



Infomerics
Credit Rating Nepal Ltd

Default Recognition Policy

A. Background

This document describes Infomerics Nepal's policy on default recognition when an entity fails to meet its debt servicing obligations in a timely manner. This document outlines Infomerics Nepal's default recognition principles for ratings assigned to all financial instruments, long-term and short-term debt, bank loan ratings, fixed deposits, structured finance instruments, and corporate credit ratings. The policy draws from the various directions and guidelines from the Securities and Exchange Board of Nepal (SEBON) and Nepal Rastra Bank (NRB) on this subject.

Infomerics Nepal considers the first instance of a missed payment as an 'event of default' for **market instruments** with pre-defined repayments such as Debentures, Bonds, Commercial Paper etc. Default is recognised irrespective of the magnitude and period of delay and can be summarized as not meeting the 'one-day-one-rupee' condition.

Default is recognized on **bank facilities** with pre-defined repayments if the payment is missed or delayed by an entity in breach of the agreed terms of the loan facility by more than 30 days while on working capital bank loan facilities without a pre-defined repayment schedule, such as Overdraft, default is recognized if the facility remains continuously overdrawn for more than 30 days. A similar default definition of 30 days of the facilities being overdue is considered for other working capital facilities such as Packing Credit and Letter of Credit. Instrument-wise definition of default is provided in the table below. Upon recognition of a default, as determined by Infomerics Nepal policy, the outstanding ratings will be downgraded to 'IRN D'.



Instrument/facility wise Default Recognition & Post-Default Curing Period

Facilities/Debt Instruments	Rating Scale	Definition of Default
Fund-based facilities & Facilities with pre-defined repayment schedule		
Term Loan	Long Term	A delay of over 30 days even of 1 rupee (of principal or interest) from the scheduled repayment date.
Working Capital Term Loan		
Working Capital Demand Loan (WCDL)		
Debentures/Bonds	Long Term	A delay of over 1 day even of 1 rupee (of principal or interest) from the scheduled repayment date.
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 from 30 days from invocation of the facility
Curing Period		90 Days for Default to Speculative Grade and 365 days for Default to Investment Grade.

Treatment of default in Initial Ratings

In case of initial ratings, a rating of 'IRN D' is assigned in case of ongoing delays in debt repayment of the rated instrument. In case of past delays in repayment on any debt instrument, four dimensions are analysed i.e.



Infomerics

Credit Rating Nepal Ltd

- i) the extent (number of days of delay)
- ii) frequency (number of times the delay occurred in the past one year)
- iii) severity (amount not paid with regards to the amount due) and
- iv) status of an on-going 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. The rating so assigned would depend on the possibility of recurrence of the events which led to the default, as per the assessment of the Rating Committee. For subordinate instrument and structured instruments, curing period will apply on instrument level.

Rating Action

In case of (iv) above, a rating of "IRN D" is assigned if the delay is in respect of the rated instrument.

In other cases, the rating would take into account i) to iii) above and assessment of recurrence of default in the near future. To assign a rating in the speculative grade other than 'IRN D' a default free track record of 90 days is required. Likewise, a default free track record of 365 days is required to assign an investment grade rating.

Default recognition in case of rescheduling of debt

Re-schedulement of debt is generally perceived as a step taken by the issuer and investors to escape the label of default. However, considering the current scenario of stress on account of pandemic, Infomerics would take cognizance of the factors that necessitated the obligor to reschedule its debt and the circumstances that led the investor to provide its consent.



Infomerics

Credit Rating Nepal Ltd

Further Infomerics will not treat the rescheduling of a debt obligation as default, provided the debt servicing had been timely before the rescheduling and it was not a case of distress. In addition, rescheduling of the debt instrument will not be treated as default if allowed by central bank as a policy without provisioning and categorisation as a Non- Performing Asset. However, in cases where the rescheduling was intentional 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 then ratings may be suitably revised downwards.

In case an entity delays 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 lenders, the delay and/or loss is treated as a default.

Default recognition for commercial dispute

On a case-by-case basis, Infomerics Nepal examines 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.

In instances where the delay is primarily because of the weak liquidity position of the entity, the delay is treated as a default.

However, if 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 instrument on account of a bona-fide commercial dispute, as assessed by Infomerics Nepal, the delay is not treated as a default. Furthermore, if such delay in debt servicing may impact the financial risk profile of the entity, then the entity's rating may be suitably revised downwards.



Infomerics

Credit Rating Nepal Ltd

Default on instruments not rated by Infomerics Nepal

In case an issuer with outstanding Infomerics Nepal rated instruments default on external debt/loan facilities rated by other CRA's, it is quite likely that the outstanding Infomerics Nepal Rating will be moved to near default grade, because the factors that caused the default on other instruments may also affect debt servicing on the rated instrument. The severity of the rating action would be based on Infomerics Nepal's assessment of the information received regarding reasons of default and the credit quality of the issuer.

However, in presence of strong instrument specific risk mitigating factors that concludes that instances of default on other instruments are unlikely to cause default on the rated instrument, then the rating of other instruments may not be revised to 'IRN 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.
- The other debt instruments on which there is no default are supported by a third-party explicit support such as a corporate guarantee.

Default recognition in case of hybrid instrument ratings

Infomerics Nepal rates hybrid instruments on the same scale as conventional debt instruments. Therefore, any delay in payment on the instrument, the rating on the hybrid instrument will be downgraded to 'IRN D', even though it may be permitted as per the terms of the instrument.

Dealing with technical delays



Infomerics

Credit Rating Nepal Ltd

Infomerics Nepal examines the reasons for default from the rated entity, duly corroborated by the investors/lender. If Infomerics Nepal is able to establish that the delay is solely because of technical reasons, beyond the control of that entity, and that such an occurrence is not a reflection of the lack of ability or willingness of the entity to pay its debt obligation, then such occurrence is not treated as default. Additionally, Infomerics Nepal would ascertain if the delay is expected to be rectified in few business days and whether the issuer has taken corrective measures to avoid such instances in future.

Disclaimer:

Ratings assigned by Infomerics Nepal are an opinion on the credit risk of the issue / issuer and not a recommendation to buy, hold or sell securities. Infomerics Nepal reserves the right to change, suspend or withdraw the credit ratings at any point in time. Ratings assigned by Infomerics Nepal are opinions on financial statements based on information provided by the management and information obtained from sources believed by it to be accurate and reliable. The credit quality ratings are not recommendations to sanction, renew, disburse or recall the concerned bank facilities or to buy, sell or hold any security. We, however, do not guarantee the accuracy, adequacy or completeness of any information, which we accepted and presumed to be free from misstatement, whether due to error or fraud. We are not responsible for any errors or omissions or for the results obtained from the use of such information. Most entities whose bank facilities/instruments are rated by us have paid a credit rating fee, based on the amount and type of bank facilities/instruments. In case of partnership/proprietary concerns/Association of Persons (AOPs), the rating assigned by Infomerics Nepal is based on the capital deployed by the partners/proprietor/ AOPs and the financial strength of the firm at present. The rating may undergo change in case of withdrawal of capital or the unsecured loans brought in by the partners/proprietor/ AOPs in addition to the financial performance and other relevant factors.