

Policy on Default Recognition

This note describes ICRA Nepal's policy for default recognition when an entity fails to meet its debt servicing obligations in a timely manner. The note is prepared based on current banking norms and regulatory provisions for recognising default.

ICRA Nepal's Definition of Default

- **Default recognition in case of borrowing programmes through markets (viz. Commercial Papers, Bonds, Debentures etc) that have a pre-defined repayment schedule**
 - » ICRA Nepal defines default as a missed or a delayed payment by an entity in breach of the agreed terms of the borrowing programme. Thus, even a 'single day single rupee' delay—in case of borrowing programmes having a pre-defined repayment schedule—is treated as a default.
- **Default recognition in case of bank facilities**
 - » ICRA Nepal defines default as a missed or a delayed payment by an entity in breach of the agreed terms of the loan facility by more than 30 days. Thus, even a 'single rupee' delay by more than 30 days—in case of bank facilities or borrowing programmes having a pre-defined repayment schedule—is treated as a default.
 - » In the case of bank facilities that do not have any pre-defined repayment schedule (such as cash credit and overdraft facility), ICRA Nepal recognises default only on continuous and sustained overdrafts.

Refer to Annexure-1 for the instrument-wise definition of default followed by ICRA Nepal.

- **Default recognition in case of rescheduling of debt**
 - » The rescheduling of a debt obligation is not treated as a default by ICRA Nepal, provided the debt servicing had been timely before the rescheduling and it was not a case of a distressed exchange¹, or, Rescheduling of the debt instrument allowed by central bank as a policy without additional provisioning and categorization as Non-Performing Assets will not be treated as a default. However, in such cases, the ratings may be suitably revised downwards in case debt rescheduling was intended to provide a relief to the borrower owing to its extant or expected financial stress or if there is a fundamental impairment in the entity's credit quality.
 - » In case an entity delays by more than 30 days on debt servicing before its lenders give consent to the rescheduling, or there is a Net present value (NPV) loss to the lender(s), the delay and/or loss is treated as a default.
- **Default recognition in case of commercial dispute**

ICRA Nepal takes into consideration, on a case-by-case basis, the reasons that led to delays in debt servicing by an entity and its potential implications on the entity's willingness and ability to service its other debt obligations in a timely manner.

¹ A distressed exchange is one whereby the investors or lenders get a diminished value relative to the debt obligation's original promise; and has the effect of allowing the entity to avoid a likely default.

» In case the delay is primarily because of the weak liquidity position of the entity, the delay in debt servicing is treated as a default.

» In case the liquidity position of the rated entity is comfortable such that it was in a position to service all its debt obligations in a timely manner and the delay in debt servicing is on a specific instrument² on account of a bona-fide commercial dispute, as assessed by ICRA Nepal, the delay is not treated as a default. However, if such delay in debt servicing may impact the financial risk profile of the entity because of reasons such as invocation of certain covenants, the entity's rating may be suitably revised downwards.

Impact of Default on Credit Ratings

Upon a default, ICRA Nepal downgrades the ratings for all the rated instruments to [ICRANP]LD or [ICRANP]D, regardless of the magnitude of the default.

However, if strong reasons exist for differentiating among the rating of the debt instrument that is in default and that of the other debt instruments that aren't, the reasons and protective factors for such instruments (that are not in default), as assessed by ICRA Nepal, would have a critical bearing on the rating of the other debt instruments. In such cases, the rating of the other instruments may not be revised to [ICRANP]LD or [ICRANP]D, but suitably reviewed. The above described rating action could be taken in the following cases, among others:

» The other debt instruments on which there is no default are senior to the debt in default and the default probability of the senior debt is distinctly lower than that of the debt in default

» The cash flows meant for servicing the other debt instruments (that are not in default) are ring fenced and no cross-default clauses apply

Annexure-1:

Facilities	Definition of Default
Fund-based facilities	
Term Loan	A delay of 30+ days even of 1 rupee (of principal or interest) from the scheduled payment date
Working Capital Term Loan	
Working Capital Demand Loan (WCDL)	
Hire Purchase, Home Loan and all other schedule loan	
Certificates of Deposit (CD)/ Fixed Deposits (FD)	A delay of 1 day even of 1 rupee (of principal or interest) from the scheduled payment date
Commercial Paper	A delay of 1 day even of 1 rupee (of principal or interest) from the scheduled payment date
Debentures/Bonds	A delay of 1 day even of 1 rupee (of principal or interest) from the scheduled payment date
Packing Credit (pre-shipment credit)	Overdue or unpaid for more than 30 days
Buyer's Credit	Continuously overdrawn for more than 30 days
Bill Purchase/Bill discounting/Foreign bill discounting /Negotiation (BP/BD/FBP/FBDN)	Overdue or unpaid for more than 30 days
Cash Credit	Continuously overdrawn for more than 30 days

² The rating of the instrument on which default has occurred is put on watch to inform the lenders/ investors that ICRA Nepal has taken cognizance of the default and the reason for taking no rating action is, as per ICRA Nepal's assessment, a bona-fide commercial dispute. The rating watch is removed upon resolution of the dispute.

Overdraft	Continuously overdrawn for more than 30 days
Non-fund based facilities	
Letter of Credit (LC)	Overdue for more than 30 days from the day of devolvement
Bank Guarantee (BG) (Performance/ Financial)	Amount remaining unpaid for 30 days from invocation of the facility
Other scenarios	
When the rated instrument is rescheduled	<p>Non-servicing of the debt (principal as well as interest) as per the existing repayment terms in anticipation of a favourable response from the banks of accepting the restructuring application/ proposal is considered as a default</p> <p>Rescheduling of the debt instrument by the lenders prior to the due date of payment will not be treated as a default, unless the same is done to avoid default or bankruptcy</p> <p>OR</p> <p>Rescheduling of the debt instrument allowed by central bank as a policy without additional provisioning and categorization as Non-Performing Assets will not be treated as a default.</p>
Curing Period	90 days for movement of rating from the default category to the Non-Investment Grade and generally# 365 days for movement of rating from the default category to the Investment Grade

#ICRA Nepal may make exceptions to the above in cases where the fundamental credit profile of the defaulting entity undergoes a significant change, while being within the curing period window. Such change may be by virtue of change in ownership, access to some form of explicit support from a strong third-party or any other such event that has a strong positive influence on the entity's credit quality.

DEFINED TERMS:

Credit Rating

A Credit Rating is an opinion on the relative credit risk of the issuer/ borrower/ instrument / borrowing limit expressed in the form of standard symbols or in any other standardised manner, assigned by ICRA Nepal and used by the issuer of instrument/ debt obligation, to comply with the requirements specified under regulations.

Rated Entity (ies)

A Rated Entity means any entity rated by ICRA Nepal or any entity that issues instrument/ raises debt obligations rated by ICRA Nepal or any entity that is seeking a Credit Rating from ICRA Nepal.



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