

SECURITIES AND EXCHANGE BOARD OF INDIA, MUMBAI

ORDER

UNDER SECTION 12(3) OF THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992
READ WITH REGULATION 27 OF THE SECURITIES AND EXCHANGE BOARD OF INDIA
(INTERMEDIARIES) REGULATIONS, 2008.

IN RESPECT OF THE HON'BLE SECURITIES APPELLATE TRIBUNAL ORDER DATED JUNE 6,
2023.

IN THE MATTER OF –

NOTICEE	SEBI REGISTRATION No.
BRICKWORK RATINGS INDIA PVT. LTD.	IN-CRA-005-2008

1. The Hon'ble Securities Appellate Tribunal ("**SAT**"), vide an Order dated June 6, 2023 ("**SAT Order**"), in the matter of **Brickwork Ratings India Pvt. Ltd. v. SEBI**¹, while substantially upholding the findings in the Securities and Exchange Board of India ("**SEBI**") Order dated October 6, 2022 ("**SEBI Order**"), remitted the matter back to SEBI to reconsider the quantum of penalty. The directions of the Hon'ble Tribunal are reproduced below:

"The matter is remitted to the Respondent to pass a fresh order on the quantum of penalty other than the order of the cancellation of the license in the light of the observation made above and in accordance with law after giving an opportunity of hearing to the appellant...While considering the quantum, the respondent will take into consideration the interim order passed by this Tribunal wherein the appellant was restrained from taking new clients as a mitigating factor."

¹ Appeal No. 694 of 2022

2. In compliance with the directions of the Hon'ble Tribunal, the Noticee was provided an opportunity of personal hearing on August 9, 2023. Mr. Somasekhar Sundaresan, Advocate, entered appearance on behalf of the Noticee. Subsequently, written submissions dated August 14, 2023, were also filed by the Noticee. The summary of the submissions made on behalf of the Noticee is given below: -

I. The Noticee has already suffered substantial monetary loss as a result of the SEBI Order

It was submitted that the SEBI Order, while providing the Noticee a period of 6 months to wind down its operations, categorically directed that no new clients /fresh mandates can be taken up by the Noticee from the date of the Order. Admitting Brickwork's statutory appeal, the Hon'ble SAT, on October 14, 2022, granted a stay on the effect and operation of the Order but continued with the direction not to take up any new clients /fresh mandates during the pendency of the appeal. The Noticee suffered substantial monetary loss during the period 6 October 2022 to 31 July 2023 as a result of the SEBI Order.

II. Remedial steps taken by Brickwork

Noticee submitted that it had, over the last few months, formulated and implemented various measures and operational changes to strengthen its rating and compliance processes. Noticee has undertaken a major overhaul of its internal systems, has automated many of the processes to avoid human error, and put in strong HR policies that focus on staff accountability and training of rating teams to achieve high standards of compliance required to avoid any lapses.

3. During the course of the oral hearing held on August 9, 2023, it was also submitted that post-hearing submissions would, *inter alia*, specifically detail the steps taken by the Noticee to address the regulatory failures which have been observed and subsequently upheld by Hon'ble SAT along with review of governance standards that the Noticee was proposing/ had already undertaken. Accordingly, vide an e-mail dated August 18, 2023, SEBI sought the Noticee's

reply on the aforesaid issues. The Noticee responded vide e-mail dated August 24, 2023, the summary of which is given below:

I. Actions taken to strengthen the processes and compliance

The Noticee had adopted a two-tier approach to address the issues that have been pointed out by SEBI and which were otherwise noticed internally.

A. Tier 1- Actions which are directly aimed at consolidation of the basic function of Brickwork as a CRA, especially the rating quality and consistency.

- a. Process improvements;*
- b. Process automation;*
- c. Improvement of rating quality;*
- d. Additional criteria and policies to define possible scenarios;*
- e. Review of scoring template;*
- f. Increased accountability of relevant personnel;*
- g. Implementation/revision of policies.*

B. Tier 2 – Actions which provide higher order capabilities to Brickwork and increase the span of the rating in terms of products and overall understanding of regulatory viewpoints.

