BEFORE THE ADJUDICATING OFFICER

SECURITIES AND EXCHANGE BOARD OF INDIA

(ADJUDICATION ORDER NO: Order/GR/KG /2020-21/8312)

UNDER SECTION 15 - I OF THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 READ WITH RULE 5 OF THE SECURITIES AND EXCHANGE BOARD OF INDIA (PROCEDURE FOR HOLDING INQUIRY AND IMPOSING PENALTIES) RULES, 1995.

In respect of:

CARE Ratings Limited (CIN: L67190MH1993PLC071691)

In the matter of credit rating of NCDs of Reliance Communication Limited

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BACKGROUND:

1. CARE Ratings Limited is a Mumbai based company that commenced operations in 1993. It has been registered as a Credit Rating Agency (hereinafter referred to as "**CRA**") with the Securities and Exchange Board of India (hereinafter referred to as "**SEBI**") since 1999. CRL Ratings Limited (hereinafter referred to as "**CRL/ Noticee**"), vide Press Releases dated May 30, 2017, downgraded the ratings assigned to the Non-Convertible Debenture (hereinafter referred to as "**NCD**s") issued by Reliance Communication Limited (hereinafter referred to as "**RCL/RCom**") to Default (D). CRL, in the aforesaid Press Release, has mentioned that:

"The revision in the ratings assigned to the bank facilities, NCD issue and short term debt issue of Reliance Communications Limited (RCOM) takes into account delays in the servicing of its debt

obligations as a result of significant stress on its cash flows and high levels of debt repayments. The company has delayed the interest as well as principal repayments due on its Non-Convertible debentures. The NCD installment of Rs.375 crore due on 7th February 2017 was paid on 10th April 2017 by the company."

2. It is observed that CRL has been rating 1 NCD issue of RCL, details whereof is stated herein below:

   Rs. 2000 Crore NCDs (Coupon: 11.25%, Tenure: 7 years; Maturity: February 2019). As on the date of initiation of the present adjudication proceedings, NCDs having a value of Rs. 750 Crores was being rated of. Life Insurance Corporation of India (LIC) was the sole investor in this NCD.

   The chronology of ratings assigned to the said NCDs by CRL is as under:

S. No.	**Date of Press Release**	**Rating Action**	**Factors leading to the Review**
1	Feb 09, 2016	Reaffirmed at A-	
2	Sep 29, 2016	Placed on Credit Watch	Announcement of R-Com Aircel Merger and possible sale of Tower Business

3	May 22, 2017	Downgraded to BB from A- (2 notches); Continues on Credit Watch with Developing Implications	Continuing stress in telecom sector due to continuation of Jio's discounted offers
4	May 30, 2017	Downgraded to D from BB (6 notches)	Announcement of Q4 results of RCL, stating delay in interest/ principal payments on NCDS

3. RCL had defaulted on the repayment of the principal amount of Rs. 375 Crore and interest of Rs. 9.7 Crore due on February 7, 2017 and March 7, 2017. Delayed payment on the same was made on April 10, 2017.

4. In view of the above, the SEBI had sought comments from CRL on the aforesaid rating action, along with the relevant documents pertaining to the rating of various instruments of RCL such as Press Releases (PRs), Rating Committee Notes (RCNs), correspondences with RCL and its bankers/ auditors etc. during the last 12 months.

5. CRL has submitted replies to the queries of the Division vide email dated June 7, 2017 and letters dated June 12 and 20, 2017. The response of CRL is summarized herein below:

    a. CRL had discussed the deterioration in the financials of RCL in Q3 internally as well as with RCL and was monitoring the credit worthiness of RCL on a regular basis. The free package offered by Reliance Jio had dented the profitability of all players in the telecom industry for the quarter ended December 31, 2016, which was expected to improve after Reliance Jio's free offer expired. Moreover, the money expected from tower assets sale to Brookfield was expected to maintain the credit profile of Reliance Communications stable. In order to gauge the timing of the asset sale proceeds as well as assess any structural shift in telecom industry credit, it was deemed appropriate to wait for one more quarter before taking any action.

b. The discussions which took place in Quarterly Reviews were not formally recorded. However, the Quarterly Review Sheet was provided, wherein it was mentioned that RCL had confirmed verbally that there were no delays for the quarter ended Dec 31, 2016.

c. RCL during its interaction with CRL had confirmed that they were regular in making payments for all their debt liabilities and were managing their liquidity adequately. Further, there was no mention of default even in the Debenture Trustee Reports for February, March and April 2017. In view of the foregoing, CRL had relied on sources of information which were deemed to be reliable.

d. The international rating scale followed by the international rating agencies and the domestic rating scale followed by domestic rating agencies such as CRL are different and cannot be compared.

e. The rating downgrade by one notch within the rating band by another rating agency was noted and discussed internally. Downgrade by other CRAs could not be a cause for downgrade by CRL because each CRA has its own opinion.

f. Vide email dated January 12, 2017, No Default Statement (hereinafter referred to as "**NDS**") for quarter ended Dec 31, 2017 was sought from RCL. The communication between CRL and RCL was going on during the period and emails exchanged between them (from April 2017 onwards) were provided to SEBI.

6. Subsequent to an analysis of the responses of CRL, it was *prima facie* observed that CRL had committed certain violations, details of which are presented below:

Failure to monitor the ratings and factors affecting the creditworthiness of the Issuer in a timely manner, resulting in significant delay in conducting the rating process and downgrading the rating, as the CRA failed to:

i. Present to its Rating committee in a timely manner, an analysis of the significant deterioration in Q3 financials of the Issuer (disseminated on Stock Exchange website on February 11, 2017) which warranted a review. An analysis of the results was finally presented to its Rating Committee on May 18, 2017, wherein, inter – alia, the following was presented:

Further, given the already high debt levels of RCL which coupled with lower cash accruals increased the stress on the financial risk profile and importantly the liquidity situation of the company.

Quarterly Performance (` crores):

Particulars	***Q1FY17***	***Q2FY17***	***Q3 FY17***
Working Results			
Income from Continuing Operations	*5259*	*5100*	*4822*
PBILDT	*1458*	*1500*	*1106*
Interest	*795*	*825*	*958*
Depreciation	*830*	*833*	*1165*
PBT	*-65*	*-116*	***-917***

PAT (After Tax Dedc)	*89*	*61*	***-489***
Gross Cash Accruals	*765*	*717*	*248*
Key Ratios			
PBILDT/ Total OI	*27.72%*	*29.41%*	*22.94%*
APAT/ Total OI	*1.69%*	*1.2%*	***-10.14%***
PBILDT Interest Coverage	*1.83*	*1.82*	*1.15*
PBIT Interest Coverage	*0.79*	*0.81*	***-0.06***

RCL has witnessed a significant impact on its cash accruals in the Q3FY17 and the same is expected in Q4FY17 as well. The cash accruals of the company dipped from Rs. 765 crore and Rs. 717 crore in Q1 and Q2 respectively to ` 248 crore in Q3 FY17

ii. Take into consideration downgrade of ratings assigned to Issuer/ instrument of the issuer by international CRAs Moody's (Nov 30, 2016 and Jan 26, 2017) and Fitch Ratings (Dec 20, 2016) while monitoring the ratings.

iii. Proactively interact with the Issuer in seeking information regarding financial/ operational performance and timely servicing of debt obligations/ No Default Statement (NDS) even after the significant deterioration in the Issuer' s Q3 results.

