

BEFORE THE ADJUDICATING OFFICER
SECURITIES AND EXCHANGE BOARD OF INDIA

[ADJUDICATION ORDER/SS/AS/2019-20/6281]

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

In respect of:

CARE Ratings Limited

(SEBI Registration No. IN/CRA/004/1999)

4th Floor, Godrej Coliseum, Somaiya Hospital Road,

Off Eastern Express Highway, Sion (East),

Mumbai – 400 022

1. CARE Ratings Limited (hereinafter referred to as ‘CARE’/ ‘Noticee’) is a credit rating agency registered with Securities and Exchange Board of India (‘SEBI’) under the SEBI (Credit Rating Agencies) Regulations, 1999 (hereinafter referred to as ‘CRA Regulations’) bearing SEBI Reg. No. IN/CRA/004/1999.
2. By a common *communication-order* dated March 25, 2019, this case, pending before an erstwhile Adjudicating Officer appointed to conduct inquiry and adjudication against the Noticee, has been transferred to the undersigned with an advise that except for the change of the Adjudicating Officer, the other terms and conditions of the original orders ‘*shall remain unchanged and shall be in full force and effect*’. The records of proceedings were provided to undersigned on April 05, 2019.
3. On receipt of records it was noted that on being *prima facie* satisfied that there are sufficient grounds to inquire and adjudicate the certain alleged violations of the provisions of the CRA Regulations by the Noticee, SEBI vide a *communication-order* dated December 13, 2018, appointed Shri Suresh B. Menon, CGM (‘erstwhile AO’) as adjudicating officer to inquire and adjudge under Rule 3 of the SEBI (Procedure for Holding Inquiry and imposing penalties by Adjudicating Officer) Rules, 1995 (Adjudication Rules) and section 15HB of the SEBI Act, the alleged violations of the provisions of Regulation 24(7) and Clauses 4 and 8 of Code of Conduct of the CRAs read with Regulation 13 of the CRA Regulations. The text of the provisions of Regulations 13, 24(7) and Clauses 4 and 8 of Code

of Conduct of the CRA Regulations and provisions of section 15HB of the SEBI Act are reproduced below: -

Code of Conduct

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

24(7) - Every credit rating agency, shall, while rating a security, exercise due diligence in order to ensure that the rating given by the credit rating agency is fair and appropriate.

Code of Conduct for Credit Rating Agencies

4. A credit rating agency shall at all times exercise due diligence, ensure proper care and exercise independent professional judgment in order to achieve and maintain objectivity and independence in the rating process.
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

Penalty for contravention where no separate penalty has been provided.

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 liable to a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees.

4. The erstwhile AO had issued the notice to show cause no. SEBI/EAD-1/SBM/34470/2018 dated December 17, 2018 ('the SCN') to the Noticee in terms of Rule 4(1) of the Adjudication Rules read with section 15I of the SEBI Act, calling upon the Noticee to show cause as to why an inquiry should not be held against it in terms of Rule 4 of the Adjudication Rules and penalty be not imposed under section 15HB of the SEBI Act for the aforesaid alleged violations. The charge in the SCN was leveled in view of the following observations/ findings observed by SEBI during its examination-
 - A. On account of default committed by Infrastructure Leasing & Financial Services Limited (hereinafter referred to as 'IL&FS' / 'Issuer') and its subsidiary company IL&FS Financial Services Ltd. (hereinafter referred to as 'IFIN') on their obligations in respect of the Commercial Paper ('CP'), inter-corporate deposits ('ICD') and also default on interest payments on its Non-convertible Debentures (NCDs), SEBI conducted an examination with respect to the role of the Credit Rating Agencies ('CRA'), including the role of the Noticee in assigning rating to various NCDs of IL&FS. It was observed that IL&FS had defaulted on its obligations in respect of the

CP and ICDs which was due for payment on September 14, 2018. The said CP was rated by the Noticee amongst other CRAs. Subsequently, IL&FS also defaulted in the interest payments on its NCDs on various dates i.e. September 17, 21, 26 and 29, 2018

- B. SEBI observed that the Noticee had downgraded the ratings of the NCDs issued by IL&FS on various occasions as follows:

Date	Rating assigned by Noticee
May 09, 2018	AAA assigned to proposed NCDs
Aug 16, 2018	Downgraded from AAA to AA+.
Sept 09, 2018	Downgraded from AA+ to BB.
Sept 17, 2018	Downgraded from BB to D.

- C. SEBI, in its assessment of the role of the Noticee in assigning the aforementioned ratings at various stages, alleged the following deficiencies on the part of the Noticee: -

I. **Allegation regarding excessive reliance placed by the Noticee on the submissions of the management of IL&FS**

- a. The Noticee had placed excessive reliance on the information provided by the Management of IL&FS with regard to updates on the status of implementation of various projects / deals / fund raising plans such as signing of agreement, decisions made during its board meetings etc. and failed to carry out independent due diligence to ascertain the veracity of the updates provided by the management of IL&FS. The Noticee also failed to keep track of the various disclosures available on the website of BSE, as made by IL&FS from time to time.
- b. From the information provided by IL&FS to the Noticee vide email dated July 23, 2018, it was observed that the Board of Directors of IL&FS, in its meeting held on July 21, 2018, approved equity infusion up to ₹4500 crore by way of rights issue. Further IL&FS had, in the disclosure made to BSE, disclosed about the resignation of Mr. Ravi Parthasarthy and appointment of Mr. Bhargava as its Non-Executive Chairman but had not disclosed the approval of the aforesaid equity infusion up to ₹4500 crore by way of rights issue.
- c. From the Press Release dated August 29, 2018 of IL&FS available on its website, it was observed that its Board of Directors had, in the meeting dated August 29, 2018, *inter alia*, approved a rights issue amounting to ₹4500 crore and specific asset divestment plan to reduce the overall debt by ₹30,000 crores. A copy of the said Press Release was also forwarded to the

Noticee by IL&FS. However, in the disclosure made to BSE with regard to the outcome of the said board meeting, IL&FS had only disclosed information regarding approval of fund raising by way of Public Issue of Secured Redeemable NCDs, for an amount not exceeding ₹50 Billion, of which there was no mention in the aforesaid Press Release.

- d. It is alleged that the abovementioned disparity in the disclosures made by IL&FS in its Press Release and the information submitted to BSE had, *prima facie*, warranted greater due diligence and care on the part of the Noticee in order to ascertain the veracity of the updates provided by the management of IL&FS to the Noticee. However, the Noticee failed to take note of the abovementioned disparity in the disclosures made by IL&FS.
- e. From various rating committee notes it was observed that, despite the declining financial indicators of IL&FS viz. the stressed balance sheet, asset-liability mismatch, debt to equity ratio being predominantly negative, the Noticee continued to assign the highest possible rating (AAA) to the NCDs issued by IL&FS, based mainly on institutional parentage of IL&FS and the assurances given by IL&FS management to the Noticee from time to time. In view of the same, it is alleged that the Noticee has failed to exercise proper due diligence by way of independent confirmation of various claims made by the management of IL&FS which ultimately led to misrepresentation of financial health of IL&FS in the eyes of the investors.

II. Allegation regarding over-reliance on the statements made by the Management of IL&FS regarding the proposed rights issue towards meeting the debt obligations

- a. From the minutes of the meeting of the Noticee with the Management of IL&FS, held on July 11, 2018, it is noted that the management of IL&FS had informed the Noticee that equity capital from the rights issue of ₹4500 Crore would be infused by October, 2018. The Noticee was also informed by the management of IL&FS about ₹3500 Crore liquidity facility from promoter entities viz. Life Insurance Corporation of India (“LIC”) and State Bank of India (“SBI”), which was proposed to be coming earlier than the right issue. However, various obligations of IL&FS towards inter-corporate deposits, CP repayments, etc. towards the repayment of CP were due from September 14, 2018 i.e. even before the date of the receipt of funds from the aforementioned rights issue. Therefore, it is alleged that the Noticee has failed to exercise due diligence and prudence as it did not take into account the fact that the funds from the proposed rights issue of IL&FS would be received by it on a date which is subsequent to the due date of its discharging the CP obligations. Therefore, it is alleged that

the Noticee failed to take appropriate steps while assigning its ratings to the debt instruments offered by IL&FS.

- b. Subsequently, IL&FS, in the Press Statement made on its website on August 29, 2018, stated that its Board had approved the Rights Issue of ₹4,500 crores to shore up the capital of the IL&FS and the same would be completed by October 30, 2018. In view of this, it is alleged that, despite the fact that the due date of payment of the aforesaid CP was near and the rights issue was being delayed substantially, the Noticee failed to take appropriate timely action by way of reduction in the ratings assigned to NCDs issued by IL&FS.

III. **Allegation regarding failure to change the Rating Outlook or place the rating under Credit Watch**

- a. The Noticee had maintained the Rating Outlook on the NCDs of IL&FS as “Stable” throughout the rating period despite the slow pace at which the asset monetization and deleveraging steps of IL&FS was taking place. From the Press Release dated March 22, 2018 of the Noticee, it was observed that the Noticee has mentioned the following under the section on “Key Rating Weaknesses” –

“Dependence on induction of strategic partner/ sale of investments: IL&FS has initiated various infrastructure projects in power, SEZ and ports segment which involve large capital outlays resulting in increase in leverage. Furthermore, IL&FS has been supporting all its verticals especially the as well as IEDCL, due to lower than expected divestment/ sale of assets in those verticals. Going forward the induction of strategic partners/ sale of investments would be critical for IL&FS to manage its leverage levels within regulatory limits and also to support its group companies.

High concentration in the asset book: The asset profile of IL&FS mainly constitutes investments (equity plus convertible instruments) and loans given to group entities. As on March 31, 2017, the top five exposures of IL&FS i.e. IL&FS Energy Development Company Ltd. (IEDCL), IL&FS Transportation Networks Ltd. (ITNL), IL&FS Engineering and Construction Company Ltd. (IECCL), IL&FS Maritime Infrastructure Company Ltd. (IMIC) and IL&FS Financial Services Ltd. (IFIN) accounted for around 65% of lending and investment book, as compared 63% of lending and investment book as on March 31, 2016. As on September 30, 2017 the top five exposures accounted 67% of the lending and investment book.”

It is alleged that, despite the above observation, the rating outlook assigned to IL&FS was still kept as “Stable” by the Noticee.

- b. The ratings were placed under “*Rating Watch Negative*” only in August 24, 2018, while downgrading the rating to AA+, on account of “*stress in some of the investments, which could have a material impact on the company’s tangible equity buffers*”. In view of this, it is alleged that the Noticee has failed to exercise its duty to the investors at large and failed to intervene in the matter on time by downgrading the ratings of NCDs of IL&FS despite having a knowledge of the deteriorating financials of the issuer.

IV. **Allegations in relation to the observations of Reserve Bank of India regarding the rapid rating downgrade of CPs issued by IFIN.**

It is observed that the Noticee, being an agency empanelled by Reserve Bank of India (RBI), had also rated the CPs issued by IL&FS and IFIN. In this regard, it is observed that the Noticee had downgraded the CPs, issued by IL&FS and IFIN, from A1 (highest possible rating) to A4 (least possible rating) in its rating outlook dated September 08, 2018 in one go. In this regard, Reserve Bank of India, vide its letter dated November 22, 2018 had given the following observations: -

- i. *The CRAs had derived comfort from the institutional parentage of IFIN. An independent assessment of IFIN by the CRAs as a standalone entity with specific focus on the effectiveness of the prevailing governance systems and executive capability is not evidenced from the clarifications furnished. Further, there is a clear gap in identifying the ultimate major shareholders in case of such diversified ownerships, who might take a call on critical issues during such adverse situations.*
- ii. *IFIN derived financial flexibility and resource raising ability solely by virtue of IL&FS parentage. Besides these, the treasury and risk management function was shared by IFIN with the parent entity. The CRAs could have also evaluated the structure of IFIN on a standalone basis to gauge the finer aspects of degree of reliance on group entities and vice versa. Further, sharing of core business functions like treasury and risk management by group entities may be a desirable set-up, as the same may have adverse externalities during a system-wide contagious event. The group risk aspects were not examined by the CRAs.*
- iii. *The CRAs derived comfort from the liquidity profile of IFIN for positions as on March 31, 2017 and March 31, 2018 which generally reflected positive cumulative mismatches across time buckets for the short and medium term time horizons except for a cumulative mismatch of Rs. 482 crores in the 1-2 months’ bucket as on March 31, 2018. In addition to this, unutilized working capital limits and undrawn bank lines aggregating to Rs. 1151 crores and Rs.812 crores as on March 31, 2017 and March 31, 2018 respectively facilitated a better perception of the liquidity position of the entity amongst the CRAs. However, the expansion in exposure of IFIN to group entities during FY 2017-18 (by 33.14%) through*

transitory loans extended in order to accommodate the delay in disbursements from banks/ FIs were not examined by the CRAs from the perspective of repayment capability.

- iv. On account of mere initiation of a few measures by IFIN's management, the rating downgrade was effected by only one notch from AAA to AA+ by CARE on August 16, 2018 despite several critical issues. Further, relying on the reasons stated by IFIN for delay as technical in nature, no downgrade was initially effected by CARE on the rating assigned to CPs. Subsequently, even though the same was recognized as a material event, the rating was not downgraded and continued to be A1+ as on September 3, 2018.*
- v. Most of the loans extended by IFIN were in respect of high ticket promoter funding and infrastructure loans with long gestation periods. Although the top 15 individual borrowers constituted around 30% of the total credit exposure of IFIN, the same was not examined by the CRAs from the perspective of concentration risk.*
- vi. The CRAs had relied on the support from group entities in favour of IFIN without evaluating such support in terms of irrevocability, enforceability and also the financial strength of the supporting entity.*

5. In view of the above, SEBI found that the Noticee, while assigning its credit rating to the NCDs and CPs of IL&FS, failed to exercise proper skill, care and due diligence while discharging its responsibilities as a credit rating agency. It was also found that the Noticee, being a responsible *credit rating agency* registered with SEBI, should have anticipated the mounting credit risks, the stressed balance sheet position of the issuer and placed the ratings accordingly to alert the market in advance regarding the deteriorating financial profile of the issuer. In view of the above, the Noticee is alleged to have violated the provisions of Regulation 24(7) and Clauses 4 and 8 of Code of Conduct of the CRAs read with Regulation 13 of the CRA Regulations.