- a. Development of new rating criteria and models;*
- b. Understanding the regulatory perspective of rating performance.*

II. Strategic and Operational Changes

A. Board Strategy

- a. In the board meeting held in June 2023, Mr. Vivek Kulkarni's resignation from the post of MD was accepted effective July 1, 2023.*
- b. Mr. Vivek Kulkarni has also resigned from the board of the company, and the resignation will be effective from the next AGM.*
- c. The Noticee proposes to induct new Independent Directors.*
- d. The Noticee is proposing to strengthen the Board by inducting reputed and well-known professionals and is currently in the process of identifying the correct candidates.*

- e. *The Board has taken a decision to meet every two months.*
- f. *Ms. Sangeeta Kulkarni, who was in a Non-Executive position since the founding of the company, was appointed by the Board as an Executive Director from July 1, 2023. In this role and until the induction of an external professional CEO, Ms. Kulkarni will be managing the day-to-day affairs of the business.*
- g. *Once the company stabilizes, the Noticee plans to bring a large institutional investor with Board representation and a complete brand makeover.*

B. Professional Management

- a. *The Noticee plans to bring in a professional CEO within three months, who will then bring in a senior leadership team as required for the organization*
- b. *Brickwork is actively hiring senior members from the rating industry who will bring in best practices and a new working culture.*

CONSIDERATION

4. Having considered the directions of the Hon'ble Tribunal and the submissions made by the Noticee, I am proceeding to consider the question of the quantum of penalty to be imposed. In this regard, it is noted that the Hon'ble Tribunal had directed that SEBI will be guided by the observations in the SAT Order while arriving at the penalty. Given the same, in order to contextualize the directions passed by the Hon'ble Tribunal, it would be appropriate to provide a brief background of the SEBI Order dated October 6, 2022, and findings in the SAT Order dated June 6, 2023, thereon.

BACKGROUND

5. The Noticee, Brickwork Ratings India Pvt. Ltd., is a SEBI registered and Reserve Bank of India ("**RBI**") accredited credit rating agency ("**CRA**"). The proceedings which led to the passing of the SEBI Order emanated from the deficiencies observed by SEBI during an Inspection of the Noticee, for the period from October 1, 2018–November 30, 2019, *inter alia* for ascertaining the compliance with the provisions of the SEBI Act, 1992 ("**SEBI Act**") and SEBI (Credit Rating Agencies) Regulations, 1999 ("**CRA Regulations**"). An

administrative warning was issued in respect of certain deficiencies, and in respect of others, an enquiry proceeding was initiated which culminated in the SEBI Order.

6. The Noticee preferred an appeal against the SEBI Order before the Hon'ble Tribunal and, as stated at paragraph 1, the Tribunal set aside the direction in the SEBI Order cancelling the Certificate of registration granted to the Noticee and remitted the matter back to SEBI for reconsideration of the quantum of penalty. While the direction issued in the SEBI Order was set aside, many of the contraventions noted therein were upheld, and the same have been summarized below:

A. Failure to follow a proper rating process:

- i. Failure to consider financial projections in the case of one issuer.
- ii. Failure to obtain Bankers' feedback prior to issuing ratings. The Tribunal noted that obtaining Bankers' feedback was an important step, and the Noticee should have maintained adequate documentation in case such steps were actually taken.

B. Failure to ensure proper maintenance of records to support its ratings.

C. Delayed dissemination of information with respect to monitoring of rating and failure to follow an appropriate rating process.

- i. Delay in disclosure of rated pool performance (September 2019 quarter – 15 days' delay).
- ii. Delay in recognition of default by Issuers (Sintex and Reliance Capital Ltd.).
- iii. Delay in review of rating of NCDs (IKF Finance Ltd.).
- iv. Delay in disclosing material events (SREI Infrastructure Finance Ltd. – 7 days' delay).
- v. Delay in publishing press release (Venus India).

D. Failure to address the issue of conflict of interest.

- i. The Hon'ble Tribunal upheld the findings in the SEBI Order that the Founder Director of the Noticee, while being on the Rating Committee assigning ratings to the instruments of IDFC, was also directly engaging with the management of the Issuer, including in fee

discussions. This, the Hon'ble Tribunal held, was an instance of conflict of interest.