7. In view of the above, CRL was *prima facie* found to be in violation of Regulation 15(1) and Clauses 3 and 8 of Code of Conduct for CRAs read with Regulation 13 of the Securities and Exchange Board of India (Credit Rating Agencies) Regulations, 1999.

APPOINTMENT OF THE ADJUDICATING OFFICER

8. Initially, Shri Sahil Malik, Deputy General Manager (as he then was), was appointed as the Adjudicating Officer (hereinafter referred to as the "**AO**") vide order dated June 27, 2018 (conveyed by communiqué dated August 14, 2018) under Rule 3 of the SEBI (Procedure for Holding Inquiry and Imposing Penalties) Rules, 1995 (hereinafter referred to as the "**Adjudication Rules**") read with section 15I of the SEBI Act, 1992 to enquire into and adjudge under section 15HB of the SEBI Act read with Rule 4 of the Adjudication Rules. Subsequent to his transfer, Shri V.S. Sundaresan, Chief General Manager (as he then was), was appointed as the AO in the present case. Thereafter, the undersigned was appointed as the AO vide order of the competent authority dated December 24, 2019 (conveyed vide communiqué dated December 26, 2019).

SHOW CAUSE NOTICE, RESPONSE AND PERSONAL HEARING

9. A Show Cause Notice dated September 7, 2018 (hereinafter referred to as the "**SCN**") was issued by the erstwhile AO, Shri Sahil Malik to CRL. The SCN had *inter alia* alleged what has already been stated at paragraph no. 6 above. CRL was called upon to show cause as to why an inquiry should not be held against it in terms of Rule 4 of Adjudication Rules and penalty be not imposed under section 15HB of the SEBI Act for the alleged violation of Regulation 15(1) and Clauses 3 and 8 of Code of Conduct for CRAs read with Regulation 13 of the Securities and Exchange Board of India (Credit Rating Agencies) Regulations, 1999. In response thereto, CRL, vide its reply dated September 21, 2018, stated the following:

   a. While the profitability of Q3 was affected, on a year- to- date basis, the PBILDT margins were healthy and interest cover was above unity. Though the company had reported net losses (*inter alia* due to higher depreciation), it had reported positive gross cash accruals for the quarter. Typically, one quarter performance would not warrant a revision in the rating, especially when it was completely due to external risks emanating from market penetrative pricing by a new entrant.

   b. Moreover, with funds expected from tower assets being sold to Brookfield, the proceeds of which were stated to be used for debt reduction, the credit profile of RCOM was expected to be stable. In order to gauge the timing of the asset sale proceeds as well as assess any structural shift in telecom industry credit, it was deemed appropriate to wait for one more quarter before taking any action. Also, the fact that the company belonged to an established promoter group was factored in the ratings. Therefore, the quarterly performance was discussed by the rating team with the concerned rating head (Chief General Manager) as well as the company and no further action was necessary.

c. The rating was subsequently downgraded from CARE BB to CARE D once CRL became aware of the defaults.

d. Indian CRAs like CARE Ratings assign credit ratings on a National (also known as 'domestic') Rating Scale [Long Term scale: 'CARE AAA' to 'CARE D' and short term scale: 'CARE A1+' to 'CARE D']. These ratings offer a relative ranking of credit worthiness of entities within the country. In this scale, the sovereign i.e, the Indian Government, enjoys the highest rating. However, global rating agencies like S&P, Moody's & Fitch assign ratings on a global rating scale, wherein each entity's creditworthiness is assessed vis-à-vis all entities across all geographies. Thus, the domestic and international scales are different and cannot be compared directly. (Several examples have been cited by the Noticee in this regard).

e. While on this, SEBI had come out with a circular in June 2017 wherein all CRAs were required to conduct review of the ratings in the event of significant events including revision in rating by an international CRA. Pursuant to this, CRL has put in place a comprehensive mechanism for review.

f. RCOM during its interaction with CRL post Q3 results had confirmed that they were regular in making payments for all their debt liabilities and were managing their liquidity adequately. Further, there was no mention of default even in the Axis Debenture Trustee Reports for February, March and April 2017. Only the report dated May 31, 2017 of the Debenture Trustee reported delays in making payments. CRL became aware on May 27, 2017 through the corporate announcement made by RCOM (while disclosing Q4 results), that NCD instalment due on Feb 7, 2017 which was paid on 10th April 2017 and interest due in March 2017 was paid only on 10th April 2017. The ratings were promptly reviewed on May 30, 2017 and were downgraded from CARE BB/ CARE A4 to CARE D.

10. Subsequent to the appointment of the undersigned as the AO, a hearing notice dated June 8, 2020, CRL was provided an opportunity of personal hearing on June 22, 2020. The said hearing was attended by the Authorized Representatives **("AR"s**) of CRL through web based video conference on the said date and reiterated the submissions already made vide the reply dated September 21, 2018. The ARs further undertook to file additional submissions with supporting documents within 10 days from the date of the hearing. Thereafter, vide email dated July 3, 2020, the additional submissions were filed on behalf of the Noticee, the contents whereof is summarized herein below:

a. As per the SEBI (Credit Rating Agencies) Regulations, 1999, ratings of companies are to be reviewed on a continuous basisand any significant development would trigger a review, i.e. which have been defined by SEBI Circular dated June 30, 2017. The Noticee indeed reviewed the issuer in question on a continuous basis. A decision not to convene the

Rating Committee for a presentation was a conscious bona fide decision but it would not mean that the rating was not monitored.

b. From the seven-step process in the Operations Manual of CRL Ratings, the following are evident: -

   i. The Noticee indeed conducts an internal review of the quarterly results of clients;

   ii. Such quarterly review of the rating/ grading is undertaken within 90 days from the end of each quarter;

   iii. Analyst/ GH coordinate with the client for the information required. (Information from client includes but is not limited to a NDS for the preceding quarter and brief financial results for the quarter, if available);

   iv. If such results are not available analysts undertake performance review through dialogue with CFO or any other authorized person of the company;

   v. If required, Analyst and GH seek clarifications from the management of the concerned company;

   vi. Quarterly Review Sheet is updated in Ci3(the proprietary software of the Noticee)] by the Analyst/GH, which is then reviewed by the RH;

vii. If after all of the above a detailed review is required, such a review is undertaken by the rating team.

c. As mandated by Regulation 24, the CRL's Rating Operations Manual, January 2017, which sets out, inter alia, the 7 steps process, was specified and filed with SEBI as required under the regulations.

d. The Q3 results of the Company came out on February 11, 2017 and Q4 results of the Company came out on May 27, 2017.Within 90 days of the end of Q3 and Q4, the Noticee undertook review of the rating/grading. After Q3, vide email of January 17, 2017, the Noticee sought an NDS and a break-up of the outstanding debt from the Company; However, since the Company failed to reply, the Noticee's representatives called up the representatives of the Company on telephone who confirmed that debt payments were being made on time. <u>This was the practice prevalent at that time</u>. Copies of the email of January 17, 2017 and the relevant extracts from the QRN are annexed hereto and marked as Annexure B. Besides interaction with the Company and its officials, the Noticee also relied on reports by the Debenture Trustee, Axis Trustee Services Limited in respect of the Debentures issued by the Company. Which of course showed no irregularity. Therefore, at the end of the review of Q3, the analyst/GH/RH did not form an opinion that the same needed to be circulated to the Rating Committee and therefore after updating the QRN the same was closed.The above review of Q4 was also duly updated in the Quarterly Review Sheet in Ci3, the proprietary software of the Noticee);It was deemed fit to place the review before the Rating Committee so internal notes were placed before them on May 18, 2017.