6. Vide letter dated January 03, 2019, the Noticee's authorized representative Joby Mathew & Associates ("AR") had submitted that, the Noticee had not been provided with copies of all relevant documents relied upon and referred by SEBI in order to make the allegations and charges in the said SCN including, examination report and observations of Reserve Bank of India (RBI) regarding rapid downgrade of CPs issued by IFIN. Accordingly, the Noticee made request for providing it with copies of all the documents and records relied upon by SEBI and for inspection of originals of the said documents. Vide letter dated February 22, 2019, the Noticee, through its AR, had again requested for the copies of all the documents / records relied upon by SEBI and inspection of the said documents. However, the decision on aforesaid request of the Noticee for documents/ records and inspection of relied upon documents/ records of the erstwhile AO was not available in records.

7. On February 26, 2019, the Settlement Division of SEBI had informed erstwhile AO that the Noticee had filed settlement application under the SEBI (Settlement Proceedings) Regulations, 2018 ('Settlement Regulations') seeking to settle the instant proceedings and had advised him to keep the instant proceedings on hold till the disposal of the settlement application of the Noticee. Further, vide letter dated February 27, 2019, the Noticee through its AR informed that it has filed settlement application before SEBI on February 18, 2019 for the settlement of the instant proceedings and requested for keeping the instant proceedings in abeyance till the final disposal of its settlement application. It was noted that the matter was kept on hold in view of the pendency of the settlement application of the Noticee.
8. On July 03, 2019, the Settlement Division of SEBI informed about the rejection of the settlement application of the Noticee in terms of Regulation 5(4) of the Settlement Regulations and requested undersigned to proceed with the instant proceedings. Since, erstwhile AO had acceded to the request of inspection of the relied upon documents of another rating agency in similar matter, in line with the same and to maintain consistency in the proceedings of similar subject matters, undersigned forwarded the request of the Noticee to the Enforcement Department of SEBI on July 10, 2019 for granting inspection of documents/ records relied upon in the matter to the Noticee. A communication in this regard was also forwarded to the Noticee and its AR vide letter dated July 11, 2019.
9. On September 19, 2019, the concerned department informed that the Noticee's ARs had undertaken inspection of the relied upon documents in the matter on September 06, 2019 and also stated that - since all the documents relied upon in SCN have been provided for inspection to the ARs, thus, the inspection stands concluded. It is noted that post inspection of the documents the Noticee had not filed its reply to the SCN.
10. Vide notice dated September 20, 2019 the Noticee, was provided an opportunity of personal hearing in terms of Rule 4(3) of the Adjudication Rules on October 03, 2019 and also allowed to file its reply to the SCN on or before the said hearing as last opportunity. After seeking short adjournment, the Noticee availed the opportunity of hearing on October 16, 2019, when Learned Advocate Shri Somasekhar S., Shri Joby Mathew and others appeared before me and tendered the reply of the Noticee dated October 15, 2019 and made submissions on the lines of the said reply. ARs also requested for 7 days' time to submit a brief written argument and 'No Default Statement' of IL&FS dated August 01, 2018. The Noticee was granted 7 days' time for submitting a brief written argument and 'No Default Statement' of IL&FS and the personal hearing in the matter was concluded. Vide letter dated October 23, 2019, the ARs submitted the said written argument and '*No Default Statement*'.
11. The replies and submissions of the Noticee, *inter alia* are as under: -

A. With regard to Regulatory overview: -

- I. The concept of "rating" is defined in regulation 2(1)(q) of the CRA Regulations "*means 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;*". Thus, 'rating' is defined in the Regulation 2(1)(q) 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.
- II. The framework under the CRA Regulations, as set out in Regulations 13 to 16, 24, 29 and the Code of Conduct contained in the Third Schedule are extracted below:

"Code of Conduct

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

Agreement with the Client

14. Every Credit rating agency shall enter into a written agreement with each client whose securities it proposes to rate, and every such agreement shall include the following provisions, namely:

(d) the client shall agree to co-operate with the credit rating agency in order to enable the latter to arrive at, and maintain, a true and accurate rating of the client's securities and shall in particular provide to the latter, true, adequate and timely information for the purpose.

Monitoring of ratings

15.(1) Every credit rating agency shall, during the lifetime of securities rated by it continuously monitor the rating of such securities, unless the rating is withdrawn, subject to the provisions of regulation 16(3).

(2) Every credit rating agency shall 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.

Procedure for review of rating

16. (1) Every credit rating agency shall carry out periodic reviews of all published ratings during the lifetime of the securities, unless the rating is withdrawn, subject to the provisions of regulation 16(3).

(2) If the client does not co-operate with the credit rating agency so as to enable the credit rating agency to comply with its obligations under regulation 15 of these regulations, the credit rating agency shall carry out the review on the basis of the best available information or in the manner as specified by the Board from time to time.

Provided that if owing to such lack of co-operation, a rating has been based on the best available information, the credit rating agency shall disclose to the investors the fact that the rating is so based.

(3) A credit rating agency shall not withdraw a rating so long as the obligations under the security rated by it are outstanding, except where the company whose security is rated is wound up or merged or amalgamated with another company, or as may be specified by the Board from time to time.

Rating process

24. (1) Every credit rating agency shall -

(a)specify the rating process;

(b)file a copy of the same with the Board for record; and file with the Board any modifications or additions made therein from time to time.

(2) Every credit rating agency shall, in all cases, follow a proper rating process.

(3) Every credit rating agency shall have professional rating committees, comprising members who are adequately qualified and knowledgeable to assign a rating.

(4) All rating decisions, including the decisions regarding changes in rating, shall be taken by the rating committee.

(5) Every credit rating agency shall be staffed by analysts qualified to carry out a rating assignment.

(6) Every credit rating agency shall inform the Board about new rating instruments or symbols introduced by it.

(7) Every credit rating agency, shall, while rating a security, exercise due diligence in order to ensure that the rating given by the credit rating agency is fair and appropriate.

(8) *A credit rating agency shall not rate securities issued by it.*

(9) *Rating definition, as well as the structure for a particular rating product, shall not be changed by a credit rating agency, without prior information to the Board.*

(10) *A credit rating agency shall 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.*

Board's right to inspect

29. (1) *The Board may appoint one or more persons as inspecting officers, to undertake inspection or investigation of the books of account, records and documents of the credit rating agencies, for any of the purposes specified in sub- regulation (2)*

(2). *The purposes referred to in sub-regulation (1) shall be the following, namely:*

(a) *to ascertain whether the books of account, records and documents are being maintained properly;*

(b) *to ascertain whether the provisions of the Act and these regulations are being complied with;*

(c) *to investigate into complaints received from investors, clients or any other person on any matter having a bearing on activities of the credit rating agency;*

(d) *in the interest of the securities market or in the interest of investors.*

(3) ***The inspections ordered by the Board under sub-regulation (1) shall not ordinarily go into an examination of the appropriateness of the assigned ratings the merits.***

(4) ***Inspections to judge the appropriateness of the ratings may be ordered by the Board, only in case of complaints which are serious in nature.***

(5) ***Inspections referred to in sub-regulation (4) shall be carried out either by the officers of the Board or independent experts, with relevant experience or combination of both.***

THIRD SCHEDULE

2. *A credit rating agency, in the conduct of its business, shall observe high standards of integrity, dignity and fairness in the conduct of its business.*

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

4. A credit rating agency shall at all times exercise due diligence, ensure proper care and exercise independent professional judgment in order to achieve and maintain objectivity and independence in the rating process.

5. A credit rating agency shall have a **reasonable** and adequate basis for performing rating evaluations, with the support of **appropriate** and in depth rating researches. It shall also **maintain records** to support its decisions.

.....

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."

III. From the foregoing it will be seen that the expression of *opinion in standardised form*, i.e. a 'rating', substantially depends on co-operation by the client {Regulation 14(d)} and it is when a client does not cooperate that the rating agency must have regard to the best available information in the public domain {Regulation 16(2)}. Therefore, at the very threshold the accusation that 'excessive reliance' was placed on information and co-operation provided by the client, is fundamentally misplaced.

IV. The overarching and overriding principle of commerce, also consistent with Indian constitutional principles is the presumption of *bona fides* and not the presumption *mala fides*. In other words, when two commercial persons engage, the standard expected of them under the Indian law is that they should presume *bona fides* unless, of course, there is evidence staring at them that the counterparty is acting *mala fide*. In the words of the Hon'ble Supreme Court, even a person placed in a fiduciary position, such as a director of a company, is not expected to convert himself into a suspecting detective distrusting every input received by him. Reliance is placed on *Chintalapati Srinivasa Raju v. SEBI, Civil Appeal No. 16805 of 2017, Supreme Court of India, Paras 17 and 21*. The above judgment cited with approval the ruling in *Dovey and the Metropolitan bank v. John Cory, [1901] AC 477*. The extract of the aforesaid order is as follows:

"17. There is no dispute that the appellant, who was wife of the Managing Director, was appointed as a Director of the Company— M/s Elite International (P) Ltd. on 1-7-2004 and had also executed a letter of guarantee on 19-1-2005. The cheques in question were issued during April 2008 to September 2008. So far as the dishonour of cheques is concerned, admittedly the cheques were not signed by the appellant. There is also no dispute that the appellant was not the Managing Director but only a non-executive Director of the Company. Non-executive Director is no doubt a custodian of the governance of the company but is not involved in the day-to-day affairs of the running of its business and only monitors the executive activity. To fasten

vicarious liability under Section 141 of the Act on a person, at the material time that person shall have been at the helm of affairs of the company, one who actively looks after the day-to-day activities of the company and is particularly responsible for the conduct of its business. Simply because a person is a Director of a company, does not make him liable under the NI Act. Every person connected with the Company will not fall into the ambit of the provision. Time and again, it has been asserted by this Court that only those persons who were in charge of and responsible for the conduct of the business of the Company at the time of commission of an offence will be liable for criminal action. A Director, who was not in charge of and was not responsible for the conduct of the business of the Company at the relevant time, will not be liable for an offence under Section 141 of the NI Act. In National Small Industries Corpn. [National Small Industries Corpn. Ltd. v. Harmeet Singh Paintal, (2010) 3 SCC 330 : (2010) 1 SCC (Civ) 677 : (2010) 2 SCC (Cri) 1113] this Court observed: (SCC p. 336, paras 13-14)

“13. Section 141 is a penal provision creating vicarious liability, and which, as per settled law, must be strictly construed. It is therefore, not sufficient to make a bald cursory statement in a complaint that the Director (arrayed as an accused) is in charge of and responsible to the company for the conduct of the business of the company without anything more as to the role of the Director. But the complaint should spell out as to how and in what manner Respondent 1 was in charge of or was responsible to the accused Company for the conduct of its business. This is in consonance with strict interpretation of penal statutes, especially, where such statutes create vicarious liability.

14. A company may have a number of Directors and to make any or all the Directors as accused in a complaint merely on the basis of a statement that they are in charge of and responsible for the conduct of the business of the company without anything more is not a sufficient or adequate fulfilment of the requirements under Section 141.”

Non-executive directors are, therefore, persons who are not involved in the day to day affairs of the running of the company and are not in charge of and not responsible for the conduct of the business of the company.

17. An instructive judgment of Lord Halsbury is contained in Dovey and the Metropolitan Bank v. John Cory [1901] AC 477. The Lord Chancellor put it thus:

“The charge of neglect appears to rest on the assertion that Mr. Cory, like the other directors, did not attend to any details of business not brought before them by the general manager or the chairman, and the argument raises a serious question as to the responsibility of all persons holding positions like that of directors, how far they are called upon to distrust and be on their guard against the possibility of fraud being committed by their subordinates of every degree. It is obvious if there is such a duty it must render anything like an intelligent devolution of labour impossible. Was Mr. Cory to turn himself into an auditor, a managing director, a

chairman, and find out whether auditors, managing directors, and chairmen were all alike deceiving him? That the letters of the auditors were kept from him is clear. That he was assured that provision had been made for bad debts, and that he believed such assurances, is involved in the admission that he was guilty of no moral fraud; so that it comes to this, that he ought to have discovered a network of conspiracy and fraud by which he was surrounded, and found out that his own brother and the managing director (who have since been made criminally responsible for frauds connected with their respective offices) were inducing him to make representations as to the prospects of the concern and the dividends properly payable which have turned out to be improper and false. I cannot think that it can be expected of a director that he should be watching either the inferior officers of the bank or verifying the calculations of the auditors himself. The business of life could not go on if people could not trust those who are put into a position of trust for the express purpose of attending to details of management. If Mr. Cory was deceived by his own officers - and the theory of his being free from moral fraud assumes under the circumstances that he was - there appears to me to be no case against him at all. The provision made for bad debts, it is well said, was inadequate; but those who assured him that it was adequate were the very persons who were to attend to that part of the business; and so of the rest. If the state and condition of the bank were what was represented, then no one will say that the sum paid in dividends was excessive. (at pages 485-86)

Per Lord Davey, it was held:

*“In this state of the evidence, my Lords, I ask whether the course of business at the board meetings, as described by the respondent, was a reasonable course to be pursued by the respondent and other directors, or whether the knowledge which might have been derived from a careful and comparative examination of the weekly states and quarterly returns from the different branches of the bank ought to be imputed to the respondent, or (alternatively) whether he was guilty of such neglect of his duty as a director as would render him liable to damages. I do not think that it is made out that either of the two latter questions should be answered in the affirmative. I think the respondent was bound to give his attention to and exercise his judgment as a man of business on the matters which were brought before the board at the meetings which he attended, and it is not proved that he did not do so. But I think he was entitled to rely upon the judgment, information, and advice of the chairman and general manager, as to whose integrity, skill, and competence he had no reason for suspicion. I agree with what was said by Sir George Jessel in *Hallmark’s Case*, and by Chitty J. in *In re Denham & Co.*, that directors are not bound to examine entries in the company’s books. It was the duty of the general manager and (possibly) of the chairman to go carefully through the returns from the branches, and to bring before the board any matter requiring their consideration; but the respondent was not, in my opinion, guilty of negligence in not examining them for himself, notwithstanding that they were laid on the table of the board for reference. The case is no doubt one of some difficulty, but the appellant has not made*

out to my satisfaction that the respondent wilfully (as that term is explained in the cases I have referred to) misappropriated the company's funds in payment of dividends.” (at pages 492-493)

- V. The term ‘*due diligence*’ must follow the dictum of ‘*trust but verify*’ and not the dictum of ‘*distrust and investigate*’. The SCN and its contents adopt the later approach.

