

Framework of registration, working and other related aspects of Credit Rating Agency in India

Statutes involved :

1. Securities Exchange Board of India (Credit Rating Agencies) Regulations, 1999
2. Securities and Exchange Board of India (Criteria for Fit and Proper Person) Regulations, 2004.
3. Securities and Exchange Board of India (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002
4. SEBI (Investment Advice by Intermediaries) (Amendment) Regulations, 2001,

List of Credit Rating Agencies in function at present :

1. *Credit Rating Information Services of India Ltd. (CRISIL)*
2. *Investment Information and Credit Rating Agency of India Ltd. (ICRA)*
3. *Credit Analysis and Research Ltd. (CARE)*
4. *Duff and Phelps Credit Rating India Pvt. Ltd. (DCR India)/ Fitch Ratings India Pvt. Ltd. (DCR has now become Fitch)*

There are two other Rating Agencies (for SME scale industries) also but it's not listed in the SEBI website :

1. *ONICRA Credit Rating Agency of India Ltd.*
2. *SME Rating Agency of India Ltd.*

Explanation :

Definition :

"Associate" in relation to a promoter, includes a body corporate in which the promoter holds ten percent or more, of the share capital;

"Associate", in relation to a credit rating agency, includes a person – (i) who, directly or indirectly, by himself, or in combination with relatives, owns or controls shares carrying not less than ten percent of the voting rights of the credit rating agency, or (ii) in respect of whom the credit rating agency, directly or indirectly, by itself, or in combination with other persons, owns or controls shares carrying not less than ten percent of the voting rights, or (iii) majority of the directors of which, own or control shares carrying not less than ten percent of the voting rights of

the credit rating agency, or (iv) whose director, officer or employee is also a director, officer or employee of the credit rating agency;

"Promoter" means a person who holds ten percent or more, of the shares of the credit rating agency.

1. Procedure of formation :

Credit Rating Agencies can work and start functioning only after due approval from the SEBI (The Board) under the Securities Exchange Board of India (Credit Rating Agencies) Regulations, 1999. Application should be made in Form A with the fees as stipulated forth; (1) Application fee (Rs) 50, 000/-, (2) Registration fee for grant of certificate (Rs) 5, 00, 000/-, (3) Renewal fee (Rs.) 10, 00, 000/-.

The validity period of the certificate granted by the Board is 3 years and then it needs to be renewed.

Application for registration should satisfy the following conditions namely (a) the company should have "rating activity" as one of its main objective in the MoA, (b) It has a minimum net worth of rupees five crore, (c) it has adequate infrastructure, to enable it to provide rating services in accordance with the provisions of the Act and these regulations; the applicant and the promoters of the applicant, referred have professional competence, financial soundness and general reputation of fairness and integrity in business transactions, to the satisfaction of the Board; (d) neither the applicant, nor its promoter, nor any director of the applicant or its promoter, is involved in any legal proceeding connected with the securities market, which may have an adverse impact on the interests of the investors; or has been convicted of any offence involving moral turpitude or any economic offence; (e) it has persons having adequate professional and other relevant experience to the satisfaction of the Board; (f) neither the applicant, nor any person directly or indirectly connected with the applicant has in the past been – (i) refused by the Board a certificate under these regulations or (ii) subjected to any proceedings for a contravention of the Act or of any rules or regulations made under the Act.

2. Promoter of credit rating agency :

The Board shall not consider an application unless the applicant is promoted by a person belonging to any of the following categories, namely: (a) a public financial institution, as defined in section 4 A of the Companies Act, 1956 (1 of

1956); (b) a scheduled commercial bank included for the time being in the second schedule to the Reserve Bank of India Act, 1934 (2 of 1934); (c) a foreign bank operating in India with the approval of the Reserve Bank of India; (d) a foreign credit rating agency recognised by or under any law for the time being in force in the country of its incorporation, having at least five years experience in rating securities; (e) any company or a body corporate, having continuous net worth of minimum rupees one hundred crore as per its audited annual accounts for the previous five years prior to filing of the application with the Board for the grant of certificate under these regulations.

3.liabilities

Every credit rating agency has the liability to continuously monitor such securities rated by it during the lifetime of those securities and to disseminate information regarding newly assigned ratings, and changes in earlier rating promptly through press releases and websites, and, in the case of securities issued by listed companies, such information shall also be provided simultaneously to the concerned regional stock exchange and to all the stock exchanges where the said securities are listed.

Every credit rating agency has to keep and maintain, for a minimum period of five years, the following books of accounts, records and documents, namely: (a) copy of its balance sheet, as on the end of each accounting period; (b) a copy of its profit and loss account for each accounting period; (c) a copy of the auditor's report on its accounts for each accounting period; (d) a copy of the agreement entered into, with each client; (e) information supplied by each of the clients; (f) correspondence with each client; (g) ratings assigned to various securities including upgradation and down gradation (if any) of the ratings so assigned; (h) rating notes considered by the rating committee; (i) record of decisions of the rating committee; (j) letter assigning rating; (k) particulars of fees charged for rating and such other records as the Board may specify from time to time.