e. From all of the above facts, it is evident that the Noticee has continuously monitored and reviewed information that became available to it including the Q3 results. The Noticee's rating process as required by the CRA Regulations and which had been duly filed with SEBI was diligently followed by the Noticee. As such, no violation of the rating process can be alleged.

f. As for the view of the Noticee, "rating" is defined in the Regulation 2(1)(q) of the CRA Regulations as an "expression" of an "opinion" in a "standardised form". Thus, it is not a statement of fact, which can be objectively challenged. Expression of such opinion i.e. rating, is part and parcel of the freedom of speech and expression subject to reasonable restriction as envisaged under Article 19(1)(a) of the Constitution of India. Therefore, a rating agency has freedom of expression subject to the law laid down under Regulations framed under the SEBI Act. The Indian regulations are subject to 'reasonable restrictions'. That is, expression of an opinion must be reasonable and logical. Therefore, the opinion of the Noticee cannot be put to test by SEBI if the process set out by the legislature and accepted by SEBI is followed diligently by the Noticee.

g. It is also pertinent to note that neither the issuer nor any of the market intermediaries involved alerted about any default or delayed compliance in payment obligations. In this regard, it is pertinent to note that SEBI initiated proceedings against the Company for not co-operating with Credit Rating Agencies and Debenture Trustees, inter alia, by not disclosing the default in repayment of Principal and interest and thereby violating the provisions of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015. The Company settled the said proceedings with SEBI. However, it is apparent from the same that the Company has admitted to not disclosing the defaults to the Noticee and ICRA as well as to the Debenture Trustee. A copy of the Settlement Order passed by SEBI is annexed hereto and marked as Annexure E.

h. SEBI's circular dated June 2017 (i.e. after the downgrade of RCL's said NCDs and therefore, after the relevant period), requires Indian CRAs to review ratings in case of a revision by an International CRA. Evidently, at the relevant time, there was no requirement for Indian CRAs to follow the downgrade by International CRAs.

i. The Show Cause Notice does not set out the basis on which it is alleged that there was no proactive interaction by the Noticee with the Company in respect of financial operational performance and timely servicing of debt obligations. The email dated January 17, 2017 (Annexure B) clearly shows otherwise. As stated hereinabove, admittedly, the Company has failed to co-operate with CRAs and Debenture Trustees and failed to disclose that they defaulted in repayment of Principal and Interest on the NCDs. Thus, the Noticee is in fact a victim of the wrongful actions of the Company and did not fail to fulfill its obligations as a CRA or to keep track of important changes relating to RCL or to monitor relevant factors that might affect its credit worthiness. Details of the manner in which the

Noticee has complied with the requirements of Regulation 15 (1) of the CRA Regulations and the Code of Conduct are more fully set out at page 8 of the Noticee's reply dated September 21, 2019.

ISSUES FOR CONSIDERATION

11. I have perused the SCN, the submissions of CRL during the hearing held on June 22, 2020, the written submissions dated September 21, 2018 and July 3, 2020. I note that the following issues arise for consideration in the present case:

    a. What is the exact nature of responsibility of a CRA towards the public? In this context, what is the level of due diligence expected from a CRA?

    b. Whether in the present case, CRL has exercised due diligence and followed all extant rules in its decision of not to place the Q3 results of RCL along with non-submission of NDS by RCL and the downgrading of the ratings of the NCDs of RCL by Fitch and Moody's, before its Rating Committee, for a review of the ratings assigned to it?

    c. If the answer to the question immediately above is in the affirmative, then does the aforesaid act constitute contravention of Regulation 15(1) and Clauses 3 and 8 of Code of Conduct for CRAs read with Regulation 13 of the Securities and Exchange Board of India (Credit Rating Agencies) Regulations, 1999? If the answer to this question is in affirmative, then does that qualify for penalty under section 15HB of the SEBI Act?

d. What should be the quantum of penalty, if any, under section 15HB read with section 15J of the SEBI Act, 1992?

FINDINGS

12. In order to deal with the argument of the Noticee with regard to overview of the regulatory architecture for '*Credit Rating Agencies*', it is relevant to deal with the whole scheme of the SEBI Act and the measures taken by SEBI with regard to the role of the '*Credit Rating Agencies'* in pursuit of objectives enshrined in the SEBI Act. The SEBI Act, being a social welfare legislation to ensure an orderly growth of securities market and to protect the interest of the investors, has to be interpreted for furtherance of its purpose and not to frustrate it. Hon'ble Supreme Court in *SEBI Vs Ajay Agarwal* vide its judgment and order dated February 25, 2010 held as under: -

"39. If we look at the legislative intent for enacting the said Act, it transpires that the same was enacted to achieve the twin purposes of promoting orderly and healthy growth of securities market and for protecting the interest of the investors. The requirement of such an enactment was felt in view of substantial growth in the capital market by increasing participation of the investors. In fact such enactment was necessary in order to ensure the confidence of the investors in the capital market by giving them some protection.

40. <u>The said Act is pre-eminently a social welfare legislation seeking to protect the interests of common men who are small investors.</u>

41. <u>It is a well -known canon of construction that when Court is called upon to interpret provisions of a social welfare legislation the paramount duty of the Court is to adopt such an interpretation as to further the purposes of law and if possible eschew the one which frustrates it.</u>" [emphasis supplied]

13. I note that it is an established principle of jurisprudence that a socially beneficial legislation needs to be interpreted in a manner such that the purpose behind such legislation is served and the provisions of such statute needs to be provided a liberal interpretation so as to enlarge the scope of the benefits/ protection being provided under such beneficial legislation. (This line of jurisprudence may be found in - *Bajaj Tempo Ltd.* v. *CIT AIR 1992 SC 1622)*. Therefore, the interpretation of socio-economic legislation such as the SEBI Act and CRA Regulations, which are also aimed at social or economic development apart for investor protection, should not be narrow but should be provided a purposive and liberal interpretation so that it favors the securities market and investors.

14. Keeping the above in mind, in order to give purposeful meaning to the terms used in CRA Regulations, the scheme of the SEBI Act and '*measures*' taken there under need to be seen as a whole and not in fragmented manner. It is also deemed necessary to look into the background of '*credit rating*' requirements so as to understand the scope of responsibilities and accountability of '*Credit Rating Agencies*'. In this connection both the preamble of the SEBI Act and Section 11(1) describes the object i.e. to protect the interests of investors and to promote the development of and to regulate the securities market and for matters connected therewith or incidental thereto and empowers the Board to take such '*measures*' as it thinks fit for carrying out those objectives and duties. In this regard SEBI had issued various guidelines such as "*Guideline*

for Disclosures and Investor Protection" and "*Guideline for Developmental Financial Institution for Disclosures and Investor Protection*" emphasizing the mandated compulsory 'credit rating' of debentures and bonds issued by the company/corporation/institutions. Subsequently it was consolidated as SEBI (Disclosures and Investor Protection) Guidelines, 2000 and under Chapter X of the same, the '*credit rating'* of debt securities by a '*credit rating agencies*' continued as a cornerstone for investor protection and for orderly development of the bond market.

15. The investors in the securities markets deal on the basis of information provided by the company, the stock exchanges and other intermediaries. It has been considered essential by SEBI that for any debt instrument, the investors would need the crucial information of the credit rating assigned by CRAs to the debt instrument. This has been the "*raison d'être*" of the existence of the CRAs in the first place. For this purpose, it is vital for the CRAs to conduct their business in the earnest that it is warranted. This casts a steep duty to act diligently on the CRAs.