A. RELIANCE ON CLIENT - REQUIREMENT OF LAW

- I. The aforesaid principle squarely applies to a ‘*credit rating agency*’ as well. The ‘*credit rating agency*’, acting as a commercially prudent person, has been mandated by law to rely on co-operation from the client and in fact the client has been obligated by law to provide the CRA true, adequate and timely information {*Regulation 14(d)*}.
- II. In the instant case, pursuant to Regulation 14(d), an agreement was indeed executed between CARE and IL&FS to enable expression of opinion in a standardised form by CARE on the creditworthiness of the instruments issued by IL&FS.

B. SALIENT FEATURES OF AGREEMENT WITH IL&FS

- I. To further elaborate that ‘*rating*’ is merely an opinion on the creditworthiness of the instrument and that reliance by CARE on information by the issuer is part of the process of the rating, the relevant provisions of the rating agreement are relied upon.
- II. Undertaking provided by IL&FS at item: This item provides that IL&FS would arrange for: information from other stakeholders such as auditors, bankers, management of IL&FS; arrange for review of ratings on occurrence of material events; provision of information to CARE which will have impact on the ‘*ratings*’, including details of default or delay in payment of interest; and provision of monthly no-default statement.
- III. Warranty by IL&FS on truthfulness and accuracy of information at item: CARE relies on information from IL&FS and from third parties provided on behalf of IL&FS, which CARE will not be obliged to independently audit and verify. In this respect, IL&FS has provided warranty on the truthfulness and accuracy of the information and that such information is not misleading. Further, it provides that IL&FS has warranted that it has conducted reasonable due diligence in respect of such information.
- IV. Thus, there is a presumption of *bona fides* on an expert report and the information to be received by CARE or ‘*credit rating agency*’.

C. PROTECTION AGAINST JUDGING APPROPRIATENESS

- I. The next facet to be borne in mind from the foregoing provisions is that the CRA Regulations have taken care to stipulate that the judgment of a '*credit rating agency*' must not be called into question on the ground of appropriateness of the assigned rating {*Regulation 29(3)*}. It is only when complaints of a '*serious nature*' arise (the term '*serious nature*' is not defined) that an inspection may be ordered. Even for such inspection care has been taken to stipulate that the officers of SEBI or the independent experts, as the case maybe, who conduct such inspection must have relevant experience.
- II. In fact, this is the reason why the Noticee has repeatedly requested for a copy of the SEBI's file noting's. In view of Regulation 29, which is a carefully nuanced and balanced stipulation of inspection standard, it is Noticee's belief that the SEBI's file noting's thereon may contain counter balancing and mitigating findings or may have pointed out exculpatory facets of the matter. Such internal expressions of opinion made by persons mandated to have appropriate experience for such an exercise is a vital facet of evidence in play. It is once again requested that the same be provided to the Noticee.

D. PROCESS RELEVANT NOT PRODUCT

- I. Towards this end, i.e. protecting a '*credit rating agency*' from judgment of the appropriateness of its ratings, the CRA Regulations have also taken care to stipulate a regulatory focus on '*rating process*' and not '*rating outcomes*'. Regulation 24 sets out various regulatory requirements for conduct of '*rating process*'. There is not a whisper in the SCN that there was any violation of the '*rating process*'.
- II. Yet, the SCN's allegations imply that the '*credit rating agency*' '*rating*' is being judged for its appropriateness with the benefit of hindsight, in utter disregard of the protections stipulated in Regulation 29, despite the CRA's process having been fully compliant with Regulation 24.
- III. Pursuant to the agreement with IL&FS, reliance is placed on each of the affirmations and confirmations provided by IL&FS pursuant to the Agreement under Regulation 14(d).
- IV. When the performance of a '*credit rating agency*' is in fact to be judged in penal proceedings of this nature, the questions to be asked would be whether Regulations 14, 16 or 24 have been violated in its terms and not to ask whether the '*rating*' assigned was appropriate (which would violate the letter and spirit of Regulation 29).

- V. It will therefore be seen that in fact CARE reacted to information made available to it under Regulation 14, followed the procedures under Regulation 16 and applied the process set out in Regulation 24 and therefore, under Regulation 29, the '*appropriateness of the rating*' assigned must not be called into question. There is not a whisper of any facet of integrity of these compliances being compromised anywhere in the SCN.
- VI. Regulation 24(7) requires a '*credit rating agency*' to exercise due diligence to ensure that the '*rating*' is '*fair*' and '*appropriate*'. Read harmoniously with Regulation 29 this would mean that one must have regard to the terms '*due diligence*' while expressing an opinion in standardised form without compromising the carefully nuanced protection accorded by Regulation 29. As stated above, the term '*due diligence*' does not connote adoption of a distrustful and suspecting attitude but must adopt an approach of a '*reasonable degree of verification*'. The rating rationale published by CARE and referred to above clearly evidence that applying due diligence, CARE indeed treated the inputs with a valid degree of scepticism and in fact reacted and altered its earlier opinions expressed. Such variations were dynamic in nature, responsive to a fair assessment and in fact demonstrated the reasonable conduct of rating process by CARE.
- VII. By referring to the provisions of the regulations and rating agreement between CARE and IL&FS, it is submitted that while formulating a '*rating*', the reliance on information given by an issuer cannot be considered as excessive and that the law permits assumption of *bona fide* for information presented by the issuer.
- VIII. Like in the case of a merchant banker, a '*credit rating agency*' role in a market is not that of an investigator, who is to proceed with distrust on the information provided by the issuer.
- IX. From a plain reading of the Code of Conduct stipulated pursuant to Regulation 13, and extracted above it, would be seen that the SCN has nothing to show in terms of the '*ratings*' of CARE not being '*fair*' or '*professional*' or '*non-independent*' for that matter. CARE had reasonable and adequate basis for its evaluations and indeed has not only maintained records but has in fact provided SEBI with the same. The review and variation of '*ratings*' has been *bona fide*, prompt and responsive taking into account all relevant factors that could have affected the creditworthiness of the issuers.

E. EXCESSIVE RELIANCE - A VAGUE TERM

- I. In view of the foregoing, it must be noted that an accusation of '*excessive reliance*' is not only contrary to the scheme of CRA Regulations but is also inherently vague, vitiating the SCN.

- II. Ratings are neither an investment guarantee nor a recommendation to buy, hold or sell any securities (*Regulation 18*). They are an expression of opinion in a standardised form without precluding investor from doing his own '*due diligence*'. It was further emphasized that capital market is continuously evolving and new practices and steps are taken to make the market stronger, which is also the case with the rating of instruments. Thus, any adjudication of alleged violations of the CRA Regulations is to be done on the basis of the process followed and material available to the '*credit rating agency*' at the relevant point in time and not in hindsight.

F. ON ALLEGATIONS IN THE SCN

- I. The replies and submissions of the Noticee, *inter alia* are summarized as under: -
- a. The Noticee have not been provided with all the relevant documents and records, which are relevant for a fair and just adjudication of the allegations and charges in the said notice. For example, there are repeated references in the records to an examination conducted by SEBI and observations made in the course of such examination. Yet, despite repeated requests; SEBI has refused to provide the Noticee with a copy of the "examination report" setting out the findings and observations of the "examination" conducted by SEBI. The refusal of SEBI to provide all the relevant documents and records including the examination report is a clear violation of the principles of natural justice and the same vitiates the proceedings.
 - b. While rating debt instruments of issuers and bank facilities of borrowers, CARE seeks financial and operational data including, but not limited to past financials, business plan audited and projected financials, capex details, loan portfolio cuts, investment details, liquidity profile, liability profile, management details and more. The rating process also includes discussion with the top management and understanding of the current and future plans of the company. CARE is regularly in possession of information which is unpublished and price sensitive in nature (in the case of unlisted companies, such information may be considered as being '*material*' instead of '*price sensitive*') and factors such information into its ratings. If such information acts as a key determinant of the underlying rating, then it is appropriately disclosed in the rating rationale and press release. Further, CARE also keeps a track of announcements/filings done by corporates on the stock exchanges and initiates '*material event review*' as per pre-specified triggers. The methodology required under *Regulation 24* of the CRA Regulations has indeed been formulated and notified. The internal and external committees that are required have indeed been formed. Likewise, the requisite agreements with clients have indeed been executed and process have all been followed.

- c. IL&FS is an infrastructure development and finance company was promoted by the Central Bank of India ("Central Bank"), Housing Development Finance Corporation ("HDFC") and Unit Trust of India ("UTI") in 1987 and has been providing financial services and developing infrastructure projects under a commercial format. Majority shareholding of IL&FS is held by marquee financial institutions like LIC (which held 25.34% stake in IL&FS), Orix Corporation, Japan (23.54%), Abu Dhabi Investment Authority (12.55%), HDFC Ltd. (9.02%), SBI (6.42%) and Central Bank (7.67%). IL&FS got registration as a Core Investment Company from Reserve Bank of India ("RBI") in September, 2012. IL&FS functions as a holding company and is involved in investing and lending to its subsidiaries, associates and group entities.
- d. The ratings of IL&FS were first assigned as CARE AAA for long term facilities/instruments and CARE A1+ for short term facilities/instruments way back in 1994. The ratings were retained at the same level after periodic reviews, till August, 2018, based on information known at all relevant points of time.
- e. CARE started engaging with the top management of IL&FS and IL&FS Financial Services Limited ("IFIN") subsequent to defaults by some of the Special Purpose Vehicles ("SPVs") of IL&FS Transportation Networks Limited ("ITNL"), and the consequential downgrade of the ratings of ITNL was effected in June and July 2018. It may be noted that these defaults pertained to standalone SPVs of ITNL and their obligations were not guaranteed by ITNL or IL&FS. Thereafter, our client interacted with IFIN management to discuss the results of the Quarter ending March 31, 2018, which were weak and regarding REI's notice to IFIN towards meeting 'CAR' and 'NOF' regulatory requirements by March 2019.
- f. After reviewing the position and taking into account various factors, the ratings were downgraded from CARE AAA to CARE AA+ and placed on '*credit watch with negative implications*' on August 16, 2018. In downgrading the rating to AA+ in August 2018, our client relied upon the various measures proposed by the company to augment liquidity. The rating was placed on watch to see if these measures materialized. By placing the ratings on '*Credit watch*', our client also disclosed to the public, that it would be reviewing the credit rating constantly and all developments with regards to equity infusion.
- g. The plan for raising funds to the extent of ₹4,500 Crores was shared with our client by the management of IL&FS vide email dated August 14, 2018. Although the disclosures by the Company to BSE/NSE did not contain any disclosure of the said fund-raising plan, in a press statement dated August 29, 2018, the Company disclosed that the Board of Directors had

approved a Rights Issue of 30 crore equity shares at ₹150 per share aggregating to ₹4,500 crores to shore up the capital. Major shareholders were represented in the Board of IL&FS including LIC, Orix Corporation, Abu Dhabi Investment Authority and HDFC and all the major shareholders were financially strong and had sufficient funds to subscribe to right issue of the size indicated. Hence, there was no reason to disbelieve that the rights issue would not be subscribed. Even if other shareholders were unwilling to subscribe, these four large shareholders viz. LIC, Orix Corporation, Abu Dhabi Investment Authority and HDFC would have contributed to over 70% of the total rights issue proceeds. On the whole, the rights issue of ₹4500 crore in itself would have aided the liquidity of the company to tide over liquidity requirement in the short term. Absence of mention of liquidity facility of ₹3500 crore in the exchange disclosures, thus, appears to be of only secondary importance.

- h. As set out hereinabove, even before the IL&FS press note dated August 29, 2018, CARE took rating action in August 2018, on account of build-up of IL&FS debt levels over a period of time on the back of increase in funding support to key subsidiaries and group companies and slower than expected monetization of assets resulting in a moderation of the financial flexibility. It was also noted that IL&FS has embarked upon several strategic measures for de-leveraging its balance sheet including capital infusion from existing shareholders and monetization of assets. As such, the proposed equity infusion was critical to IL&FS credit profile, which was also mentioned in CARE Press Release dated August 16, 2018. Moreover, the plan for rights issue, asset monetization and plan for approaching shareholders for liquidity support were also reported in the media (*Article which appeared in the Financial Express dated August 31, 2018 Annexure "F"*).
- i. Prior to rating action on IL&FS in August 2018, the ratings factored in the financial performance of IL&FS until FY17. There had been no audit alerts or qualifications or aspersions of any doubt throughout this relevant period from the statutory auditors of IL&FS. Trends in some of the key financial parameters were looked at, in tandem with the underlying business model of the group viz. strong institutional ownership, experienced management team, expertise in advisory, financing and infrastructure, diversified funding profile, financial flexibility and resource raising capacity and regulatory compliance.
- j. Explained below is the analysis contained in our previous review, wherein the ratings of CARE AAA and CARE A1 + were retained (*Review based on FY17 (Audited) done on September 30, 2017, Press Release Date October 09, 2017 – Annexure - G*):

- i. Being a holding company, the income profile of IL&FS witnessed volatility as its *year-on-year* income and profit figures at a standalone level were impacted by presence /absence of (*and indeed the quantum of*) income on sale of strategic investments. However, IL&FS enjoyed healthy cash flows in the form of interest income, business centre income and dividend income from its group companies.
- ii. The company had initiated various infrastructure projects in roads, power, SEZ and ports segment which involved high capital outlay. IL&FS would therefore, on an ongoing basis, require to induct strategic partners/ divest some of its mature investments to prevent further rise in its gearing levels to fund ongoing projects. The speed of monetization of these assets is dependent upon prevailing external environment.
- iii. IL&FS was unable to have significant divestment during Financial Year 2016 and Financial Year 2017 in its core infrastructure assets. However, it did sell stake in non-core assets like IL&FS Trustee Ltd. to an external party whereby it booked a profit of ₹113 crore in Financial Year 2016 and ₹37 crore in Financial Year 2017 respectively. During Financial Year 2017, IL&FS borrowing levels declined, as some exposures to the group companies got refinanced, due to which, the proceeds received from the same were used to repay the debt of IL&FS. This helped improve the leverage ratio in Financial Year 2017 vis-a-vis Financial Year 2016.
- iv. During Financial Year 2011 to Financial Year 2016, IL&FS indeed exited some of the exposures and booked profit on sale of stake in strategic investments of around ₹ 1,951 crore.
- k. As in the past, the management of IL&FS indicated that the funding requirement of its subsidiaries for servicing debt obligations and executing projects was to be met through stake sales in various group entities/projects. IL&FS management also indicated divestment in assets to take place during Financial Year 2018 and Financial Year 2019 so as to meet commitments towards under construction projects in subsidiaries. Given the track record of IL&FS on divestments, this plan was considered positively by CARE. It was not unreasonable for a CRA to assess this as a reasonable confirmation in the course of monitoring the rating.
- l. The ratings done by our client rely primarily on audited financial statements. In case of IL&FS, the auditors had not made any qualification on inadequate provisioning nor had they made any mention of impairment of assets in the audited statements.