E. Failure to make correct disclosures in Press Releases.

7. It can, therefore, be noted that the Hon'ble Tribunal upheld the findings in the SEBI Order relating to conflict of interest, delays on the part of Noticee in taking rating action, failure to maintain records as per the regulatory prescription and certain aspects related to the rating process (obtaining bankers feedback and reviewing financial projections).
8. It may also be pointed out that, prior to the aforementioned Inspection mentioned at paragraph 5 ("**3rd Inspection**"), SEBI had earlier carried out an inspection of the Noticee for the periods April 1, 2014–September 30, 2015 ("**1st Inspection**") and April 1, 2017–September 30, 2018 ("**2nd Inspection**"). The contraventions /deficiencies observed in the *1st* and *2nd* Inspections led to the initiation of separate adjudication proceedings culminating in the imposition of monetary penalties. The said Orders were appealed by the Noticee before the Hon'ble Securities Appellate Tribunal. In appeal, the Tribunal upheld certain findings in the respective SEBI Orders while reducing the quantum of monetary penalty in both cases. It is observed that the SAT Order had also noted the repeated violations (upheld by the Tribunal) across the three enforcement proceedings initiated by SEBI, are as under:

"In our view, the repeated violations, which remain after this Tribunal's Order in Appeal no. 439 of 2018 (1st Inspection), Appeal no. 475 of 2020 (2nd Inspection) and this order, are basically two, namely, delay in recognition of default of NCDs (one instance each in three Inspections) and conflict of interest issues due to non-segregation of roles (in 2 out of 3 Inspections)."

9. The Hon'ble Tribunal has therefore, noted that repeated violations on the part of the Noticee included delay in recognizing defaults, observed across all three enforcement proceedings, and "*conflict of interest*", which had stood established against the Noticee in two out of the three proceedings. Apart from these two issues, the other material contraventions established in the SEBI Order, provided in paragraph 2 above, that have been upheld in the SAT Order

pertain to deficiencies in adopting a proper rating process. Given the same, it would be appropriate to delve into the nature of these violations to arrive at the directions to be issued in the present proceedings.

CONFLICT OF INTEREST

10. It is noted that SEBI, in a recent order² passed against the KMPs of another registered CRA, elaborated on the importance of avoiding conflict of interest in credit rating agencies. The said observations, I note, would be relevant in the present context and are therefore being reproduced below:

“The critical regulatory challenge faced by the rating model that has been adopted the world over – the ‘Issuer pays’ model – involves addressing the inherent conflict of interest that arises when the Issuers of the security, rather than the consumers of the rating, pay for the rating. Under this model, the Issuers can potentially engage in rating shopping and pressurize the CRAs to assign inflated ratings to the former (issuer) to retain their business. This issue came to a head post the Global Financial Crisis in 2008-09 when the role played by credit rating agencies in the lead-up to the crisis was widely called into question. Significant steps were taken in the aftermath of the crisis to strengthen the regulatory oversight over credit rating agencies and address the issues of conflict of interest. SEBI subsequently issued a Circular dated May 3, 2010, specifying additional “Guidelines for Credit Rating Agencies” which included:

- a. Directing the CRAs to formulate policies and internal codes for dealing with conflict of interest.*
- b. Mandating CRAs to ensure that analysts involved in credit rating do not participate in any kind of marketing or business development, including negotiation of fees.*
- c. Directing CRAs to disclose compliance status with the provisions of the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies.*

Thereafter, in 2016, SEBI prescribed “Enhanced Standards for Credit Rating Agencies” vide Circular dated November 1, 2016, which inter alia provided that:-

² Order in the matter of CARE Ratings Ltd. dated April 20, 2023

“Persons who have business responsibility shall not be part of the Rating Committee. However, the MD/ CEO may be a member of the Rating Committee if the majority of the Rating Committee members are independent.”

It can, therefore, be noted that central to the measures mandated by SEBI to address the issue of conflict of interest inherent in the ‘Issuer pays’ model of credit ratings is the separation of the rating and business development vertical of the CRA – individuals who are involved in business development activities, including fee negotiations with the Issuers, are not permitted to undertake rating functions. Such restrictions seek to insulate the Rating Committee members and analysts from the pressures of business development to mitigate the possibility of the ratings issued being linked to the fees charged. The only exception to this rule was the MD being permitted to be part of the Rating Committee on the condition that majority of the members of such Committee were independent. This relaxation was also done away vide Circular dated November 4, 2019.”