16. With respect to the argument regarding the definition of 'rating', it is pertinent to say that this word has to be understood in the context of a 'credit rating agency'. The term 'rating' cannot be construed in isolation so as to limit it as *any* 'opinion' regarding securities expressed in the form of 'standard symbols'. When seen along with the real intent behind CRA Regulations or the role of a 'credit rating agency' as already detailed in the preceding paragraphs, the term 'rating' as defined in Regulation 2(1)(q) must be construed to apply for 'credit rating'. The term 'credit rating' has not been defined in the CRA Regulations but the word 'rating' is defined in regulation 2(1)(q) of the CRA Regulations as *"…. an opinion regarding securities, expressed in the form of standard*

symbols or in any other standardised manner, assigned by a credit rating agency and used by the issuer of such securities, to comply with a requirement specified by these regulations;". Further, considering the contemporary role and responsibilities of 'credit rating agencies' in financial markets and the legitimate expectation towards creditworthiness of borrowers in a dynamic and constantly growing bond market, the content of the CRA Regulations must not be subjected to a narrow/ grammatical approach. Any attempt to truncate the scope of 'credit rating', would be to violate its widest possible amplitude as enshrined in the SEBI Act and the '*measures*' taken by SEBI for development of corporate debt market and investors protection.

17. It is a settled position that while interpreting social –economic welfare legislations, there should be more concern with the context and the content of the statute rather than its literal meaning. In this connection, I would like to make reference to the Judgment of the Hon'ble Supreme Court in *Reserve Bank of India vs. Peerless General Finance And Investment Co. Ltd. & Ors*. [(1987) 1 SCC 424] wherein the Hon'ble Supreme Court has stated as reproduced herein below:

> *"33. Interpretation must depend on the text and the context. They are the bases of interpretation. One may well say if the text is the texture, context is what gives the colour. Neither can be ignored. Both are important. That interpretation is best which makes the textual interpretation match the contextual. A statute is best interpreted when we know why it was enacted. With this knowledge, the statute must be read, first as a whole and then section by section, clause by clause, phrase by phrase and word by word. If a statute is looked at, in the context of its enactment, with the glasses of the statute-maker, provided by such context, its scheme, the sections, clauses, phrases and words may take colour and appear different than when the statute is looked at without the glasses provided by the context. With these glasses we must look at the Act as a whole and*

discover what each section, each clause, each phrase and each word is meant and designed to say as to fit into the scheme of the entire Act. No part of a statute and no word of a statute can be construed in isolation. Statutes have to be construed so that every word has a place and everything is in its place. It is by looking at the definition as a whole in the setting of the entire Act and by reference to what preceded the enactment and the reasons for it that the court construed the expression 'Prize Chit' in Srinivasa and we find no reason to depart from the court's construction."

18. It is, thus, clear that the provisions of the CRA Regulations need to be looked at as a whole in setting of the entire SEBI Act and by reference to what preceded the enactment and the reasons for it and roles and responsibilities assumed by 'credit rating agencies' in several measures taken by SEBI and other regulators. Therefore, the definition of 'credit rating agency' and 'rating' should be interpreted with reference to the contemporary roles and responsibilities of the 'credit rating agencies' so as to apply the CRA Regulations of 1999 in response to the changing needs and conditions of the securities market.

19. As accepted in common parlance a 'credit rating' is an opinion of a 'credit rating agency' as to the borrower's/ issuer's capacity to meet its financial obligations to the lender / investor on a particular issue or type of instrument in a timely manner. The 'credit rating' measures the relative risk of the borrowers' / issuers' ability and willingness to repay both interest and principal over the period of the rated instrument. Thus, the 'credit rating' signifies the creditworthiness of instruments and the issuer and also the 'probability of default' of the instrument that is rated. The limitation on this definition of 'rating' as an 'expression of opinion' of the 'credit rating

agency' regarding securities is that it cannot be construed as a recommendation to buy, hold or sell the securities (Regulation 18) nor it can predict default nor does it guarantee against loss. But it necessarily includes a qualitative well- informed and analysed opinion that largely influences the investment decisions.

20. It has been a well-accepted position that '*credit rating'* quality has become one of the main criteria for investment in corporate bonds. A '*credit rating agency'* needs to go through thoroughly into all the relevant information such as the financials of the company, its strengths and weaknesses, its competitive position in the industry and its future prospects before it announces its '*rating'* value. Therefore, '*terms'* and '*expressions'* used in the CRA Regulations must be interpreted in the context of this functional role of a CRA in the contemporary situation instead of the technical and grammatical approach as sought to be contended by CRL. Further, the statutory requirements under the SEBI Act and CRA Regulations and obligation of the '*credit rating agency*' therein are reasonable restrictions on the fundamental rights under Article 19(1) (a) of the Constitution of India. Though the '*standard symbols*' assigned by a '*credit rating agency'* with regard to a security is not necessarily a statement of fact, it cannot be construed merely '*a symbol*' as sought to be argued. These '*standard symbols*' are of considerable significance to the investors in the corporate bond market. A good '*credit rating'* can help the issuer to access high value investors both domestic and foreign. These symbols also serve as benchmark of financial market regulations. Thus, any attempt to say that a "rating" is only a subjective opinion of the concerned CRA, is to nullify the objectivity that is required in the process of rating and undermines the importance that is actually assigned to such ratings by the investors/lenders at large.

21. Regulation 13 of CRA Regulations read with the Code of Conduct contained in Third Schedule of the CRA Regulations provide for the principle- based benchmark for the conduct of a '*credit rating agency*', while Regulation 24 provides for the Rating Process and *inter alia* obligates the '*credit rating agency*' to follow a '*proper*' rating process, have professional rating committees and should be staffed by analysts to carry out a rating assignment. Regulation 24(7) provides a crucial obligation of a '*credit rating agency*' while '*rating*' a security. It commands the '*credit rating agency*' to "*exercise due-diligence in order to ensure that rating given by the CRA is fair and appropriate*".

22. From the aforesaid regulatory scheme, it is noted that while the agreement of a CRA with the client that specifies right and liabilities of each parties also *inter alia* requires the agreement on periodic review of the '*rating*', co-operation of client in providing true, adequate and timely information to the '*credit rating agency*'. However, the obligation of the '*credit rating agency*' under Regulation 14(d) "*to arrive at and maintain* **true and accurate rating"** cannot be diluted by any agreement as Regulation 16(2) clearly enables the '*credit rating agency*' to carry out the review of assigned '*rating*' on the basis of best available information or in the manner specified by the Board from time to time. Further, the aforesaid benchmarks/ conduct regulations in Regulation 16(2) read with Regulation 14(d), 13 read with Code of Conduct specified in Third Schedule particularly Clauses 1, 2, 3, 4,5,6 and 8 and Regulation 24 (7) are not subservient to the agreement between a '*credit rating agency*' and its client. In the above scheme of the CRA Regulations, the agreement between the '*credit rating agency*' and its client is a part of the aforesaid Code of Conduct and the regulatory requirements, rather than to supplant them

23. The words '*true*', '*accurate', 'fair'* and '*appropriate*' contained in the CRA Regulations enjoins upon a '*credit rating agency*' not merely to accept mechanically the information given by its client but to have an independent professional judgment about the quality of information, creditworthiness of the client and about the probability of default of the respective debt security based on any other available information. This clearly negates the argument of the Noticee that discharge of its obligation is wholly dependent on the cooperation of the client and that the issuer is solely responsible for the quality of information. The presumption of *bona fide* would help if the compliance with the desired Code of Conduct is shown. I further note that the above scheme of the CRA Regulations does not require existence of *mala fide* or bad motive in order to bring home the charge. Once it is established that a '*credit rating agency*' has failed to comply with its statutory obligations under the CRA Regulations the consequences would follow.