- m. CARE relied on the ALM profile of IL&FS as on March 31, 2018 and cash and liquid investments in its balance sheet as on that date to assess the liquidity position of IL&FS. It is pertinent to note that IL&FS was solvent, as evidenced by the fact that there were parties interested in acquiring IL&FS. The sharp deterioration in financial risk profile and defaults were primarily due to non-rollover of liabilities by the lenders due to higher level of risk perceived by the lenders to IL&FS group as a whole, following defaults in group SPVs.
- n. IL&FS had, in the past, demonstrated its ability to refinance its debt (including rollover of CP) thereby maintaining liquidity. The maturity of CP and other debt instruments was well spread out throughout the year, and CARE looked at IL&FS overall debt obligations and the means through which it would meet them. It is also to be noted that IL&FS had sizeable assets maturing within the 1year time bucket. Such assets were neither considered impaired nor recognized as '*sub-standard*' or '*doubtful*' and did not show up as NPAs in the books of IL&FS, which led to the reasonable conclusion by our client that inflows from assets would happen as per their scheduled maturity.
- o. In September 2018, once it was known that the plans would not materialize as planned, the rating of the debt instruments of IL&FS were downgraded to below investment grade category. Therefore, it is erroneous to allege that the proposed equity infusion was taken for granted by CARE. In fact, the '*Credit watch*' meant that CARE Ratings would take action depending upon the likelihood of the same happening within a reasonable time frame.
- p. In the case of IL&FS, our client started engaging with the top management of IL&FS and IFIN subsequent to defaults by some of the SPVs of ITNL, and the consequential downgrade of the ratings of ITNL in June and July 2018. These defaults pertained to standalone SPVs of ITNL and their obligations were not guaranteed by ITNL or IL&FS. Our client also interacted with IFIN management to discuss Q4FY18 results which were weak, and RBI's notice to IFIN towards meeting CAR and NOF regulatory requirement by March 2019.
- q. While the disclosure on the stock exchange by IL&FS did not mention about approval from the Board for rights issue of ₹4,500 crore, the plan to effect such a fund-raising transaction had been shared with CARE by IL&FS vide its email dated August 14, 2018. This information was shared by IL&FS under the obligation under CRA regulations to give correct and adequate information to CARE. Thereafter, IL&FS issued a press statement on August 29, 2018, wherein it was disclosed that the Board of Directors had approved a Rights Issue of 30 crore equity shares at ₹50 per share aggregating to ₹4,500 crores to shore up the capital. CARE did

not raise any concerns because IL&FS disclosed the same in a press statement and the same was widely reported in the press. did not raise any concerns because the company disclosed the same in a press statement and the same was widely reported in the press. CARE further submits that as a '*Credit Rating Agency*', it cannot be held liable for misrepresentations or wrong disclosures by IL&FS regarding its financial health or otherwise. That responsibility is cast on other agencies including the statutory auditor.

- r. SEBI in its Adjudication Order – Order/SS/AS/2019-20/4523 dated September 18, 2019 examined the issue of non-disclosure of the decision of IL&FS Board in its meeting dated July 21, 2018 and August 29, 2018 regarding raising equity capital by way of *rights issue* and *Specific Asset Disinvestment plan* to reduce the overall debt by ₹30,000 crores, respectively. SEBI in said order found that IL&FS had made disclosure about *rights issue* to '*Credit Rating Agencies*' and about *Specific Asset Disinvestment plan* on its website, however, the said information was not disclosed to the stock exchange i.e. BSE.
- s. As regards the *rights issue*, it was reported in the media (*ET Article dated June 12, 2019*) that LIC and SBI had asked IndusInd Bank to advance a loan to the IL&FS group and had provided assurances to the bank that the said loan would be returned after the ₹4,500 crore rights issue. It has also been reported that following the assurances, IndusInd Bank lent about ₹2,000 crore to the IL&FS Group in June 2018. The rights issue of ₹4500 crore in itself would have aided the liquidity of the company to tide over liquidity requirement in the short term.
- t. It has been widely acknowledged and understood by the market participants, regulators and government bodies that infrastructure financing in India carries an inherent ALM. IL&FS had historically relied on refinancing and rollover of debt as its liabilities matured periodically while assets took longer time to mature. In this background, the slowdown in asset monetization faced by IL&FS was perceived as a normal outcome, and lenders continued to extend funding for refinancing and rollover on the back of tangible assets created by the group and its institutional parentage. It was assumed that once the infrastructure sector revives, asset monetization would gain pace and that would help the group pare down its debt. This was a reasonable expectation to make and linked to the nature of the industry that was being rated.
- u. IL&FS group SPVs also managed to roll over debt from banks thereby reducing the need for the parent to provide funding support. Keeping in view these factors, the ratings were not kept under watch nor was the outlook changed. However, rollovers at SPV level got impacted due to many public sector banks going under the *Prompt Corrective Action* (PCA) framework of

the RBI. Certain SPVs in the road vertical defaulted, building up further pressure on the parent. The ratings of IL&FS were downgraded and placed on credit watch with negative implications in August 2018.

- v. CARE is not in possession of any communication or observations of the RBI as stated in the SCN and therefore it is not in a position to effectively respond to the allegation. CARE is entitled to an inspection of all material relied upon and relevant to the findings and to make further submissions regarding the same. The following response is therefore without prejudice and CARE reserves its right to submit further documents and supplementary response once it has reviewed the RBI report.
- w. The Noticee has applied its mind to the information provided by the Issuers and Management, including publicly available disclosures which IL&FS was legally obliged to make along with taking steps to corroborate the same through interaction with Management and feedback from bankers and auditors of IL&FS. This demonstrates that it had exercised proper professional judgment, in adherence with its operating process and rating methodology, and conducted reasonable diligence to ensure that the Management representations and financial information of IL&FS were reviewed and analyzed for the purpose of undertaking the rating actions with relevant publicly disclosed information and fair and appropriate '*ratings*' were assigned to the instruments of IL&FS. There were no adverse feedback from lenders, auditors and debenture trustee. In light of the past track record of IL&FS and IFIN, there was no reason to expect future defaults by IL&FS and IFIN or extreme weakness in their respective financial position, that could have reasonably given it grounds to anticipate the sudden default by IL&FS as observed in September 2018. The Noticee's rating committees considered various factors that might be an area of concern in the future, and such factors were disclosed in its rating rationales. Therefore, it reiterates that it had exercised proper skill, care and diligence while assigning '*credit rating*' to the instruments issued by IL&FS and IFIN, and have responsibly discharged its duties as a '*credit rating agency*'.

G. Due Diligence

- I. The Noticee was in compliance with applicable regulations and exercised proper '*due diligence*', commensurate with its role as a '*credit rating agency*'. The Supreme Court of India has interpreted the meaning and scope of '*due diligence*' in the matter of *Chander Kanta Bansal v. Rajinder Singh Anand* ((2008) 5 SCC 117), as follows:

"...according to Oxford Dictionary (Edn. 2006), the word "diligence" means careful and persistent

application or effort. "Diligent " means careful and steady in application to one's work and duties, showing care and effort. As per Black's Law Dictionary {18th Edn), "Due Diligence" means the diligence reasonably expected from, and ordinarily exercised by, a person who seeks to satisfy a legal requirement or to discharge an obligation. According to Words and Phrases by Drain-Dyspnea (Permanent Edn. 13-A) "due diligence", in law, means doing everything reasonable, not everything possible "Due Diligence" means reasonable diligence; it means such diligence as a prudent man would exercise in the conduct of his own affairs..."

- II. It is pertinent to mention that the Noticee is not an auditor (*much less a forensic auditor*) and does not/ought not to conduct 'due diligence' consistent with the role of the audit industry. The Noticee formed a *bona fide* opinion on the credit worthiness of IL&FS and its subsidiaries, after thorough review and analysis of the relevant credit strengths and challenges. Its actions in analyzing the creditworthiness of IL&FS and its subsidiaries was reasonable and therefore, liability upon it cannot be imputed. As noted above, diligence in this context requires only doing what is reasonable but not everything possible. That is precisely what the Noticee has done. Hence, in the absence of positive evidence of 'actual malice' in the assignment of the 'rating', or, at the least, gross disregard to stated and applicable methodology, it would be unfair to find fault with it. It must be remembered that 'ratings' are not statements of facts but merely forward looking subjective 'opinions' of a 'credit rating agency' based on its analysis of the available information. In this regard, it is pertinent to note that in the matter of *Price Waterhouse Coopers vs SEBI* decided on September 9, 2019, the SAT observed as under:

"68. From the aforesaid decisions, the principles which can be culled out is that the auditor is required to employ reasonable skill and care but the auditor is not required to begin with suspicion or to proceed in the manner of trying to detect a fraud or a lie, unless some information has reached which creates suspicion. What is reasonable care and skill must depend upon the circumstance of each case. The auditor is not required to perform the functions of a detective. The auditor is a watchdog and not a blood hound. The duty of an auditor is verification and not detection. "

H. Chilling Effect

- a. The judgement on CARE rating as is sought to be made in the SCN is unsustainable since it would violate the very care and nuance adopted in the CRA Regulations, and in particular Regulation 29 thereof. It was also submitted that if the approach adopted in the SCN were to be accepted, there would be a 'chilling effect' on free speech in the field of rating of creditworthiness of issuers or debt – essentially an arbitrary curtailment in the exercise of the fundamental right to free speech and expression.

- b. In *Shreya Singhal vs. Union of India*, (2015) 5 SCC 1, Para 87 to 94, the Hon'ble Supreme Court, after discussing various earlier judgments of the Hon'ble Supreme Court held, inter alia, that the law should not be used in a manner that has *chilling effects* on freedom of speech and expression. Section 66A of the Information Technology Act was struck down as unconstitutional since the reach of the said section so wide that if it were to withstand the test of constitutionality, "*the chilling effect on free speech would be total*".
- c. Adopting the principle, it should be noted that if the approach of the SCN were to be adopted, it would mean that arbitrary reading of the CRA Regulations would be unconstitutional. Each head of the SCN is an expression of judgement on the Noticee's judgement and opinion in form of 'rating'. If every expression of opinion can be questioned in this manner merely because at a subsequent stage, a downgrade is warranted, it would follow that 'credit rating agencies' would face a *chilling effect* and would not speak freely as to what their opinions are. On the other hand, if a constitutionally valid approach were to be adopted, it would only follow that its 'rating' cannot be questioned unless any serious disruption of the integrity is brought to light. The SCN is silent on any such circumstances and in fact calls into question, all past ratings on the basis of the opinion expressed in the SCN. This approach is shunned under Regulation 29 of the CRA Regulations.

I. Hon'ble SAT judgment in the matter of Brickwork Ratings India Private Limited v. SEBI, Appeal No. 439 of 2018:

"6. The AO has found that GPL had defaulted on NCDs due for redemption on December 1, 2014 in spite of which the appellant failed to downgrade the rating to "default" instead of downgrading the rating to "BWR BB-". It was also observed by the AO that the details of the default and restructuring were not mentioned in the Rating Rationale dated February 27, 2015. The AO further found that the mere fact that the said Company GPL subsequently rectified the default did not reduce the gravity of the violation and that the appellant was expected to act swiftly no sooner the default was made.

7. We find that the approach adopted by the AO is not correct. From a perusal of the minutes of the Central Rating Committee ('CRC') we find that the current outstanding balance of NCD of the Company and the Company being in dialogue with the investors for reschedulement was noticed and considered. A conscious decision was taken to downgrade the rating of the Company from "BWR A" to "BWR BB-". No Regulation or Circular has been shown to us by the respondent to indicate that whenever a default is made by a Company the CRA is required to automatically downgrade the Company to "default".

8. Regulation 24(7) of the CRA Regulations 1999 provides as under: -

“24.(1)...

(2) Every credit rating agency shall, in all cases, follow a proper rating process.

...

(7) Every credit rating agency, shall, while rating a security, exercise due diligence in order to ensure that the rating given by the credit rating agency is fair and appropriate.”

9. The aforesaid provision indicates that a CRA is required to exercise due diligence in order to ensure that the rating given is fair and appropriate. In the instant case, we find that a conscious decision was taken by the Central Rating Committee of the appellant and considering the default as well as the dialogue between the Company and with the investors with regard to reschedulement of the default the appellant recommended a revision of rating from “BWR A” to “BWR BB-”. In our opinion due diligence was exercised. Thus, the order of the AO to this extent is not correct and cannot be sustained.”