11. Measures to avoid conflict of interest is the central pillar supporting the entire edifice of the Regulations applicable to credit rating agencies. In furtherance of this objective, SEBI has taken numerous steps to shield the credit rating function from the imperatives of business development. It is, however, noted that multiple instances have been noticed in respect of the Noticee where the boundary between assigning ratings and Business Development functions was blurred; personnel engaged in rating activities were also observed to be engaging in business development functions. It was noted that the Founder Director of the Noticee was engaging in business development activities while also being on rating committees of the Noticee. Such repeated lapses are emblematic of the failure of the internal governance structures to place guardrails to shield the rating function and comply with not just the spirit but also the letter of the Regulations.
12. I am therefore proposing to issue directions to address this issue. These directions can be clubbed under two broad heads – 1. Governance issues at the board level, and 2. Professionalizing the management. It is noted that some

of these concerns have been addressed by the Noticee in its reply dated August 24, 2023. The proposals put forward by the Noticee will be considered alongside the directions being proposed herein:

BROADBASING THE BOARD OF THE CRA.

13. It is noted that presently, the Noticee has a five-member Board of Directors. Three out of the five members are Independent Directors (“ID”). Apart from the IDs, the Founder Director and his wife are presently on the Board. Considering that the Board plays critical role of overseeing the management and, in a regulated entity, ensuring that there are systems and structures in place for ensuring compliance with the regulatory prescriptions, it is being directed that the Noticee shall take steps for broadbasing the Board by inducting new members who are persons of ability, integrity and standing in the fields of finance/economics/administration etc.
14. It is noted that the Noticee has replied stating that Founder Director has tendered his resignation from the Board, which will be effective from the next AGM of the Noticee. It has also been stated that efforts are being made to induct new members to the Board. These developments will be considered while proposing directions to broaden the Board.

PROFESSIONALIZING MANAGEMENT

15. As per the scheme of CRA Regulations, the Chief Rating Officer (“CRO”) plays a vital role in ensuring compliance with the regulatory mandates. The CRO, as provided under the Regulations, is envisaged to be in charge of the Rating functions of the CRA, and therefore, it is important to ensure that a person with adequate experience in the rating and regulatory functions is appointed to play this role. The Noticee has also submitted in its reply that it is currently engaged in the process of identifying a professional CEO to take over the management. It was submitted that once the CEO is appointed, the said person will be given the mandate to bring in a new team. The directions being proposed in this Order regarding professionalizing management will take into consideration the aforementioned submissions made by the Noticee.

16. The next issue for consideration is the delay in recognition of defaults. Multiple instances were observed across all three Inspections, where the rating response of the Noticee tended to lag well behind public disclosures that indicated credit deterioration. In this regard, it is noted that SEBI had issued Circular dated June 30, 2017 – “*Monitoring and Review of Ratings by CRAs*”, laying down guidelines for CRAs to ensure prompt recognition of any delay in meeting debt obligations by entities rated by them. The rationale for issuing the Circular is reproduced below:

*“It has come to notice that there have been instances where Credit Rating Agencies have not taken cognizance of information regarding delays in servicing debt obligations by the Issuer, even though the information has already been discounted by the market. **As responsible institutions, CRAs are expected to proactively track all important changes relating to the client companies in order to yield timely and accurate ratings. It is reiterated that CRAs are required to ensure prompt and accurate rating action.**” (Emphasis supplied)*

17. The Circular dated June 30, 2017, casts an obligation on the CRA to be proactive and take measures for early detection of potential defaults by tracking the financials of the Issuer Company to understand signs of deterioration in its financial condition.
18. The repeated failure of the Noticee in proactively identifying the deteriorating financial condition of the Issuers of instruments rated by it, as required under the SEBI circulars, has been acknowledged by the Hon’ble Tribunal on two instances. It was noted that in such instances, rating downgrades undertaken by the Noticee have not just followed the market (rather than lead it), but were also undertaken with a delay even after adverse information regarding rated issuers become publicly available.
19. These repeated instances of failure on the part of the Noticee to closely monitor ratings, after being assigned, points towards deficiencies in the monitoring systems put in place by the Noticee. This could potentially be the result of fewer

resources being employed by the Noticee in scanning for new information that may have an impact on the rating or due to gaps within the systems put in place by the Noticee to review ratings that have been assigned.