24. It is also a settled position that '*due diligence'* means careful and persistent application or effort [*Chander Kanta Bansal Vs. Rajinder Singh Anand* -(2008) 5 SCC 117]. Normally, the degree of prudence in this regard is the diligence reasonably expected from, and ordinarily exercised by, a person who seeks to satisfy a legal requirement or to discharge an obligation. In *JM Mutual Fund and JM Capital Management Private Limited Vs. SEBI* [SAT order dated 22.11.2004], the Hon'ble Securities Appellate Tribunal had held that –

> *"40. In our view no hard and fast rule or straightjacket method can be applied with regard to the principles of due diligence. Due diligence is nothing but a watchful caution and foresight as the circumstances of the particular case demands. (see P-Ramanathan Aiyar's Law Lexicon 1997 edition page 599)*

41. The due diligence is an obligation to exercise reasonable care. Black's Law Dictionary, 6th edition defines "Due Diligence" at page 457as follows:

"Such a measure of prudence, activity or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent man under the particular circumstances; not measured by any absolute standard, but depending on the relative facts of the special case."

25. Thus, the obligation of *'due diligence'* varies according to a given situation and the same cannot have or any single sacrosanct formula for determination of '*due diligence'*. Under the CRA Regulations, the '*due diligence'* expected from a '*credit rating agency*' is much more than just to '*trust but verify'* the information received from the client. The high standards of the conduct obligations under the aforementioned clauses of Third Schedule entail that the '*credit rating agency*' must exercise independent professional judgment at all times in order to achieve and maintain objectivity and independence in rating process. The '*objectivity'* and '*independence'* is very important and crucial element in the '*due diligence'* to be exercised by the '*credit rating agency*'. Such '*due diligence'* would follow that the '*credit rating agency*' should receive the information from the client, independently verify and confirm the '*truthfulness*', '*adequacy'* of the same for the purpose of arriving at and maintaining '*a true and accurate rating'* of the securities of the client {*Regulation 14(d)*}and if, the client does not cooperate in provide the true and adequate information, then use the best available information {*Regulation 16(2)*}and exercise independent professional judgment and using rating processes that reflect consistent and international rating standards{*Regulation 13 read with Third Schedule and Regulation 24(7)*}. In view of the scheme and

object of the CRA Regulations as discussed hereinabove, the *due diligence* obligation of a '*credit rating agency*' is a continuing obligation and it has to ensure compliance with the same at all time. Therefore, I do not agree with the proposition of CRL that the role of a CRA in a rating exercise is only to express its opinion in standardized symbols based on the material made available by the issuer.

26. Whether the events with respect to RCL, right from the significant decline in cash accruals for the Q3FY2017 till the actual default on the payment of principal and interest on is NCDs within the stipulated time and finally the downgrade of the ratings of its NCDs by CRL to 'Default' (D) merited a review of the ratings of the said NCDs, has been disputed by CRL both in its replies dated September 21, 2018 and July 3, 2020. In this regard, I note that CRL has referred to the Circular dated June 30, 2017 (SEBI/ HO/ MIRSD/ MIRSD4/ CIR/ P/ 2017/71) and has stated the following at paragraph no. 6 of its submissions dated July 3, 2020:

    "As per the SEBI (Credit Rating Agencies) Regulations, 1999, ratings of companies are to be reviewed on a continuous basis and any significant development would trigger a review, <u>i.e. which have been defined by SEBI Circular dated June 30, 2017."</u> [emphasis supplied]

27. It is pertinent in this context to note that the Circular dated June 30, 2017, clearly states that it only clarifies the already existing contents of Regulation 15 read with Clause 8 of the Code of Conduct of CRA Regulations. Thus the list of "material events" stated therein at paragraph no. 1 (b) which should trigger a review of ratings is not any addition which, for the first time came into existence on June 30, 2017, but had always been there as events which should have reasonably triggered a review of existing ratings. Further, the Circular also says that the list is

only indicative and not exhaustive. Understandably, all such events which should trigger a CRA to undertake a review of existing ratings of any securities cannot be predicted and spelt out due to the very dynamic nature of securities market. It would also be absurd to say that prior to the clarification provided by the said Circular, no such events existed which could have triggered a review of an existing rating. To say that, would tantamount to nullifying the entire concept of periodic and event specific reviews of an existing rating. Further, Clause 8 of the Code of Conduct specifically casts an obligation on the CRA to monitor *closely all relevant factors that might affect the creditworthiness of the issuers*. With this understanding of Regulation 15 read with Clause 8 of the Code of Conduct, I shall now proceed to ascertain if the conduct of CRL was befitting the standards of diligence, CRL and promptitude as demanded by the CRA Regulations and discussed in details in the preceding paragraphs.

28. In order to ascertain whether the conduct of CRL since the declaration of the third quarter (hereinafter referred to as "**Q3**") results of RCL during the Financial Year (hereinafter referred to as "**FY**") 2017-18, was in line with the requirements of *due diligence* and *promptitude*, in order to deliver a *true, fair* and *appropriate* ratings of its NCDs, it is felt necessary to look into its conduct from January 1, 2017 (i.e., immediately after the expiry of Q3 of the FY 2017) till the date when it had downgraded the ratings of RCL to Default (D). i.e., May 30, 2017.

29. It is an admitted fact that the cash accruals to RCL had dipped significantly in its Q3FY2017 as compared to its Q1 and Q2 results for the same FY. The following is an excerpt from the documents of CRL which has been referred to in the SCN as well:

"Quarterly Performance (Rs. crores):

Particulars	***Q1FY17***	***Q2FY17***	***Q3 FY17***
Working Results			
Income from Continuing Operations	*5259*	*5100*	*4822*
PBILDT	*1458*	*1500*	*1106*
Interest	*795*	*825*	*958*
Depreciation	*830*	*833*	*1165*
PBT	*-65*	*-116*	*-917*
PAT (After Tax Dedc)	*89*	*61*	*-489*
Gross Cash Accruals	*765*	*717*	*248*
Key Ratios			
PBILDT/ Total OI	*27.72%*	*29.41%*	*22.94%*
APAT/ Total OI	*1.69%*	*1.2%*	*-10.14%*
PBILDT Interest Coverage	*1.83*	*1.82*	*1.15*
PBIT Interest Coverage	*0.79*	*0.81*	*-0.06*

RCL has witnessed a <u>significant impact</u> on its cash accruals in the Q3FY17 and the same is expected in Q4FY17 as well. <u>The cash accruals of the company dipped from Rs. 765 crore and Rs. 717 crore in Q1 and Q2 respectively to Rs. 248 crore in Q3 FY17</u>". [emphasis supplied]

30. I note that vide its letter dated June 20, 2017, in response to the queries of SEBI raised vide email dated June 14, 2017, CRL had *inter alia* stated that:

"The <u>significant deterioration</u> in the <u>results of the company</u> for the quarter ended December 2016 was discussed with the company. Usually these discussions happen either by way of telephonic conversations or meetings. In this case, we had telephonic conversations with the company and hence <u>we have no written communication with respect to the same.</u>" [emphasis suppied]

Again, vide its letter dated July 3, 2018, CRL had *inter alia* informed SEBI that:

"The <u>significant deterioration</u> in the <u>credit profile of the company after Q3FY17 results</u> was discussed internally as well as with the company." [emphasis supplied]

I, therefore, note that CRL itself had considered the **deterioration** in the Q3FY2017 results of RCL as a "**significant**" event which had deteriorated the "**credit profile**" of RCL.