J. Reply on Specific Allegations –The SCN is broadly divided into four allegations and each of these is exhaustively dealt with in the Reply dated October 15, 2019. The following table is noteworthy:

Sr. No.	Allegations in the SCN	SCN (Para and Pages)	(Para and Pages) of Reply
a.	Excessive reliance placed by the Noticee on the submissions made by the management of IL&FS.	Para 5-9, Pg. 2-4	Para 38-54, Pgs. 24-35
b.	Over reliance on the statements made by management of IL&FS regarding the proposed right issue towards meeting the debt obligations..	Para 10-11, Pgs. 4-5	Para 55 - 61, Pgs. 35- 37
c.	Failure to change the rating outlook or place the rating under credit watch.	Para 12-13, Pg. 5-7	Para 62 - 70, Pgs. 38- 41
d.	Observations of the Reserve Bank of India regarding rapid downgrade of CPs issued by IFIN.	Para 14-15, Pgs. 7 - 9	Para 71-83, Pgs. 41 to 49

12. I have considered the allegations levelled in the SCN, the reply/submissions of the Noticee and the relevant and relied upon material as available on record. Before dealing with the reply of the Noticee on merits, I deemed it appropriate to deal with technical objection raised by the Noticee with regard to supply of documents relied upon in support of the allegations, copy of ‘examination report’ setting out the findings and observations of the examination conducted by SEBI and the request of the

Noticee with regard to inspection of several documents. It is noted from records that the allegations against the Noticee have been levelled on the basis of –

- a) IL&FS disclosure to BSE dated July 21, 2018.
 - b) Copy of e-mail dated July 23, 2018 by IL&FS forwarded to the Noticee informing about the decision taken by its Board of Directors in meeting dated July 21, 2018.
 - c) Press Statement dated August 29, 2018 made by the IL&FS on website.
 - d) IL&FS disclosure to BSE dated August 29, 2018.
 - e) Rating Committee Notes of the Noticee dated September 29, 2017, October 25, 2017, January 19, 2018, March 22, 2018, May 04, 2018, August 14, 2018 and September 17, 2018 w.r.t. IL&FS.
 - f) Press Release dated May 10, 2017, October 09, 2017, January 23, 2018, March 22, 2018 and May 09, 2018 w.r.t. IL&FS.
 - g) Rating Methodology adopted by the Noticee.
 - h) Auditor Report for Financial Year 2015-16 and 2016-17 w.r.t. IL&FS.
 - i) SEBI Letter dated October 04, 2018 to CARE seeking comments.
 - j) CARE letter dated October 10, 2018.
 - k) SEBI Letter dated November 14, 2018 to RBI.
 - l) RBI letter dated November 22, 2018 to SEBI.
13. It is also noted that the copies of all the aforesaid documents have been provided to the Noticee during inspection of documents on September 06, 2019. It is pertinent to mention that charge in this case is not based upon any formal inspection under Regulation 29 of the CRA Regulations rather the same is based upon examination of information and material available to SEBI, including the documents available in the public domain and the documents within the possession and knowledge of the Noticee itself. Further, the observations found during examination undertaken by SEBI that are the basis of allegation and charges are clearly spelt out in the SCN. Since that has been done and copies of all the relied upon documents had been provided to the Noticee to enable it to file its reply, in my view, the principle of natural justice has been duly complied with, in this case. Thus, in my view, no prejudice is caused to the Noticee, if SEBI has not provided it with copy of examination report containing the observations of the examination undertaken in the matter. This view also finds support from the following judgment of Hon'ble SAT on the similar issue in the case of *Manoj Gaur Vs. SEBI, in Appeal Number 64 of 2012* decided on October 03, 2012: -

"The investigation report is not the evidence on which reliance was placed by the adjudicating officer. Since the adjudicating officer has complied with the statutory requirements, there is no legal obligation on the Board to furnish the entire investigation report to the appellants. Learned counsel for the parties have relied on certain

case law relating to principles of natural justice. We do not consider it necessary to refer to all those details in view of the fact that regulation 9 of the Regulations makes it obligatory to communicate the findings in the investigation report and not the whole report. It is nobody's case that such findings were not made available. If the procedure laid down in the regulations has been followed by the adjudicating officer, the grievance of violation of principles of natural justice is without any foundation."

14. In this context, it is pertinent to mention that while dealing with similar arguments as raised by the Noticee, Hon'ble SAT, vide its order dated May 12, 2017 in *Satyam Computers case*, considered the order dated January 10, 2017 passed by Hon'ble Supreme Court in the matter of *Price Waterhouse case* and held and clarified that observations made by Hon'ble Supreme Court were general directions given as and by way of clarifications without going into the merits of the case and the same cannot be said to be the ratio laid down by Hon'ble Supreme Court applicable to all other cases. [Para 21 page 40 of the order]. It is also relevant to note that Hon'ble Supreme Court in the matter of *Kamwar Natwar Singh v. Directorate of Enforcement [(2010) 2 SCC 497]*, has held that "...Even the principles of natural justice do not require supply of documents upon which no reliance has been placed by the Authority to set the law into motion. Supply of relied on documents based on which the law has been set into motion would meet the requirements of principles of natural justice..." Further, in the matter of *Chandrama Tewari Vs. Union of India, Through General Manager, Eastern Railways, (1988) 1 SCR 1102*, Hon'ble Supreme Court has held that it is not necessary that each and every document must be supplied to the Noticee facing charges. Only material and relevant documents are necessary to be supplied to him. If a document, even though mentioned in the Memo of charges, is not relevant, or if it is not referred to or relied upon by the adjudicating officer or the punishing authority in holding the charges as proved against the Noticee, no exception can be taken to the validity of the proceedings on the ground of non-supply of the copy of such documents. As the Noticee has been given reasonable opportunities to file written representation and opportunity of personal hearing as per the Adjudication Rules, I am of the view that no prejudice has been caused to the Noticee, if documents not relied upon and internal examination observations were not provided to it.
15. 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. The said Act is pre-eminently a social welfare legislation seeking to protect the interests of common men who are small investors.

41. 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.

16. Further, a beneficial statute has to be construed in its correct perspective so as to fructify the legislative intent and provision in the statute granting incentives for promoting growth and development should be construed liberally, so that real object of such enactment is not frustrated - *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 in the perspective favouring the securities market and investors having regard to ‘teleological purpose and protective intendment’ of the legislation.
17. Keeping the above principle in mind, in order to give purposeful meaning to the terms used in CRA Regulations, the scheme of the SEBI Act and ‘measures’ taken thereunder need to be seen as a whole and not in fragmented manner. It is also deemed necessary look into the background of ‘credit rating’ requirements necessitated by Regulators so as to understand the entire gamut and scope of responsibilities and accountability of ‘Credit Rating Agencies’. The preamble of the SEBI Act describes the object of SEBI (Board) 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. Section 11(1) broadly prescribes the same objectives as duty of the Board established under Section 3 of the said Act and empowers the Board to take such ‘measures’ as it thinks fit for carrying out those objectives and duties. It is relevant to mention here that, shortly after its establishment as statutory expert body, SEBI had issued “Guidelines for Disclosures and Investor Protection” vide its circular No. PMD/Cir.4545/92 dated June 11, 1992 (Clause F) and clarification thereto vide circular No. PMD/Cir.4730/92 dated June 18, 1992. (Clause G). These Guidelines / clarification had mandated the compulsory ‘credit rating’ of debentures including NCDs where maturity exceeded 18 months. In addition, vide its circular No. PMD/Cir. 9317/92 dated September 29, 1992, SEBI issued “Guidelines for

to Developmental Financial Institutions for Disclosures and Investor Protection” (Clause H) whereby it again mandated compulsory ‘credit rating’ of debentures and bonds issued by companies/corporations/institutions that are engaged mainly in developmental activities and which play a catalytic role in the industrial/infrastructural development of the country.

18. In pursuit of orderly development of debt/bond market the Central Government and respective sectoral regulators have, from time to time, taken several ‘measures’. Vide circular F. NO.1/10/SE/94 dated July 20, 1994, Government of India, Ministry of Finance laid down policy for listing of privately placed debt securities issued by companies and Financial Institutions in order to create a broader and more liquid market for privately placed debt securities issued by such companies/financial institutions. By this circular the Central Government exempted all categories of pure debt securities from the requirements of Rule 19 (2)(b) of the Securities Contracts (Regulation) Rules, 1957 (which applies for listing of securities on any recognized stock exchange) subject to the condition that such securities shall carry a ‘credit rating’ of not less than investment grade from any of the then existing ‘credit rating agencies’ namely, *The Credit Rating Information Services of India, Ltd.*, *Investment Information and Credit Rating Agency of India Ltd.*, and *Credit Analysis and Research Ltd.* The list of such pure debt securities included NCDs, the non- convertible portion of partially convertible debentures (PCDs), deep discount bonds and commercial paper. It was further clarified that the privately placed debt securities already issued but not rated could also be listed on the stock exchange after obtaining the requisite ‘credit rating’. This policy was laid down with the view that the requirement of obtaining at least an investment grade ‘credit rating’ for securities sought to be listed on the stock exchange would ensure protection of the interest of investors and the listing of privately placed securities on the stock exchange was expected to promote the development of an orderly and liquid secondary market for such debt securities.
19. The aforesaid requirement was subsequently consolidated in the 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 measure for investor protection and for orderly development of the bond market. Apart from this SEBI also took several measures by issuing circulars with respect to issue, listing and trading of debt securities. For example, in order to provide the greater transparency in issuance and listing of privately placed corporate debt securities and to protect the interest of the investor, vide circulars no. SEBI/MRD/SE/AT/36/2003/30/09 dated September 30, 2013 and SEBI/MRD/SE/AT/46/2003 dated December 22, 2003, SEBI had laid down certain requirements including the mandatory ‘credit rating’ of not less than investment grade. Those requirements were applied with regard to already listed privately placed debt securities of the companies including PSUs as well. Consequent to these developments the Central Government had withdrawn its aforesaid circular dated July 20, 1994.

20. In view of growing importance of corporate bond market in national economy, SEBI had taken several steps based upon the *Report of High Level Expert Committee on Corporate Bonds and Securitization* of 2005. In order to facilitate development of a vibrant market for corporate bonds in India, the SEBI (Issue and Listing of Debt Securities) Regulations, 2008 (ILDS Regulations) were notified. The ILDS Regulations, while provided certain relaxations, it emphasized adequate information disclosures, due diligence by involved intermediaries and more importantly ‘*credit rating*’ as the cornerstones of transparency and investor protection. As per Regulation 4(2)(c) of the ILDS Regulations for public issue of debt securities the ‘*credit rating*’ should be obtained from at least one ‘*credit rating agency*’ registered with the Board and should be disclosed in the offer document. In terms of Regulation 20(b) of the ILDS Regulations for debt securities issued on private placement basis ‘*credit rating*’ should be obtained from at least one ‘*credit rating agency*’ registered with the Board. Further, Regulation 23 of the ILDS Regulations requires that - “*Every rating obtained by an issuer shall be periodically reviewed by the registered credit rating agency and any revision in the rating shall be promptly disclosed by the issuer to the stock exchange(s) where the debt securities are listed.*” Similar requirements were prescribed in the applicable listing agreements. Subsequently, by Regulation 55 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015 it was re-emphasised that - “*Each rating obtained by the listed entity with respect to non-convertible debt securities shall be reviewed at least once a year by a credit rating agency registered by the Board*”.
21. Commercial Paper (CP) is an unsecured money market instrument issued in the form of a promissory note and regulated by the Reserve Bank of India (RBI). CP as a privately placed instrument, was introduced in India in 1990 with a view to enabling highly rated corporate borrowers to diversify their sources of short-term borrowings and to provide an additional instrument to investors. The RBI directives and guidelines issued from time to time under the Reserve Bank of India Act, 1934 also mandate ‘*credit rating*’ for issuance of CP from either the Credit Rating Information Services of India Ltd. (CRISIL) or the Investment Information and Credit Rating Agency of India Ltd. (ICRA) or the Credit Analysis and Research Ltd. (CARE) or the FITCH Ratings India Pvt. Ltd. or such other credit rating agency (CRA) as may be specified by the RBI from time to time, for the purpose. The Insurance Regulatory and Development Authority, vide its IRDA (Investment) Regulations, 2000 has also mandated all insurers to make investments in specified securities graded by a reputed and independent ‘*credit rating agency*’.
22. It is also pertinent to mention that prior to 1995 the regulatory framework for registering and regulating the activities and conduct of ‘*credit rating agencies*’ was missing. With effect from January 25, 1995 section 11(2)(ba) of the SEBI Act was amended so as to include *registering and regulating* the working of ‘*credit rating agencies*’ as one of the ‘*measures*’ referred to in section 11(1). Section 12(1A) was

inserted to provide a negative mandate for the '*credit rating agencies*' to act as such only in accordance with the conditions of a certificate of registration obtained from the Board in accordance with Regulations made by the Board. Though the provisions of section 12(1A) existed in the SEBI Act since 1995 there was no regulatory framework for regulation of the '*credit rating agencies*' till SEBI framed the CRA Regulations in 1999. It is also seen that the provisions of section 11(2) (ba) and section 12(1A) of the SEBI Act are co-terminus and must be interpreted to mean that the '*credit rating agencies*' that are registered and regulated by the Board under the CRA Regulations must also carry on their activities in furtherance of the aforesaid twin objectives of promoting orderly and healthy development of the securities market and for protecting the interest of the investors.

23. Regulation 2(1)(h) defines the expression '*credit rating agency*' as a "*body corporate which is engaged in, or proposes to be engaged in, the business of rating of securities offered by way of public or rights issue*". However, being the beneficial legislations the SEBI Act as amended with effect from January 25, 1995 and CRA Regulations would apply with regard to debt securities issued and listed prior to coming into force of the said amendment to SEBI Act and commencement of the CRA Regulations and the '*credit rating agency*' which has rated the debt securities of the issuers prior to the commencement of the CRA Regulations would be under obligations to comply with the provisions thereof including the code of conduct and all other prudential norms applicable to its '*rating*' activities whether the securities are issued to public or not. Further, as the '*rating*' obligations mandated under the aforesaid policies is a continuous obligation, the prescribed due diligence, independent assessment/ evaluation, monitoring of assigned '*ratings*' and creditworthiness of the issuers shall apply at all times till the obligation under the rated securities is outstanding or the issuer is wound up, whichever is earlier. Accordingly, SEBI can, at any time, look into the conduct of the '*credit rating agency*' so as to examine whether it has complied with its obligations or not. Any such examination, inspection or enforcement action cannot be construed as an action in hindsight as sought to be contended by the Noticee.
24. As regards the argument regarding the definition of '*rating*', it is pertinent to say that this word has to be understood in the context of the expressions '*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 purport or role of a '*credit rating agency*', 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;*". It is gainsaying that SEBI has made aforesaid regulations and has taken '*measures*' which were meant to sub-serve the interest of investors as also promote and regulate

the securities market. The CRA Regulations which are directly connected and concerned with the debt securities and financial instruments cannot be read in isolation and must be read and interpreted in the context in which they apply and operate i.e. the issuance, 'credit rating' and listing of debt securities by companies/institutions/corporations. 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 pedantic or lexicographic approach. Any attempt to truncate all-embracing scope and meaning of 'credit rating', would be to violate its widest possible amplitude and magnitude as enshrined in the SEBI Act, 'measures' taken by SEBI for development of corporate debt market and investors protection. The 'credit rating' is an ongoing and dynamic concept and it encompasses many aspects and dimensions and it cannot be cribbed, cabined and confined within traditional and doctrinaire limits of the definition of 'rating' with relation to merely an 'expression of opinion by symbols' with a grammatical approach.

25. It is settled position that while interpreting social –economic welfare legislations, there should be more concern with the colour, the context and the content of the statute rather than its literal import. 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 at paragraph no. 33 has stated as to how statute should be construed after ascertaining legislative intent and in the context and scheme of the Act. Said paragraph no. 33 reads as under:

"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." (Also see JASBIR SINGH v. VIPIN KUMAR JAGGI & ORS. - (2001) 8 SCC 289).