20. The lapses on this count, noticed across the three Inspections, point out that considerable effort needs to be put in by the Noticee to monitor the existing ratings. It is noted that the Noticee, in its replies, has listed an elaborate set of actions taken to improve the rating response. However, the efficacy of these measures is yet to be tested. Further, remedial measures adopted after the first and second Inspections do not seem to have had the desired effect, as similar violations have been observed even in the 3rd Inspection. The proof, as they say, is in the pudding. Therefore, an embargo on onboarding new clients need to be in place for some more time till the Noticee demonstrates improved surveillance capabilities.
21. The other contraventions in the SEBI Order, which have been upheld by the Hon'ble Tribunal, relate to delays in complying with regulatory mandates, deficiencies in the rating process and issues related to record keeping. The Noticee, as already noted above, has undertaken that significant revisions have been made to operating protocols to ensure that these contraventions are not repeated. The effectiveness of the revised system will depend on the familiarity and ability of the personnel employed by the Noticee to work within the new system. Therefore, directions are being issued to ensure that the employees of the Noticee are well-versed with the extant regulatory prescriptions and revised protocols put in place by the Noticee.

ORDER

22. I, in exercise of the powers conferred upon me under Section 19 read with Regulation 27 and 35 of the Intermediaries Regulations, hereby issue the following directions to the Noticee:
 - a. The Noticee shall endeavor to broaden its Board such that the aggregate number of directors is nine (9). The new members who are

inducted to the Board shall either be Independent Directors or Non-Executive Directors not related/connected to the founding management of the Noticee. The Noticee shall ensure that not more than 25% of the members of the newly constituted Board are related/connected to the founders/present management of the company.

- b. The Noticee shall ensure that only an independent director not related/connected to the founding management of the Noticee is appointed as the Chairperson of its board.
- c. The Noticee shall ensure that members of the founding management of the Noticee are not part of any rating committees constituted by the Noticee or involved in the rating process.
- d. The Noticee shall ensure that persons related/connected to the founding management of the Noticee, are not appointed to the Audit Committee or the Rating Sub-Committee of the Board of the Noticee.
- e. The Noticee shall ensure that the person functioning as CRO has adequate experience in credit rating and risk management, and shall also undergo in-depth training by an entity not related/connected to the Noticee, to familiarize himself/ herself with the regulatory framework. Such person shall also ensure that systems and rating models are in place at the Noticee that are fully compliant with the CRA Regulations and Circulars issued thereunder. The CRO shall provide a certificate to SEBI evidencing compliance with this direction.
- f. The Noticee, as proposed, shall endeavor to appoint an independent professional CEO.
- g. The Noticee shall ensure that all the persons undertaking rating function, including the analysts, are adequately trained by an entity not related/connected to the Noticee, and be fully aware of the regulatory framework governing ratings. The Noticee shall also ensure that periodic

workshops are conducted to ensure that personnel in the rating function are familiar with the changing regulatory requirements. The Noticee shall submit a certificate to SEBI, along with the details of the training programs conducted, stating the status of compliance with this direction.

- h. The Noticee shall ensure compliance with the directions contained in this Order within a period of five months from the date of this Order. SEBI shall conduct a review after the period of five months to examine the compliance by the Noticee with the directions issued in this Order. The review shall be completed by SEBI within six months from the date of this Order.
- i. The Noticee shall be restrained from onboarding new clients or taking fresh mandates from existing clients for a period of six months from the date of this Order or till such time the Noticee ensures satisfactory compliance with the directions contained in this Order, whichever is later.

23. This Order shall come into force with immediate effect.

Place: Mumbai
Date: September 13, 2023

ASHWANI BHATIA
WHOLE TIME MEMBER
SECURITIES AND EXCHANGE BOARD OF INDIA