31. The legislative intent and the scheme of CRA Regulations have already been detailed in the preceding paragraphs in this order. It is noted there from that the CRA Regulations and the duties /code of conduct mentioned therein have provided the broad structure/ framework of regulatory structure for the CRAs and the broad scope of such provisions have been periodically clarified by the Circulars issued by SEBI in this regard. It is also noted that the said Circulars in the context of CRAs do not add or alter any provisions of CRA Regulations/ Code of Conduct, but only aid in its interpretation/ elucidation with the fast evolving scenarios in a dynamic field such as the securities market. Thus, as is the case with other Regulations framed under the SEBI Act, CRA Regulations too needs to be read with the Circulars issued under it. I note that the

Circular No. SEBI/HO/MIRSD/MIRSD4/CIR/P/2016/119 dated November 1, 2016, issued under Regulation 20 of the CRA Regulations, *inter alia* stipulated that the Operations Manual of a CRA shall contain the "*Policy regarding monitoring and review of ratings, including the timelines within which such review is to be completed*". [emphasis supplied]. In line with this, "**CARE RATINGS OPERATIONS MANUAL,** which is in operation from January 1, 2017, also *inter alia* contains its 'review policy', which is reproduced herein below:

> ***"Policy regarding Review/Surveillance of Ratings***
>
> *CARE regularly reviews the ratings which have been accepted by clients. The review is carried out on an ongoing basis till the maturity of the instrument. A comprehensive surveillance of accepted ratings is carried out at least once a financial year unless regulatory requirements require it to be done more frequently (securitisation and Recovery ratings are required to be reviewed at least once in six months). Further, the time gap between 2 PRs shall not exceed 15 months.*
>
> *Apart from this, a review may also be triggered by a major development in the company or in the industry, which may have a significant bearing on the credit-worthiness of the company."*

32. I also note that at point no.7 of the Operations Manual of CRL, the following is stated under the heading "*Acceptance of Initial Rating*" and the sub-heading "*Timelines of receipt of Acceptance from client and course of action adopted by CARE*" that when acceptance of the initial rating is received from the client after 30 days but less than 6 months:

*"In case there are delays reported or if there is deterioration in the credit profile of the issuer, a review note has to be placed before IRC (***Internal Rating Committee** comprising senior executives of the company for specific assignments) *and subsequently RC (***External Rating Committee** of CARE comprising majorly independent professionals) *if necessary*."

33. From the aforesaid excerpts from the internal policy document of CRL (submitted with its additional submissions dated July 3, 2020) it is therefore clear that a review of an accepted ratings of a company is triggered by a major/significant development in the company being rated, or in the industry at large in which such company is functioning, which may affect the credit-worthiness/ credit profile of the said company. It is already noted that the decline in cash accruals of RCL in Q3FY2017 was noted as a "*significant deterioration in the credit profile of the company after Q3FY17 results"* by CRL. I note that vide its reply dated July 3, 2018, CRL had also stated that:

"The free package offered by Reliance Jio had dented the profitability of all players in the telecom industry for the quarter ended December 31, 2016. While the entry had affected all players in the industry, it was not clear how many consumers would stay with Jio after the expiry of the free offer. It was expected that going forward he scenario would improve after Reliance Jio starts charging for usage; however, much depended on the tariff plans that it would levy. [emphasis supplied]

The same stand was reiterated by CRL in its reply dated September 21, 2018.

34. It is thus clear from a plain reading of the aforesaid submissions of CRL that the entry of Reliance Jio in the telecom industry and the offers which were provided by it to the customers were considered to be a 'major development' in the mobile telecommunication industry by CRL itself. Despite the same, no review of the existing ratings of NCDs of RCL was considered to be necessary by CRL even in the face of such *major development in the company or in the industry, which may have a significant bearing on the credit-worthiness of the company*. In this regard, it is important to note that the rationale for review of an existing rating of an instrument is futuristic, i.e., it is premised upon the 'likelihood' of an event/ development to impact the credit worthiness of a company in near/ foreseeable future, expressed by the phrase "*may have a significant bearing*" contained in the internal policy of CRL. In order to explore/analyze such 'likelihood' of the 'major development' in the telecom industry and 'significant deterioration' in the cash accruals of RCL on its credit profile, a review of the existing ratings of the NCDs of RCL ought to have been conducted by CRL by placing such 'major developments' at least before its Internal Rating Committee keeping compliance with the spirit of point no. 7 in its Operations Manual as already reproduced above. In all reasonableness, such an act of placing the developments during Q3FY17 of RCL before Rating Committee, as a measure of caution, in the interests of the investors at large, should have been done by CRL. That is the minimum standard of diligence expected from a CRA as per the CRA Regulations, the Code of Conduct and even by the internal operations manual of the said CRA.

35. At the cost of reiteration, it is pertinent to note that CRL in its own opinion had considered the decline in cash accruals as a significant deterioration impacting the credit profile of RCL and the

entry of Reliance Jio as a major development in the telecom industry. I therefore hold that CRL had defaulted in its duty as a CRA by not placing the results of Q3FY2017 of RCL before the Rating Committee.

36. Further, CRL has not been able to produce any record of its discussions about the Q3FY2017 results with RCL. It has not been able to produce any records of analysis of the Q3 results, discussion within the CRA, decision of waiting for one more quarter before taking a rating action, discussions with the Issuer company post completion of the review in September 2016 till April 13, 2017. In this regard I note that CRL vide its reply dated June 20, 2017, had stated that:

"..the significant deterioration in the results of the company for the quarter ended December 2016 was discussed with the company. Usually these discussions happen either by way of telephonic conversations with the company and hence we have no written communication with respect to the same.

37. It is indeed strange to note that a "significant deterioration in the results of the company" affecting its credit profile, was discussed with the concerned company without any written communication whatsoever. A company such as RCL having significant market capitalization when faces a sudden and major decline in its cash accruals (from Rs. 765 Crore and Rs. 717 Crore in Q1 and Q2 respectively to Rs. 248 Crore in Q3 FY17, i.e., a <u>decline of 65.68% compared to Q2 results</u>), it is an event which is of grave significance for its investors and the gravity of such an event cannot by any means be addressed through verbal discussions lacking any records whatsoever. Further, CRL had not placed this fact

of significant *deterioration in the credit profile of the issuer,* through a written review note before its Internal Rating Committee. The spirit of the review policy and point no. 7 contained in the Operations Manual of CRL, squarely and logically applies to any situation wherein there is a likelihood of a significant impact of any event on the credit profile of a company whose issue of securities is being rated by it. I therefore hold that CRL had not even complied with its own Operations Manual in letter or spirit by not placing the fact of the significant decline in the cash accruals of RCL which was likely to have impacted its credit worthiness, through a review note before its Internal Rating Committee in particular or any written communication with RCL in general.