26. In Bhavnagar University vs. Palitana Sugar Mill (P) Ltd. & Ors. - (2003) 2 SCC 111 in paragraphs 23, 24 & 25, Hon'ble Supreme Court observed thus:

"23. It is the basic principle of construction of statute that the same should be read as a whole, then chapter by chapter, section by section and words by words. Recourse to construction or interpretation of statute is necessary when there is ambiguity, obscurity, or inconsistency therein and not otherwise. An effort must be made to give effect to all parts of the statute and unless absolutely necessary, no part thereof shall be rendered surplusage or redundant.

24. True meaning of a provision of law has to be determined on the basis of what it provides by its clear language, with due regard to the scheme of law.

25. Scope of the legislation on the intention of the legislature cannot be enlarged when the language of the provision is plain and unambiguous. In other words, statutory enactments must ordinarily be construed according to its plain meaning and no words shall be added, altered or modified unless it is plainly necessary to do so to prevent a provision from being unintelligible, absurd, unreasonable, unworkable or totally irreconcilable with the rest of the statute."

27. It is, thus, clear that the provisions of the CRA Regulations need to be looked at as a whole in setting of the entire 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 sectoral regulators. Further, in order to give purposeful meaning to any term the entire scheme of the SEBI Act and the CRA Regulations must be considered. In order to understand the scope of 'credit rating' it is necessary to take into account the role of 'credit rating agency' in 'credit rating' of a debt securities and any financial instruments. It is also pertinent to note that the relevant Regulations of CRA Regulations contemplate principle –based approach for conduct obligations of registered 'credit rating agencies' so as to achieve regulatory objectives and for addressing new challenges and risks that may arise in the process of dynamic growth and development of the debt market. Further, considering the developments taken since the CRA Regulations came into the force before two decades and continuing an ongoing role and accountability of 'credit rating agencies', the definition of 'credit rating agency' and 'rating' should be interpreted adopting the dynamic theory and the meaning should be given 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 as a 'living tree approach'.

28. 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.
29. The '*credit rating*' is effectively a pre-requisite for bond market access and also the minimum requirement for listing a corporate debt on the stock exchange. It has been well recognized and accepted position that '*credit rating*' quality has become the main criteria for investment in corporate bonds. In the contemporary situations, the '*credit rating agency*' play a crucial and important catalytic role in fostering the growth of the capital markets. A '*credit rating agency*' goes through thoroughly into all the relevant information before it announces its '*rating*' value. The '*credit rating*' is expected to encapsulate the analysis of the financials of the company, its strengths and weaknesses, its competitive position in the industry, and its future prospects. Thus, the '*credit rating agency*' accesses the financial strength of the borrowers/ issuers, specially their ability to pay the principal and interest on their debt. Therefore, '*terms*' and '*expressions*' used in the CRA Regulations must be interpreted in the context of the functional role in the contemporary situation instead of the mechanical and grammatical approach as sought to be contended by the Noticee. In my view, the code of conduct obligations and degree of due diligence required from a '*credit rating agency*' as statutory obligations under the CRA Regulations do not have a '*chilling effect*' on free speech in the field of rating nor do have an arbitrary curtailment in the exercise of the fundamental right to free speech and expression as sought to be argued. I have perused the judgment in *Shreya Singhal vs. Union of India*, (2015) 5 SCC 1, Para 87 to 94, wherein Hon'ble Supreme Court held, *inter alia*, that the law should not be used in a manner that has *chilling effects* on freedom of speech and expression. This judgement was delivered in the context of which made sending of information that is grossly offensive or has menacing character or which, being false, is sent for causing annoyance, inconvenience, insult or injury etc. In that case the advocacy and incitement was discussed and distinguished. It was held that discussion and advocacy are the core of freedom of speech and expression, even if they cause annoyance, inconvenience or grossly offend, etc., they cannot be curbed by law. Accordingly, section 66A of the Information Technology Act was struck down as unconstitutional. In my view this judgement of Hon'ble Supreme Court has been delivered in different context and does not curb or inhibit the application of the CRA Regulations.

30. 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. The fundamental freedom of speech and expression of a ‘*credit rating agency*’ while assigning a ‘*credit rating*’ to any financial instrument is not absolute and is always subject to the statutory obligations under the SEBI Act and the CRA Regulations. The ‘*standard symbols*’ assigned by a ‘*credit rating agency*’ with regard to a security cannot be construed merely ‘*a symbol*’ or ‘*merely expression of opinion*’ as sought to be argued. These ‘*standard symbols*’ are of considerable significance as the investors in the corporate bond market rely largely on those ‘*rating symbols*’ which are assigned by the professional ‘*credit rating agencies*’ after a qualitative and independent evaluation of the creditworthiness of the instrument and the issuers thereof. Such ‘*rating symbols*’ are considered as indicators of the creditworthiness as well the risk. 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.

31. In context of role and responsibilities of the ‘*credit rating agencies*’ in securities market it is pertinent to refer to the following extracts from the “*Statement of The Technical Committee of the International Organization of Securities Commissions*” dated 25 September 2003-

“Credit rating agencies (CRAs, or ratings agencies) issue opinions on the future creditworthiness of a particular company, security or obligation as of a given date. These opinions tend to be relied upon by investors, lenders, and others, and, accordingly, CRAs can have an effect on securities markets in a variety of ways. Credit ratings can affect issuers’ access to capital, influence the structure of financial transactions, and determine the types of investments fiduciaries and others can make. Some regulators use the ratings issued by CRAs for various regulatory purposes.

Given the influence CRA opinions can have on securities markets, the activities of CRAs are of interest to investors, lenders, issuers and securities regulators alike. The core objectives of securities regulation, as described by IOSCO’s “Objectives and Principles of Securities Regulation,” are protecting investors, ensuring that securities markets are fair, efficient, and transparent, and reducing systemic risk. In offering informed, independent analyses and opinions, CRAs contribute to achieving these objectives.

Rating agencies that the market recognizes as credible and reliable can play a valuable role in global securities markets....”

32. Going further in the scheme of the CRA Regulations it is noted that Chapter III provides for the general obligations of the ‘*credit rating agencies*’. Regulation 13 obligates the ‘*credit rating agency*’ to abide by the code of conduct contained in the Third Schedule. Regulation 14 provides for an agreement between the ‘*credit rating agency*’ and its clients and contents thereof. Regulation 14(d) obligates the client

to cooperate with the ‘*credit rating agency*’ and provide true, adequate and timely information. This regulation also envisages for the ‘*credit rating agency*’ to arrive at, and maintain, “*a true and accurate rating*”. Regulation 15 provides for the obligation of a ‘*credit rating agency*’ to continuously monitor the rating of debt securities rated by it. The ‘*credit rating agency*’ is further obligated to disseminate and disclose the information regarding newly assigned ‘*rating*’ and changes in earlier ‘*ratings*’ promptly. Regulation 16 provides for periodic review of all published ‘*ratings*’ during the lifetime of the securities. It further provides that if a client does not cooperate with a ‘*credit rating agency*’ in monitoring of the ‘*rating*’ the ‘*credit rating agency*’ must carry out the review on the basis of best available information or in the manner as specified by the board and disclose to the investor that ‘*rating*’ is so based. Regulation 17 requires the ‘*credit rating agency*’ to frame appropriate internal systems and procedures for monitoring the ‘*rating*’ of securities by its employees. Regulation 18 obligates the ‘*credit rating agency*’ to make the definition of the concerned ‘*rating*’ public along with the ‘*symbol*’ and also state that the ‘*rating*’ do not constitute a recommendation to buy, hold or sell a security. Regulation 19 obligates the ‘*credit rating agency*’ to submit information to the Board. Regulation 20 requires it to comply with the circulars, guidelines, directives and instructions issued by the Board from time to time. Regulation 20A provides for appointment of a compliance officer who is responsible for the compliance of the securities law. Regulation 21 deals with maintenance of book, accounts and records *inter alia* with regard to rating assigned to various securities, rating notes of rating committee, record of decisions of rating committee and letter assigning ‘*rating*’, etc., Regulation 22 provides for obligation of ‘*credit rating agency*’ to rectify the deficiency, if any, in the auditor’s report and Regulation 23 provides for the confidentiality of the information between ‘*credit rating agency*’ and its client.

33. It is very important to mention that Regulation 13 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*’. Some of the important benchmarks/ Code of Conduct in the said Third Schedule are as under:

- a. Clause 1 requires a ‘*credit rating agency*’ to make all efforts to protect the interest of investors.
- b. Clause 2 of requires a ‘*credit rating agency*’ to observe **high standards** of ‘*integrity*’, ‘*dignity*’ and ‘*fairness*’ in the conduct of its business.
- c. Clause 3 obligates ‘*credit rating agency*’ to fulfill its obligations, ‘*prompt*’, ‘*ethical*’ and ‘*professional*’ manner.
- d. Clause 4 mandates that a ‘*credit rating agency*’ shall ***at all times exercise due diligence, ensure proper care and exercise independent professional judgment in order to achieve and maintain objectivity and independence in the rating process.***

- e. Clause 5 provides that a ‘*credit rating agency*’ shall have reasonable and adequate basis for performing **rating evaluations**, with support of appropriate and in depth rating researches.
 - f. Clause 6 mandates a ‘*credit rating agency*’ to have in place a rating process that reflects **consistent and international rating standards**.
 - g. Clause 8 provides that 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***.
34. 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***”.
35. The ‘*credit rating agency*’ accesses the probability of default with respect to specific debt securities and the issuer. From the above regulatory scheme, it is noted that while the agreement 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. Regulation 24(7) as it is worded and intended requires the ‘*credit rating agency*’ to give ‘*fair and accurate credit rating*’ after exercising ‘*due diligence*’. 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 aforesaid 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 supplement to the aforesaid Code of Conduct and the regulatory requirements rather than to supplant them.
36. Thus, the regulatory scheme is clear that first and foremost obligation of a ‘*credit rating agency*’ is to make all efforts to protect the interest of investors. As per the CRA Regulations, the ‘*credit rating agency*’, at all times and in all circumstances, remains under obligation to give *true*, ‘*accurate*’, ‘*fair*’ and ‘*appropriate*’ rating and in order to fulfil such obligation the higher standards of due diligence, integrity, dignity, fairness, care, etc. are expected from it. The words ‘*true*’, ‘*accurate*’, ‘*fair*’ and ‘*appropriate*’ with

regard to obligation for giving or of much significance and they expect higher degree of skill, care and diligence from the ‘*credit rating agency*’. Thus, the ‘*credit rating agency*’ is not merely to accept mechanically the information given by its client but is also required 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. The obligations to exercise independent professional judgment in order to achieve the objectivity and independence in the rating process requirements requiring reasonable and adequate basis for performing rating evaluations with the support of appropriate and in depth rating researches coupled with ability to use available information and the obligation of exercising due diligence, proper care and ethics, clearly negate the argument of the Noticee that discharge of its obligation is substantially 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. The above scheme of the CRA Regulations does not necessarily require proof of *mala fide* 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. In view of these findings, I hold that the judgment in the case of *Chintalapati Srinivas Raju* is of no help to the Noticee.

37. In my view, the ‘*credit rating agency*’ is expected to provide an independent evaluation of the creditworthiness of the debt securities issued by the issuers. The independent, comprehensive and objective analysis and judgment about the debt instrument and subsequent and impartial assessment and judgment of default risk by a professional ‘*credit rating agency*’ offer several benefits to the economy, bond market, the borrower and the investors both domestic and foreign. Any other interpretation as sought to be contended would render the CRA Regulations unintelligible, unreasonable, unworkable and irreconcilable with the object of the SEBI Act and the CRA Regulations.
38. The Noticee has submitted that the *due diligence* must follow the dictum of ‘*trust but verify*’ and not the dictum of ‘*distrust and investigate*’. Further, like in the case of a merchant banker, a ‘*credit rating agency*’s role in a market is not that of an investigator, who is to proceed with distrust on the information provided by the issuer. It is also settled position that ‘*due diligence*’ means careful and persistent application or effort. It requires careful and steady in application to one’s work and duties, showing care and 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. It means such diligence as a prudent man would exercise in the conduct of his own affairs. With regard to such obligations of ‘*credit rating agency*’, it is relevant to mention that a ‘*credit rating agency*’ plays a crucial and pivotal role not only to further its or its client’s interests but also to protect the investors and securities market at large.

Often, it has been observed that this duty to exercise due care and diligence has come in conflict with the pecuniary interests of the intermediary. It is seen that it has been a consistent stand of the Hon'ble SAT to seek a balance while dealing with such conflicting interests, with a justifiable tilt in favour of the larger interest of the securities market. In *JM Mutual Fund and JM Capital Management Private Limited Vs. SEBI* [SAT order dated 22.11.2004] Hon'ble SAT 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 457 as 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."

39. Thus, the obligation of 'due diligence' varies according to a given situation and the same cannot have hard and fast rule or straightjacket method or absolute standards or any single sacrosanct nature for determination of 'due diligence'.
40. The Noticee has contended in its reply that in terms of provisions of Regulation 14(d) it is the obligations of issuer to cooperate with the 'credit rating agency' to enable it to formulate its rating. The allegation of 'excessive reliance' is not only contrary to the scheme of the CRA Regulations but also is inherently vague. The submissions of the Noticee in this regard though attractive in the first blush but the closer scrutiny of the overall scheme of the CRA Regulations as above would show otherwise. In terms of Regulation 14(d), the obligation is to write an agreement between the 'credit rating agency' and its client whereby the client is under the obligation to cooperate with 'credit rating agency' and to provide it true, adequate and timely information. Under this Regulation, the reasonable and legitimate obligation of the 'credit rating agency' remains that it has to arrive at and maintain, a 'true' and 'accurate' rating. 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. Such obligations is much more than that. 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'. This apart, the specific and very important obligation of the 'credit rating agency'

to have in place the rating process that reflects consistent and international rating standards further expects higher and special degree of ‘*due diligence*’ from a ‘*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*’ and ‘*promptitude*’ 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 with the support of appropriate and in depth rating researches and using rating processes that reflect consistent and international rating standards {*Regulation 13 read with Third Schedule and Regulation 24(7)*}. It is in the context of determining such legitimately expected ‘*due diligence*’ that the expression ‘*excessive reliance*’ has been used in the SCN. What it actually contemplates and envisages is that - the Noticee failed to exercise independent professional judgement in order to ‘*achieve and maintain*’ *objectivity and independence in the rating process*. In my view, while applying the CRA Regulations, which have *bona fide* purpose of investors’ protection and orderly development of securities market, the object of the Regulations should not be pushed aside giving way to mere technicalities and any measure in the interest of the investors which would pass the legal tests provided in the Regulation should be welcome. It is obligatory upon the Regulator to apply the law keeping in mind the objective and purpose of the Regulations and it must evince rational interpretation and not be influenced by moral propensity.

