post an earlier default on any instrument of similar seniority has not lapsed. For subordinate instruments and structured instruments, curing period will apply on instrument level.

Rating Action

- In case of (d) above, a rating of 'CARE (za) D' is assigned if the delay is in respect of the rated instrument.
- In other cases, the rating would take into account the extent, frequency and severity of the delay as also how recent the delay has occurred. A default free track record of 90 days is required to assign ratings in the speculative grade other than CARE (za) BB+ to CARE (za) C- (long term rating) and CARE (za) A4+ or CARE (za) A4 (short term rating)], and generally a default free track record of 365 days is required to assign an investment grade rating. CARE SA may deviate from the stipulated curing period as elaborated in CARE SA's policy on curing period available at www.careedgesouthafrica.com.

4. Treatment of default in review of outstanding ratings

Whenever CARE SA becomes aware of any missed payment on a rated instrument, the rating of that instrument is brought down to 'CARE (za) D'. The rating of all other instruments rated by CARE SA which have the same seniority as the instrument which has defaulted, would move to near default grade as the circumstances which caused a delay in debt servicing on one instrument may also affect the debt servicing of other instruments. However, CARE SA may in certain situations not move the ratings on all other instruments to near-default grade if strong instrument -specific mitigating factors exist to conclude that instances of delinquencies/defaults on other instruments are unlikely to lead to default on the rated instrument. After curing of the delay, the default grade rating can be moved within the sub-investment category based on extent, frequency, severity and the date of occurrence of delay. A default free track record of 90 days is required to move an instrument/facility's rating from CARE (za) D to other ratings in the speculative grade and generally a default free track record of 365 days is required to move an instrument/facility's rating from CARE (za) D to investment grade. CARE SA may deviate from the stipulated curing period as elaborated in CARE SA's policy on curing period available at www.careedgesouthafrica.com.

5. Default on instruments not rated by CARE SA

In case an issuer with an outstanding CARE SA's rating defaults on any instrument (other than the rated one), which has same seniority as the instrument rated by CARE SA, the rating of the instrument rated by CARE SA (which is not in default) will move to near default grade. This is because the factors which caused the delinquency/default on other instruments may also affect debt servicing on the rated instrument. However, CARE SA in certain situations may not move the ratings on all other instruments to CARE (za) D/near default grade, if strong instrument-specific risk mitigating factors exist to conclude/believe that instances of delinquencies/defaults on other instruments are unlikely to lead to default on the rated instrument.

6. Treatment of default in case of hybrid instrument ratings

The terms of the hybrid instruments may allow deferment of principal and / or interest payment in case of invocations of certain pre agreed clauses. Any delay in payment of interest/principal (as the case may be) following the invocation of the lock-in clause, is considered an event of default as per CARE SA's definition of default and as such, these instruments may exhibit a somewhat sharper migration of the rating compared with conventional subordinated debt instruments.

7. Treatment of default in case of technical delay / dispute

CARE SA examines the reasons for default from the rated entity, duly corroborated by the investor / lender. If as per CARE SA's assessment, the delay was not caused by liquidity stress at the issuer level but due to some technical problem, then default is not recognised. However, based on the assessment, severity and frequency of such incidences, the credit rating of the issuer may be reviewed.

- 'Technical problem' referred above is a procedural issue which may result in delay in payment and not a credit issue related to the ability of the entity to meet the debt obligations. Technical problem would typically be with respect to transfer of funds or mechanism of transfer of funds by the issuer/obligor and not related to availability of funds and willingness of the issuer/obligor to meet obligations on time.

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About Us:

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