4.Rating process

A CRA needs to get into a written agreement with the Issuer before rating its securities and this is a mandatory process. Every CRA is bound to specify and file with the Board the rating process and a copy of the same or modification or addition therein and it shall follow a proper rating process. It needs to have a professional rating committee, comprising members who are adequately qualified and knowledgeable to assign a rating. All rating decisions, including the decisions regarding changes in rating is taken by such rating committee. It must be staffed by analysts qualified to carry out a rating assignment. Apart

from that CRA is bound to inform the Board about new rating instruments or symbols introduced by it. Rating definition, as well as the structure for a particular rating product can not be changed by a CRA without prior information to the Board. A credit rating agency is bound to disclose to the concerned stock exchange, through press release and websites for general investors, the rating assigned to the securities of a client, after periodic review, including changes in rating, if any.

5.Restrictions

A credit rating agency can not rate securities issued by it nor their promoters. In case promoter is a lending institution, its Chairman, director or employee shall not be a Chairman, director or employee of credit rating agency or its rating committee. Apart from that, it can not rate a security issued by an entity, which is a borrower of its promoter; or a subsidiary of its promoter; or an associate of its promoter, if (i) there are common Chairman, Directors between credit rating agency and these entities; (ii) there are common employees; (iii) there are common Chairman, Directors, Employees on the rating committee.

Also it can not rate a security issued by its associate or subsidiary, if the credit rating agency or its rating committee has a Chairman, director or employee who is also a Chairman, director or employee of any such entity. But in such a case it can rate a security issued by its associate having a common independent director with it or rating committee if such an independent director does not participate in the discussion on rating decisions, and the Credit Rating Agency makes a disclosure in the rating announcement of such associate (about the existence of common independent director) on its Board or of its rating committee, and that the common independent director did not participate in the rating process or in the meeting of its Board of Directors or in the meeting of the rating committee, when the securities rating of such associate was discussed.

6.Code of Conduct :

Credit Rating Agencies are bound to follow some code of conducts and ethics under Regulation 13 of the said Regulation, 1999. Chiefly, A CRA can not indulge in unfair competition nor shall they wean away client of any other rating agency on assurance of higher rating and they can not make any exaggerated statement, whether oral or written, to the client either about its qualification or its capability to render certain services or its achievements in regard to services rendered to other clients. It can not generally and particularly in respect of issue of securities rated by it be party to (a) creation of

false market; (b) passing of price sensitive information to brokers, members of the stock exchanges, other players in the capital market or to any other person or take any other action which is unethical or unfair to the investors. It needs to maintain an arm's length relationship between its credit rating activity and any other activity. Either a CRA or any of his employees can not render, directly or indirectly any investment advice about any security in the publicly accessible media, whether real – time or non- real time, unless a disclosure of his interest including long or short position in the said security has been made, while rendering such advice. It has to ensure that the Board is promptly informed about any action, legal proceedings etc., initiated against it alleging any material breach or non-compliance by it, of any law, rules, regulations and directions of the Board or of any other regulatory body and in case an employee of the credit rating agency is rendering such advice, he shall also disclose the interest of is dependent family members and the employer including their long or short position in the said security, while rendering such advice.

It is bound to comply with award of the Ombudsman passed under the Securities and Exchange Board of India (Ombudsman) Regulations, 2003. It can not render, directly or indirectly any investment advice about any security in the publicly accessible media. It can not offer fee-based services to the rated entities, beyond credit ratings and research. Every CRA has to develop its own internal code of conduct for governing its internal operations and laying down its standards of appropriate conduct for its employees and officers in the carrying out of their duties within the credit rating agency.

7.Enquiry and Action

If there is any need for inspection or investigation/ inquiry then the Board or the Chairman shall after consideration of inspection or investigation report take such action as the Board or Chairman may deem fit and appropriate including action under the Securities and Exchange Board of India (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002

It includes :

- (1) A penalty of cancellation of certificate of registration of a credit rating agency may be imposed by the Board, if:
 - (a) the credit rating agency is guilty of fraud, or has been convicted of an offence involving moral turpitude or an economic offence; or
 - (b) in case of repeated defaults of the nature mentioned in sub-regulation (1) of regulation 34.

(c) the credit rating agency is declared insolvent or wound up;

(2) The Board shall furnish to the credit rating agency reasons in writing for cancellation of registration

8.Appeals

Any person aggrieved by an order of the Board made, on and after the commencement of the Securities Laws (Second Amendment) Act, 1999, (i.e., after 16th December 1999), under these regulations may prefer an appeal to a Securities Appellate Tribunal having jurisdiction in the matter.

Appeal to the Central Government

Any person aggrieved by an order of the Board under these Regulations;

(a) Suspending a certificate of registration;

(b) Cancelling certificate of registration,
may prefer an appeal to the Central Government against such order, in accordance with the Securities and Exchange Board of India (Appeal to Central Government) Rules, 1993]

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