41. The *due diligence* expected from a merchant banker has to be seen in the context of the activities of a merchant banker. A merchant banker, while discharging its activities as such in the issue process or other specified activities, is obligated to exercise independent professional judgment and owes a crucial responsibility towards protection of interests of investors and not merely to further its commercial purpose for pecuniary benefits. Thus, its role is also not limited to just receive information from issuers or its management and simply ‘trust and verify’ without applying its independent professional judgement. In the case of ‘*credit rating agencies*’, the ‘*due diligence*’ obligations in Third Schedule of the CRA Regulations are much wider than the ‘*due diligence*’ obligations of a merchant banker under the SEBI (Merchant Bankers) Regulations, 1992 as discussed hereinabove. Further, 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 times. The power of SEBI to examine such compliance obligations is not limited to look only prospectively. If it is observed that the ‘*credit rating agency*’ has failed in exercise of its obligations in the past SEBI can look into the same for the appropriate action in the interest of the investors and securities market. Therefore, it is not correct to say that the instant adjudication of alleged violations of the CRA Regulations is in hindsight as sought to be contended by the Noticee. It is well settled in the above mentioned *Ajay Agrawal* judgment that action can be taken by the Board for past defaults if on the

date of order the power to pass order exist. I, therefore, do not agree with submissions of the Noticee in these regards.

42. Another submission of the Noticee is that in terms of Regulation 29(3) of the CRA Regulations the judgment of a '*credit rating agency*' must not be called into question on the ground of *appropriateness of the assigned rating*. It is only when complaints of a '*serious nature*' arise that an inspection may be ordered. Even for such inspection care has been taken to stipulate that the officers of SEBI or the independent experts, as the case may be, who conduct such inspection must have relevant experience. At the first place as seen from the SCN, SEBI has not sought to examine the *appropriateness of the assigned rating* on merits. In this case, SEBI has examined whether the Noticee has exercised *due diligence* in the rating of the NCDs of IL&FS. The charge is for inquiry and adjudication as to whether the Noticee has failed to observe the obligations under Regulation 24 (7) and Clause 4 and 8 of Code of Conduct read with Regulation 13 of the CRA Regulations in the facts and circumstances as observed during the examination by SEBI. Further, such embargo, if any, is applicable only during inspection of the '*credit rating agency*'. In this case SEBI has not ordered any inspection and Regulation 29 does not apply accordingly in this case. The instant proceedings have been initiated under Chapter VIA of the SEBI Act based upon the examination of information as mentioned hereinabove. The power to initiate inquiry and adjudication is not necessarily to be preceded by an inspection under Regulation 29. Under the plenary power in the SEBI Act, it is the choice and discretion of the Board to take any appropriate enforcement action at any stage, if it is *prima facie* satisfied that the '*credit rating agency*' has contravened any of the provisions of the CRA Regulations. Once it is *prima facie* found that '*credit rating agency*' has failed to comply with the conduct regulations as mentioned above it need not order inspection and right away initiate appropriate enforcement action. I, therefore, do not find merit in these submissions of the Noticee.

43. It is also pertinent to mention that the events that occurred in the year 2009 in the global financial system had underlined the pivotal role that *credit ratings* play in debt markets. In the wake of the same and in order to impart higher credibility to the processes and procedures associated with the *credit rating*, SEBI, vide Circular Number CIR/MIRSD/CRA/6/2010 dated May 03, 2010 specified several transparency and disclosure norms for '*credit rating agencies*'. Those prescriptions included detail requirements with regard to '*rating process*', '*rating procedures*', '*default studies*' and '*disclosures*'. It emphasised that default studies are central to evaluating the performance of a '*credit rating agency*' and whether its ratings can predict default over a period of time. In order to promote transparency and to enable the market to best judge the performance of the ratings, the '*credit rating agencies*' were directed to publish information about the historical default rates of rating categories and whether the default rates of these categories have changed over time, so that the public can understand the historical performance of

each category and if and how rating categories have changed, and be able to draw quality comparisons among ratings given by different '*credit rating agencies*'. Thus, it is clear that the standards of compliance obligation of '*credit rating agencies*' in Third Schedule read with regulation 13 and Regulation 24(7) are much higher than those for any other intermediary.

44. When seen in the context of CRA Regulations as discussed above, the '*credit rating agencies*' are also under a very important obligation to have in place a rating process that reflects consistent and international rating standards. By aforesaid circular dated May 03, 2010 it was also obligated that the '*credit rating agencies*' should disclose the compliance status of each provision of IOSCO code of conduct. These requirements are though not charged as violation in this case, they are relevant for determining the overall *due diligence* obligations of the Noticee in the facts and circumstances of the instant case. It is noted that The '*IOSCO CRA Principles*' *inter alia* address following key objectives to promote informed, independent analyses and opinions by '*credit rating agencies*':

- **Quality and integrity of the rating process:** *credit rating agencies* should endeavour to issue opinions that help reduce the asymmetry of information among borrowers, lenders and other market participants.
- **Transparency and timeliness of ratings disclosure:** *credit rating agencies* should make disclosure and transparency an objective in their ratings activities.

45. The international standards adopted by '*credit rating agencies*' include the 'distance to default' and the 'probability of default' as the essential credit risks in the financial markets. Such assessment of credit risks provides an estimate of the likelihood that an issuer will be unable to meet its debt obligations. It is crucial for the '*credit rating agencies*' to know which parameter effects more on 'distance to default' and the 'probability of default' so that investors will prevent future risks.

46. In my view, if the interpretation on the basis of prescriptive approach as forwarded on behalf of the Noticee is adopted it will lead to make application of regulatory scheme too constrictive and will defeat the object and purpose of the SEBI Act and the CRA Regulations. I also hold the view that such an interpretation will create hindrance in achieving regulatory objectives and would enable the '*credit rating agencies*' to be lax in their important statutory obligations.

47. Having dealt with all technical submissions and those on regulatory overview and architecture and now coming to the merit of the case to determine as to whether the Noticee had duly complied with Regulation 24(7) and Clauses 4 and 8 of Code of Conduct for the '*credit rating agencies*' read with Regulation 13 of the CRA Regulations, it is noted that the allegations in this case are levelled in the

background of default committed by IL&FS and its subsidiary IFIN on their obligations in respect of the CP, ICD and also default on interest payments on its NCDs and the role of the Noticee in assigning rating to various NCDs of IL&FS. It was observed that IL&FS had defaulted on its obligations in respect of the CP issue and ICDs which was due on September 14, 2018. The said CP was rated by the Noticee, among other CRAs. Subsequently, IL&FS also defaulted on the interest payments on its NCDs on September 17, 21, 26 and 29, 2018. Further, the Noticee had downgraded the ratings of the NCDs issued by IL&FS on various occasions as described in the SCN.

48. The Noticee has claimed that it was continuously monitoring the IL&FS and its group companies, was meeting with top management of IL&FS and the information's regarding right issue of ₹4,500 crore was extensively reported in media. It is established fact that the decision of IL&FS with regard to equity infusion by way of rights issue amounting to ₹4,500 cores taken on July 21, 2018 was informed to the Noticee by IL&FS but the said material information was not disclosed to the stock exchange by it. It is matter of common prudence that whenever a listed entity comes with a right issue it has to promptly disclose the same to the stock exchanges. When the Noticee was informed by IL&FS about the approval of the said right issue by IL&FS, it has not put any effort to verify the same from the stock exchange. When IL&FS made the claim about its said right issue and *Specific Asset Disinvestment plan* to reduce its overall debt by ₹30,000 crores on August 29, 2018 *via* a disclosure on its web site and informed the Noticee about the same, the Noticee again did not verify the truth and veracity from the disclosures made on stock exchange. As a reliable 'credit rating agency' it would be prudent to verify the information received from the publicly disclosed information. I also note that the disparity in the disclosures made by IL&FS in its Press Statement and the information submitted to BSE in this case had resulted in information asymmetry, and that should have triggered a 'red flag' to the Noticee, being a registered 'credit rating agency' for rating the IL&FS and its debt instruments. In my view the Noticee lacked in exercising reasonable prudence of responsible *credit rating agency* and was lagging in exercise of desired due diligence.

49. In terms of allegation regarding the Noticee failure to take appropriate timely action by way of reduction in the ratings assigned to NCDs issued by IL&FS, as due date of payment of the CP maturing on September 14, 2018 was near and the rights issue was being delayed substantially. The Noticee submitted that the maturity of CP and other debt instruments of IL&FS was well spread out throughout the year and IL&FS had sizeable assets maturing within a year time period. Such assets were neither considered impaired nor recognized as 'sub-standard' or 'doubtful' and did not show up as NPAs in the books of IL&FS which led to the reasonable conclusion that inflows from assets would happen as per their scheduled maturity and thereby there would not be any problem with repayment of the CPs. The Noticee has submitted that the said right issue of ₹4500 crore would have aided the

liquidity of IL&FS in the short term. In this regard, I note that, though the Noticee claimed that as per the scheduled maturity IL&FS could have repaid the CPs, however, it is an admitted fact that not only IL&FS failed to repay the CPs on September 14, 2018, but also defaulted in the interest payments on its NCDs on various dates i.e. September 17, 21, 26 and 29, 2018. It shows that being a reputed '*credit rating agency*' with years of experience in the field of rating, the Noticee failed in assessing the ALM position of IL&FS as a group. Thus, I note that the Noticee has lacked '*due diligence*' in assessing the ALM situation as alleged in the SCN.

50. On allegation keeping the rating as '*stable*' despite the slow progress in the divestment schemes and other asset monetisation plans by IL&FS, the Noticee submitted that it considered strong institutional ownership, experienced management team, expertise in advisory, financing and infrastructure, diversified funding profile, financial flexibility and resource raising capacity and regulatory compliance, etc. as parameters in its '*rating*' to IL&FS. IL&FS had historically relied on refinancing and rollover of debt as its liabilities matured periodically while assets took longer time to mature. In this background, the slowdown in asset monetization faced by IL&FS was perceived as a normal outcome. In this regard, I note that, what the Noticee was assessing as the normal outcome were in fact the '*sensitive*' parameter or '*challenges*' in its rating committee notes, which it said to be closely monitoring and were important '*negative*' indicators of the financial health of IL&FS. I also note that the slow progress in the divestment schemes and other asset monetization plans by IL&FS had affected its revenue generation and subsequently IL&FS and its group companies failed in meeting their debt obligations and defaulted in payment of NCDs and interest payments. It is undisputed fact that the Noticee had maintained the Rating Outlook on the NCDs of IL&FS as "*Stable*" throughout the rating period despite the slow pace at which the asset monetization and deleveraging steps of IL&FS was taking place. In the press release dated March 22, 2018 by the it had given the outlook as '*stable*' despite stating that the induction of strategic partners/ sale of investments would be '*critical*' for IL&FS to manage its leverage levels within regulatory limits and also to support its group companies. It also noted that the concentration of the 5 subsidiaries in the asset book has increased up to 6% of the lending and investment book as on September 30, 2017. It is also an admitted fact that the ratings were placed under "*Rating watch negative*" only in August 16, 2018, while downgrading the rating to AA+ on account of stress in some of investments, which could have a material impact on IL&FS tangible equity buffers. Thus, it is clear that the Noticee despite being aware of the aforementioned facts indicating inordinate delays in monetisation of assets by IL&FS/ generating cash flows, maintained the outlook for the debt instruments of IL&FS as stable. The Noticee failed to adequately caution the investors regarding the high leverage and delay in implementation of asset monetization plans by IL&FS as it was waiting for further deviations to turn the outlook to negative.

51. The sum and substance of the explanation of the Noticee on the specific allegations is that it had consistently considered the reliance on the information from the management and the board of the issuer as prudent. It has analysed the information gathered from different sources and prepared the rating report. The Rating Committee determines the appropriateness of the rating based on the rating report and analyst recommendation. It adopts rating methodology for determine the rating alongwith outlook/ watch, if any. Based on its ongoing analysis and monitoring of the available information it has started signalling the potential weakening credit profile of IL&FS and its subsidiaries in its several rating press releases. Once it determined that the credit profile of IL&FS had indeed deteriorated it acted promptly to downgrade the ratings on August 16, 2018 from IL&FS.
52. It is relevant to mention that the important financial parameters, as noted from the standalone and consolidated balance sheet of the IL&FS (Source: IL&FS website) during Financial Years ending on March 31, 2015, March 31, 2016, March 31, 2017 and March 31, 2018 show as following:

All figures in ₹ Million

S.No.	Particular	March 31, 2015	March 31, 2016	March 31, 2017	March 31, 2018
Standalone (IL&FS)					
1	Long Term Borrowings	83723	96056	93440	101790
2	Current Maturities of Long Term Debt	7029	12933	14709	23848
3	Short Term Borrowings	11049	19913	13072	33714
4	Proceeds from Sale in Investments in Subsidiaries/ Associates	27980	13958	7010	2136
5	Revenue	14303	19124	17872	18994
6	Operating Profit	3261	3992	3596	3324
Consolidated (IL&FS)					
1	Long Term Borrowings	486486	546651	597640	652935
2	Current Maturities of Long Term Debt	77187	64443	97449	122386
3	Short Term Borrowings	67466	92649	122386	105087
4	Proceeds from Sale in Investments in Subsidiaries/ Associates	2654	9855	7518	1046
5	Proceeds from sale of Other Non-current Investments	2084	2843	9897	1508
6	Proceeds from Sale in Investments in Associates	0	0	3926	379
7	Operating Profit	7043	5208	6177	-21092
8	Revenue	116405	150977	171564	187986
9	Expenses	109361	145769	165388	209080
10	Borrowing Cost	45175	54979	65165	79228
11	Cost of Raw Materials	5527	6854	14641	22167

53. From the above table it is observed that: -

- a. The expenses of the IL&FS on consolidated basis was increasing continuously i.e. 33% in FY 2015-16, 13% during FY 2016-17 and 26% during FY 2017-18. Two of the main contributing factors in the rise in expenses of IL&FS as a group are – Borrowing Cost and Cost of raw materials, apart from Operating and Administrative Expenses and Sub Contracted Construction Cost and others. The increase in revenue during the same period for IL&FS on consolidated basis was also increasing continuously i.e. 29% in FY 2015-16, 13% during FY 2016-17 and 9% during FY 2017-18. On comparison of both it is seen that increase Revenue and Expenses were in tandem till FY 2016-17, however, the situation in FY 2017-18 was different, wherein rise in expense was almost three times that of revenue, contributed by rise in borrowing cost and cost of raw materials.
- b. The operating profitability of IL&FS on standalone as well as consolidated basis was subdued, especially when the same is compared with the increase in its revenue from operation. It is noted that on consolidated basis, during FY ending on March 31, 2016, there was fall in operating profit of approx. 26%. Similarly, on standalone basis, during FY ending on March 31, 2017, there was fall in operating profit of approx. 10%. This shows that IL&FS was facing issues to maintain its business profitability.
- c. The cash flow from the proceeds from sale in investments in Subsidiaries or Associates of IL&FS on consolidated basis was declining during FY ending on March 31, 2016 and March 31, 2017, wherein in each of the financial years, there was decline of approx. 50%. Though, in FY ending on March 31, 2017, the cash flow of ₹ 24,222 million has been observed from the proceeds from sale/ redemption of other Non-current Investments. This shows that IL&FS was facing issues in monetizing its assets in the group companies.
- d. The Debt Equity ratio of the IL&FS on consolidated basis was in the higher range during financial years 2015-16 to 2017-18. During, financial year 2015-16 and 2016-17, the increase in Debt Equity ratio was gradual, but same has risen at alarming level during financial year 2017-18. This shows that IL&FS debt burden was quite high and there was visible mismatch between its debt and equity portfolio.
- e. The short term borrowing of IL&FS on consolidated basis was rising sharply during FY ending on March 31, 2016 and March 31, 2017. During FY ending on March 31, 2016 it rises by approx. 37% and during FY ending on March 31, 2017 by 32%. This shows that IL&FS reliance on short term borrowings was increasing at a rapid level.