38. As per the Operations Manual of CRL, review of quarterly financials of clients is conducted as a part of its continuous monitoring of securities rated by it in compliance with Regulation 15 read with Clause 8 of the Code of Conduct of CRA Regulations. For the purpose of such review it coordinates with the client for the requisite information. As per point no 18 of the Operations Manual, such "*Information from client includes but is not limited to a NDS (*Default if any' statement) *for the preceding quarter*" [explanation supplied]. It is therefore clear from a plain reading of the point no. 18 of the Operations Manual that a NDS is an essential document to be received from the client in order to conduct its review of quarterly financials of the client. As per point no. 20 of the Operations Manual,

> "*In case the issuer does not provide the information sought by CARE for monitoring the rating in a timely manner, despite adequate efforts by CARE, CARE shall categorize the issuer as 'non-cooperating'.*"

In case of non-cooperating clients, CARE reviews the rating of instrument(s)/facilities on the basis of the 'best available information'. This includes any information shared by the client with CARE, any publicly available information including the report published by the debenture trustees from time to time, feedback from bankers/ auditors/ debenture trustees etc.

CARE discloses the aspect of non-cooperation in its PR along with the reasons for non-cooperation, details of follow-up done by CARE for getting the information etc. In such cases, CARE shall use the suffix "ISSUER NOT COOPERATING" with the credit rating symbol. This will be followed by an asterisk mark. The asterisk mark shall be explained and shall read as 'Based on best available information'.

Minimum information that is required for reviews/surveillance:

Information for monitoring (including surveillance) of the Rating would inter alia include quarterly sales, monthly cash credit utilization, outstanding debt, details of delay/default (if any) in meeting debt servicing obligations, latest financial results, financial projections, details of ongoing/planned capital expenditure along with its cost and means of finance etc.

Although the annual and quarterly financial results of listed companies are available publicly on the website of the stock exchanges and the annual financial statements of unlisted companies & LLPs are available with the ROC, other details mentioned above need to be provided by the client to CARE.

However, no information is generally available in public domain for partnership firms, sole proprietorships, trusts, societies etc.

Process to be followed in case client is not cooperating:

In case of clients who are not co-operating, CARE will make the client aware in writing about the actions likely to be taken by CARE in case of continued no-cooperation in the review/surveillance exercise. At least 3 letters/mails will be sent by the Rating team to the client before informing the Rating Committee that client is not cooperating. The content of the letter/email is available in the SOP.

The Rating Committee shall take on record that client is not cooperating. It may also take a rating action if in its opinion the available information is sufficient to do so.

The rating team will then communicate the Rating Committee's decision to the client and publish the 'non-cooperation PR'. The formats are available in the SOP.

39. CRL has stated in its letter dated September 21, 2018 and additional submissions dated July 3, 2020, at paragraph no. 11(d) that:

"After Q3, vide email of January 17, 2017, the Noticee sought an NDS and a break-up of the outstanding debt from the Company; <u>However, since the Company failed to reply, the Noticee's representatives called up the representatives of the Company on telephone who confirmed that debt payments were being made on time.</u>" [emphasis supplied]

CRL had also communicated with the Debenture Trustee of RCL, and information provided by them had shown no irregularities with respect to the debenture issued by RCL.

40. It is however, to be noted that the non-supply of the NDS (which according to the Operations Manual is an essential document to carry out a review/ surveillance of quarterly financials of a company), to CRL by RCL is itself an act of non-cooperation as per the stipulations of the Operations Manual of CRL. The fact that the Debenture Trustees had supplied certain information in this regard does not and cannot take away the fact RCL had not cooperated with CRL when it had failed to produce the NDS sought by CRL or at any time thereafter. CRL has not provided copy of any mails following-up on the mail of January 17 2017, reminding RCL to provide NDS. This is a serious omission on the part of CRL in not following up with RCL for obtaining information regarding the timely servicing of debt obligations even after the significant deterioration in RCL's Q3 results. The steps to be taken by CRL as a consequence of such non-cooperation are detailed in its own Operations Manual and have been reproduced above in the preceding paragraphs. None of the said steps have admittedly been taken by CRL, including conducting a review of the quarterly financials based on available information and publishing a Press Release to this effect mentioning the act of non-cooperation by RCL. The aforesaid steps which are to be taken by CRL in case of non-cooperation by a client in the process of a review/ surveillance are a reproduction of the statutory requirements in this regard under point no. 5 of the Circular No. SEBI/HO/MIRSD/MIRSD4/CIR/P/2016/119 dated November 1, 2016. Such an act of condoning the serious non-cooperation of RCL despite the

statutory requirements to the contrary, is a serious lapse on the part of CRL itself. I, therefore hold CRL to be in violation of the statutory requirements under the said Circular, which constitutes a failure in effective and continuous monitoring of NCDs of RCL rated by it.

41. In addition to the factors already mentioned above (major decline in cash accruals in Q3FY2017, non-submission of NDS), another development had happened with respect to RCL during and immediately after the Q3FY2017. I note that on November 30, 2016 and January 26, 2017, Moody's Investor Service (hereinafter referred to as "**Moody's**") had downgraded the ratings of debt instruments of RCL from Ba3 to B1 and from B1 to B2 respectively. Also, Fitch Ratings (hereinafter referred to as "**Fitch**") on December 20, 2016, had downgraded the ratings of debt instruments of RCL from BB- to B+. The information regarding these downgrades were disseminated to the public through the websites of both the rating agencies on real time basis and was also reported immediately by various media outlets. Thus, the said information pertaining to the downgrading of the ratings of RCL was in public domain from the very dates when the decision was taken to downgrade them by both these international CRAs. The knowledge of such downgrade has also not been denied by CRL. I note that both Moodys and Fitch had stressed upon the deterioration in financials of RCL and increased debt levels of the entity's Indian business operations while taking the rating action. The factors considered by both Fitch and Moody's for this downgrading of ratings of RCL's debt securities have been elaborated under the head "rating rationale"/ "key rating drivers" in their concerned press releases.

42. Nowhere in these rating actions either did they consider any geopolitical aspect/ event or did they consider any change in the sovereign ratings of the Government of India. CRL has sought to argue in its reply dated June 12, 2017, at page 6 of its reply dated September 21, 2018 and at paragraph no. 18 of is submissions dated July 3, 2020, that:

"*The rating assigned to RCL and its securities by international rating agencies Moody's and Fitch Ratings, the Noticee repeats, reiterates and submits that the method and scale of rating is different from the one adopted by Indian CRAs such as the Noticee. Significantly, the sovereign rating given to India by such international CRAs determines the rating of Companies such as RCL, registered in India."*

43. In this context I note that Clause 6 of the Code of Conduct under CRA regulations stiulates that:

6. A credit rating agency shall have in place a rating process <u>that reflects consistent and international rating standards</u> [emphasis supplied].

Therefore, it is not a ground for CRL o say that its rating policies are at variance from international rating standards.