- f. Other important factor is rise in 'Current Maturities of Long Term Debt' during FY 2016-17 and FY 2017-18 of the IL&FS on consolidated basis, wherein rise of 51% was observed in FY 2016-17 and 25% in FY 2017-18. If same is seen in tandem with rise in Short Term Borrowings for IL&FS on consolidated basis as well as standalone basis for FY 2015-16 and 2016-17, it can be said that, long term maturities of IL&FS were being funded by short term borrowings. This finding also gets support from the slow pace of monetization of assets of the IL&FS and its group companies.
54. In view of the above, I note that financial parameters of the IL&FS and its group companies especially, short term borrowings, debt equity ratio, current maturities of long term debt, operating profit, monetization of assets etc., were not as conducive or healthy as assumed by the Noticee in its rating report or rating rationale.
55. The extracts from rating reports of the Noticee clearly show that key updates considered for credit rating of NCDs of IL&FS were not healthy since 2017. Certain important extracts from Press Release of rating rationales of securities of IL&FS as given below also suggest the above assessment:

Press Release – May 10, 2017

- i. Due to lower than expected divestment/ sale of assets in IL&FS verticals, strategic partners/ sale of investments would be critical for IL&FS to manage its leverage levels. Out of top ten exposures, some of them fall in the category of projects under development and need funding support.
- ii. During Financial Year 2016, the infrastructure sector continued to witness stress leading to delays in various project which impacted performance of some of IL&FS's subsidiaries/ group companies. This coupled with unfavorable market conditions for divestment of exposures led to increase in its debt as IL&FS infused funds into projects under constructions.
- iii. The decline in profit is due to rise in interest expense, increase in operating expenses, increase in tax provision on account of higher interest disallowance and increase in taxable capital gain.
- iv. With IL&FS close to its regulatory cap on leverage, it would largely have to depend on strategic sale in various projects/ group companies to support various entities going forward.

Press Release – October 09, 2017

Due to lower than expected divestment/ sale of assets in IL&FS verticals, strategic partners/ sale of investments would be critical for IL&FS to manage its leverage levels. As on June 30, 2017 the top five exposures accounted 65% of the lending and investment book.

Due to lower than expected divestment/ sale of assets in IL&FS verticals, strategic partners/ sale of investments would be critical for IL&FS to manage its leverage levels. As on September 30, 2017 the top five exposures accounted 67% of the lending and investment book.

56. The Noticee has claimed that it has evaluated all aspects while rating IL&FS i.e. financials, asset quality, liquidity, institutional parentage, past record etc. and on the basis of the same it has maintained the rating of IL&FS as ‘stable’ up to August 16, 2018. In this regard, I note that, from the abovementioned extracts from press releases of the Noticee with respect to Issuer / its Group companies, analyzed by the Noticee, it has been observed that IL&FS financial parameters or credit profile was not as greener as shown by the Noticee. In every press release (from 2017 – 2018), the Noticee has mentioned that IL&FS ability to monetize its assets in a timely manner, maintaining leverage levels, high concentration in group companies, etc. will remain sensitive /critical elements while rating the NCDs of IL&FS. There was considerable delay in monetization of assets by the Noticee by IL&FS as admitted by the Noticee its press releases of the rating of NCDs of IL&FS. Further expanded lending to its group companies by IL&FS has always remained a concerned area for the Noticee, while rating IL&FS and its group company’s debt instruments. I find that though the Noticee has shown its concern regarding aforementioned deteriorating financial factors on continuous basis in its rating rationales, it had not acted upon the same diligently while rating the NCDs of IL&FS. I therefore find that the Noticee has failed to exercise its duty to the investors at large and failed to intervene in the matter on time by downgrading the ratings of NCDs of IL&FS despite having knowledge of the deteriorating financials of the issuer.
57. The Noticee has claimed that while ‘rating’ the issuer and its group companies, it placed reliance on institutional parentage, experience of management, expertise and financial flexibility, regulatory compliance, past performance and track record; and the standing of the statutory auditors. However, from the financial parameters mentioned above, it is clearly visible that the Noticee has shown laxity in its approach.
58. I also note that RBI, in its letter dated November 22, 2018 to SEBI observed that the Noticee failed in analyzing the information received/ obtained by it, from the perspective of repayment capability, concentration risk, etc. RBI, in its letter dated November 22, 2018, *inter alia* stated that “*The CRAs had derived comfort from the institutional parentage of IFIN. An independent assessment of IFIN by the CRAs as a standalone entity with specific focus on the effectiveness of the prevailing governance systems and executive capability is not evidenced from the clarifications furnished... IFIN derived financial flexibility and resource raising ability solely by virtue of IL&FS parentage*”. The said observations of RBI show that the Noticee has failed in

implying independent professional assessment while ‘rating’ the NCDs of IL&FS and placed undue weightage on institutional parentage. The approach of laxity and complacency of the Noticee has further been highlighted by RBI in its letter dated November 22, 2018 to SEBI, wherein *inter alia* it had mentioned as follows:

“.....The CRAs derived comfort from the liquidity profile of IFIN for positions as on March 31, 2017 and March 31, 2018 which generally reflected positive cumulative mismatches across time buckets for the short and medium term time horizons except for a cumulative mismatch of Rs. 482 crores in the 1-2 months bucket as on March 31, 2018. In addition to this, unutilized working capital limits and undrawn bank lines aggregating to Rs. 1151 crores and Rs.812 crores as on March 31, 2017 and March 31, 2018 respectively facilitated a better perception of the liquidity position of the entity amongst the CRAs. However, the expansion in exposure of IFIN to group entities during FY 2017-18 (by 33.14%) through transitory loans extended in order to accommodate the delay in disbursements from banks/ FIs were not examined by the CRAs from the perspective of repayment capability.....

.....The rating reliance was more on the commitments provided by the management on gradual reduction of such group exposures through monetizing and refinancing of these project debts at the underlying SPVs as well as the access to the shares treasury infrastructure of IL&FS by IFIN which failed to materialize beneficially.....

.....On account of mere initiation of a few measures by IFIN’s management, the rating downgrade was effected by only one notch from AAA to AA+ by CARE on August 16, 2018 despite several critical issues. Further, relying on the reasons stated by IFIN for delay as technical in nature, no downgrade was initially effected by CARE on the rating assigned to CPs. Subsequently, even though the same was recognized as a material event, the rating was not downgraded and continued to be A1+ as on September 3, 2018.....

...Most of the loans extended by IFIN were in respect of high ticket promoter funding and infrastructure loans with long gestation periods. Although the top 15 individual borrowers constituted around 30% of the total credit exposure of IFIN, the same was not examined by the CRAs from the perspective of concentration risk.....”

59. The Noticee has claimed that report of RBI has not been provided to it during the instant proceeding. However, it may be noted that Enforcement Department of SEBI had provided the copy of the said letter of RBI along with the observations to the Noticee during inspection of documents on September 06, 2019. The aforesaid observations of RBI being the regulators for other financial instruments such CP of IL&FS rated by the Noticee corroborate the charge as found in this case.
60. Further, the Noticee’s argument that Auditor had not raised any concerns or red flag regarding the financial parameters of IL&FS and its group companies and therefore, it cannot be questioned on

basis of financial parameters is out of context. I note that, a ‘*credit rating agency*’ responsibility is to evaluate the credit profile of the issuer whose instruments it is ‘*rating*’ and for assessing credit profile, it must exercise due diligence as expected from it and consider all the financial parameters independently and apply independent professional judgment in assessing the ‘*true*’, ‘*accurate*’, ‘*fair*’ and ‘*appropriate*’ credit rating as required under the CRA Regulations. I, therefore agree with observations of examination by SEBI that the Noticee, being a responsible *credit rating agency* registered with SEBI, should have anticipated the mounting credit risks, the stressed balance sheet position of IL&FS and placed the ratings accordingly to alert the market in advance regarding the deteriorating financial profile of the issuer.

61. In this case, the Noticee has placed its reliance on the judgment of Hon’ble SAT in the matter of *Brickwork Rating India Limited Vs SEBI in appeal No. 439 of 2018, para 6-9*. In this regard I note that, said judgment of Hon’ble SAT is case specific. It is noted that the said judgment has come to be passed in different set of facts and circumstances than present one. In *Brickwork Rating* case, in the facts and circumstance of that case as brought out in para 7 and 9 of the order dated June 03, 2019, it was found that the ‘*credit rating agency*’ in that case exercised *due diligence*. The differentiating factors were that the company in question was continuously in dialogue with the investors of NCDs for reschedulement and same was considered. The facts and circumstances of the instant case are entirely different than those of *Brickwork Rating* case. I further note that in para 8 of the order dated June 03, 2019 the Hon’ble SAT has applied Regulation 24(7) in different context than that of the present one. Hon’ble SAT has not held the interpretation that in all circumstances the regulation should be applied as sought to be contended by the Noticee. In fact, Hon’ble SAT has very clearly held that provisions of Regulation 24(7) “*indicates that CRA is required to exercise due diligence in order to ensure that rating given is fair and appropriate*”. The aforesaid findings in this order also find support from this interpretation.
62. In view of the aforesaid findings, the failure on the part of the Noticee is apparently vivid and obvious in this case. I, therefore, find that the Noticee, while assigning its credit rating to the NCD of IL&FS, failed to exercise proper skill, care and due diligence while discharging its responsibilities as a *credit rating agency* and violated the provisions of Regulation 24(7) and Clauses 4 and 8 of Code of Conduct of the CRAs read with Regulation 13 of CRA Regulations and is liable for penalty under Section 15HB of the SEBI Act.
63. In view of the allegations as charged in this case, the admissions of the Noticee and above findings, I find that the Noticee has failed in exercising ‘*due diligence*’ to ensure ‘*true*’, ‘*fair*’, ‘*adequate*’ and ‘*appropriate*’ ‘*rating*’ to IL&FS and its instruments. It also failed in exercising independent professional

judgment in order to achieve and maintain objectivity and independence while ‘rating’ the IL&FS and its instruments and in closely monitoring all relevant factors that might affect the creditworthiness of the issuers. In view of the above, I hold that the Noticee is liable for penalty under Section 15HB of the SEBI Act.

64. For the purpose of adjudication of quantum of penalty, it is relevant to mention that under section 15I of the SEBI Act imposition of penalty is linked to the subjective satisfaction of the Adjudicating Officer. The words in the section that "*he may impose such penalty*" are of considerable significance, especially in view of the guidelines provided by the legislature in section 15J. Further, while adjudging the quantum of penalty the adjudicating officer has discretion and such discretion should be exercised having due regard to the factors specified in section 15J. The factors stipulated in Section 15J of the SEBI Act, which reads as follows: -

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 investor/ +s 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.

65. 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 judgement 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 IL&FS is a systematically important Non Deposit Accepting Core Investment Company. It is in the business of raising and holding public funds. The exposure of IL&FS, at the relevant times, was critical to the financial stability as its share in total exposure of banks to NBFC sector was fairly high. There was substantial public interest involved in the affairs of the IL&FS considering its importance for financial stability. Though there is no allegation of any *mala fide* on the part of the Noticee, the failure by the Noticee is blameworthy and 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 lethargic indifference and needless procrastination and laxity of the Noticee. 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. The law does not permit any allowance to be made for such lethargic indifference and needless procrastination as found in this case. The brazen failure as found in this case, had clearly defeated the purposes of the 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.

66. 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 ₹25,00,000/- (Rupees Twenty-Five Lakh only) 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.
67. The Noticee shall remit / pay the said total amount of penalty within 45 days of receipt of this order by way online payment on SEBI website at following tabs on SEBI website www.sebi.gov.in – ENFORCEMENT -> Orders -> Orders of AO -> Pay Online or by way of using the web link <https://portal.sebi.gov.in/intermediary/AOPaymentGateway.html> . In case you face any difficulties in payment of penalties, you may contact the support at portalhelp@sebi.gov.in .
68. The said confirmation of e-payment made in the format as given in table below should be sent to "The Division Chief, EFD-DRA-IV, Securities and Exchange Board of India, SEBI Bhavan, Plot no. C- 4 A, "G" Block, Bandra Kurla Complex, Bandra (E), Mumbai - 400 051" and also to e-mail id:- tad@sebi.gov.in

1	Case Name	
2	Name of the 'Payer/Noticee'	
3	Date of Payment	
4	Amount Paid	
5	Transaction No.	
6	Bank Details in which payment is made	
7	Payment is made for (like penalties/disgorgement / recovery/ settlement amount and legal charges along with order details)	

69. In the event of failure to pay the said amount of penalty within 45 days of the receipt of this Order, recovery proceedings may be initiated under section 28A of the SEBI Act, 1992 for realization of the said amount of penalty along with interest thereon, inter alia, by attachment and sale of movable and immovable properties.
70. In terms of Rule 6 of the Adjudication Rules, copies of this order are sent to the Noticee and also to SEBI.

Date: December 26, 2019

Place: Mumbai

Santosh Shukla
Adjudicating Officer