44. Without prejudice to what has been stated immediately above, I have perused the "ratings rationale"/ "key rating drivers" of both Fitch and Moody's, in the instant case. It was RCLs increasing debt and declining inflow of funds which were considered as the primary material for deciding upon the rating downgrade. Further, certain other issues were also considered like merger of some of the businesses of RCL, sale of its Towers etc. which are specific to the

business being conducted by RCL and not any other factor, as sought to be projected by CRL. Be that as it may, even if the argument of benchmarking of a company's ratings against the sovereign ratings of the Government of India is accepted for the sake of argument, in the instant case it was not that Fitch and/ or Moody's were assigning any initial ratings to RCL for the first time, but was changing the ratings already assigned to it. In other words, in the instant case, the ratings downgrade of RCL by these two international CRAs was against the same sovereign benchmark as it was in the case of the previous ratings assigned to RCL by them. I therefore hold that such downgrade should have been considered as a relevant factor by CRL in its periodic review of the quarterly financials of RCL. However, as per the CRA's submission, it appears that rating actions by international CRAs were not considered at all while conducting the rating exercise. It is also noted that it is an admitted fact that the Q3 results of RCL came out on February 11, 2017, i.e., well after these aforesaid rating actions (downgrade) by Fitch and Moody's. By this time, RCL had also failed to supply NDS with respect to its Q32017 to CRL in response to the email dated January 17, 2017 from CRL. Further, the knowledge of the significant decline in the cash accruals of RCL in Q3 and the entry of Reliance Jio in the telecom industry in India as 'major development' was also available with CRL. All these factors taken together, did indeed create more than adequate rationale for any CRA to review its existing ratings. Such a review might not have resulted in any change in the ratings assigned to the debt instruments of RCL assigned by CRL. However, the very absence of such a review shows absolute lack in diligence of CRL in continuous monitoring of an entity/ securities rated by it.

45. Thus, in view of the aforesaid findings, I hold that CRL had defaulted in its diligence as a CRA and in complying with its own Operations Manual in the course of the following events:

i. When it had failed to initiate a review of its earlier ratings assigned to RCL even after the publication of Q3FY2017 results which *inter alia* showed major decline in cash accruals affecting its credit profile and major development in the telecommunications industry with the entry of Reliance Gio denting the profit margins of all other players in the market;

ii. When it had failed to take steps in accordance with Regulation 16 of CRA Regulations read with Circular dated November 1, 2016, when it had not received NDS from RCL despite its email dated January 17, 2017. CRL had not even followed up with RCL for such NDS despite the same being a crucial document for conducting review of quarterly financials of an entity, as per it own review policy;

iii. When it had failed to take into consideration the ratings downgrade of RCL's debt securities on the basis of declining cash flows and increasing debts along with other commercial specifics of RCL by Fitch and Moody's during and immediately after Q3FY2017, for conducting a review of its own ratings;

iv. When it had failed to conduct a review despite being adequately triggered by the factors stated above at points no. (i), (ii) and (iii), which had all happened during the same quarter or just immediately thereafter and waited till May 22, 2017, to conduct its first review since assignment of the earlier rating to RCL.

46. I conclude that the aforesaid defaults of CARE Ratings Limited constitute contravention of Regulation 15(1) and Clauses 3 and 8 of the Code of Conduct read with Regulation 13 of CRA Regulations which makes it liable for penalty under Section 15HB of the SEBI Act.

Contents of the said statutory provisions are reproduced herein below:

13. *Every credit rating agency shall abide by the Code of Conduct contained in the Third Schedule.*

15(1). *Every credit rating agency shall, during the lifetime of securities rated by it continuously monitor the rating of such securities.*

Code of Conduct

3. *A credit rating agency shall fulfill its obligations in a prompt, ethical and professional manner.*

8. *A credit rating agency shall keep track of all important changes relating to the client companies and shall develop efficient and responsive systems to yield timely and accurate ratings. Further a credit rating agency shall also monitor closely all relevant factors that might affect the creditworthiness of the issuers.*

SEBI Act

15HB. *Whoever fails to comply with any provision of this Act, the rules or the regulations made or directions issued by the Board thereunder for which no separate penalty has been provided, shall be 86[liable to a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees.]*

47. While determining the quantum of penalty under section 15HB, it is important to consider the factors stipulated in section 15J of SEBI Act, which reads as under:

> ***"15J- Factors to be taken into account by the adjudicating officer While adjudging quantum of penalty under section 15-I, the adjudicating officer shall have due regard to the following factors, namely:***
>
> *(a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;*
>
> *(b) the amount of loss caused to an investor or group of investors as a result of the default;*
>
> *(c) the repetitive nature of the default."*
>
> *Explanation- For the removal of doubts, it is clarified that the power of an adjudicating officer to adjudge the quantum of penalty under sections 15A to 15E,clauses (b) and (c) of section 15F, 15G, 15H and 15HA shall be and shall always be deemed to have been exercised under the provisions of this section.*

48. Having regard to the factors listed in section 15J and the guidelines issued by Hon'ble Supreme Court of India in *SEBI Vs Bhavesh Pabari Civil Appeal No(S).11311 of 2013* vide judgment dated February 28, 2019, it is noted that from the material available on record, any quantifiable gain or unfair advantage accrued to the Noticees or the extent of loss suffered by the investors as a result of the default in this case cannot be computed. It is also a settled position that the factors

under Section 15J are not exhaustive but are inclusive. It is also important to mention that RCL had/has significant market capitalization and thereby a significant presence in the securities market. It was one of the biggest players in telecommunication industry at the time when the aforesaid defaults were committed by CRL. Though there is no allegation of any mala *fide* on the part of the Noticee, the failure by the Noticee is serious considering the degree of responsibility bestowed upon it by the statute. Further, in the peculiar facts and circumstances of this case the default has occurred due to negligence of the Noticee in discharging its statutory duties as a CRA. Considerable reliance of investors and regulators on opinion of *credit rating agencies* as hallmark of creditworthiness of issuer and the rated instruments clearly outweighs any kind of lack of due diligence by the credit rating agencies. This default on the part of CRL, had clearly defeated the purposes of the CRA Regulations i.e. investor protection and orderly development of the securities markets. Considering the role and responsibility of the Noticee in these regards and important obligations cast upon it under the CRA Regulations, in my view, the default is grave and the gravity of this matter cannot be ignored. Therefore, no lenient view should be taken in this matter and the case deserves imposition of monetary penalty proportionate to the default as found in this case.

ORDER

49. Considering all the facts and circumstances of the case and exercising the powers conferred upon me under section 15I of the SEBI Act read with rule 5 of the Adjudication Rules, I hereby impose a penalty of **Rs. 1,00,00,000/- (Rupees One Crore)** on the Noticee *viz.* CARE Ratings

Limited under section 15HB of SEBI Act. In my view, the said penalty is commensurate with the violation committed by the Noticee in this case.

50. The amount of penalty shall be paid either by way of demand draft in favour of "SEBI - Penalties Remittable to Government of India", payable at Mumbai, or by online payment through following path at SEBI website www.sebi.gov.in ENFORCEMENT → Orders → Orders of AO → Click on PAY NOW or at linkhttps://siportal.sebi.gov.in/intermediary/AOPaymentGateway.html

51. The said demand draft and its details or details of online payments made (in the format as given in table below) should be forwarded to "The Division Chief (Enforcement Department I-DRA-2, the Securities and Exchange Board of India, SEBI Bhavan, Plot No. C4 – A, "G" Block, Bandra Kurla Complex, Bandra (E), Mumbai – 400 051."

Case Name :	
Name of Payee :	
Date of Payment:	
Amount Paid :	
Transaction No. :	
Bank Details in which payment is made :	

Payment is made for : (like penalties/ disgorgement/ recovery/ settlement amount and legal charges along with order details)	

52. In the event of failure to pay the said amount of penalty within 45 days of the receipt of this Order, consequential proceedings including, but not limited to, recovery proceedings may be initiated under section 28A of the SEBI Act, for realization of the said amount of penalty along with interest thereon, *inter alia,* by attachment and sale of movable and immovable properties.

53. In terms of Rule 6 of the Adjudication Rules, 1995, copy of this Order is sent to CARE Ratings Limited and also to the Securities and Exchange Board of India.

Date : July 24, 2020 **G. Ramar**

Place : Mumbai **Adjudicating Officer**