

BEFORE THE SECURITIES APPELLATE TRIBUNAL
MUMBAI

Order Reserved on: 24.04.2023

Date of Decision : 06.06.2023

Misc. Application No. 1185 of 2022

And

Appeal No. 694 of 2022

Brickwork Ratings India Private Limited
No. 29/3 & 32/2, 3rd Floor, Raj Alkaa Park
Kalena Agrahara, Bannerghatta Road,
Bangalore – 560 076 Appellant

Versus

Securities and Exchange Board of India
SEB Bhavan, Plot No. C-4A, G-Block,
Bandra-Kurla Complex, Bandra (East),
Mumbai – 400 051. ... Respondent

Mr. Somasekhar Sundaresan, Advocate with Mr. Abishek Venkataraman, Ms. Savani Gupte, Mr. Lalit Munshi, Ms. Fatima Fernandes, Advocates i/b Samvad Partners for the Appellant.

Mr. Gaurav Joshi, Senior Advocate with Mr. Abhiraj Arora, Mr. Shourya Tanay, Ms. Misbah Dada, Mr. Deepanshu Agarwal, Advocates i/b ELP for the Respondent.

CORAM : Justice Tarun Agarwala, Presiding Officer
Ms. Meera Swarup, Technical Member

Per : Ms. Meera Swarup, Technical Member

1. Brickwork Ratings India Private Limited (the Appellant) has filed Appeal no. 694 of 2022 against the order dated October 6, 2022 (the Impugned Order) passed by the Whole Time Member („WTM“ for short) of Securities and Exchange Board of India („SEBI“ for short), the respondent, cancelling the Certificate of Registration as Credit Rating Agency („CRA“ for short) in exercise of powers under Section 19 read with Section 12(3) of the SEBI Act, 1992 and Regulation 27 of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008 („Intermediaries Regulations“ for short).

2. The Appellant was granted registration by SEBI in 2008 as a CRA and a securities market intermediary. The Appellant has also been accredited by the Reserve Bank of India (RBI). In exercise of powers contained under the SEBI Act read with SEBI (Credit Rating Agencies) Regulations, 1999 („CRA Regulations“ for short), the Respondent along with RBI conducted an inspection for the period October 1, 2019 to November 30, 2019 in January 2020 for ascertaining whether the Appellant has been complying with the provisions of SEBI Act and the CRA Regulations. This was the third inspection carried out by the Respondent. The first inspection

was carried out for the period April 1, 2014 to September 30, 2015 and the second inspection for the period April 1, 2017 to September 30, 2018.

3. The impugned order was passed as a result of violation noticed in the third inspection and consequent enquiry proceedings. However, based on the inspections held earlier the impugned order notes that the appellant repeatedly violated various regulations and provisions of SEBI Act and CRA Regulations. Both orders passed consequent to the earlier inspections were challenged in this Tribunal. Some of the violations were upheld by this Tribunal and the penalties were reduced.

4. We have heard Shri Somasekhar Sundaresan, the learned counsel with Shri Abishek Venkataraman, Ms. Savani Gupta, Shri Lalit Munshi and Ms. Fatima Fernandes, the learned counsel for the Appellant and Shri Gaurav Joshi, the learned senior counsel with Shri Abhiraj Arora, Shri Shourya Tanay, Ms. Misbah Dada and Shri Deepanshu Agarwal, the learned counsel for the Respondent.

5. We have two issues before us. Firstly, the alleged violations pointed out is the third inspection and the findings

qua each of these. And, secondly, whether the cancellation of registration of the Appellant as CRA is justified in view of the repeated violations.

6. The details of the alleged violations noticed during the third inspection and our findings against each of them are as follows:-

A. FAILURE TO FOLLOW A PROPER RATING PROCESS.

7. The WTM held in the impugned order that the Appellant failed to follow a proper rating process as it failed to verify projections obtained from Issuers, undertake site visit, interact with management and review the rating criteria periodically thereby violating provisions of Regulation 24(2) and 24(7) of the CRA Regulations, Regulation 13 read with Clause 4 and 5 of Code of Conduct of CRA Regulation and Clause 1 and 2 of Annexure A of SEBI Circular No. SEBI/HO/MIRSD/MIRSED4/CIR/P/2016/119 dated November 1, 2016. The inspection report pointed to three instances wherein projections provided by the Issuers where were accepted without further verification – Welspun Industries Ltd, IDFC First and Adani Rail Infra Pvt. Ltd. (ARIPL). The WTM has finally held that in two instances,

Welspun and IDFC First, the Appellant has not independently verified the projection given by the Issuers. We agree with the WTM that the Appellant has failed to produce any evidence of discussions with Welspun. Contention that the projections were discussed telephonically cannot be accepted on its face value unless supported by evidence. However, in the case of IDFC First, the explanation given by the Appellant and accepted by the Designated Authority in the inspection report seems plausible and relevant for financial firms. If two views are possible then benefit has to be given to the appellant.

8. On interaction with management, three instances were noticed of lack of interaction with management / site visit. The WTM holds that in two instances (IKF Finance Ltd and Entry India) there was lack of interaction with management as no supporting document could be produced to indicate that site visits and discussion with management took place. We find that in the case of IKF Finance, adverse inference has been drawn on the ground that there was no reference of site visit in the minutes of the rating committee. Evidence in the form of flight tickets to Hyderabad were filed to show some proof of site visit. We also find that the requirement to mention site visit in the minutes of the rating committee came

into effect for the first time vide Circular dated November 8, 2019 whereas the alleged site visit was taken in May 2019. These aspects were not considered. Therefore, in our opinion, benefit of doubt can be granted to the appellant. In the case of Entry India, the fact that there was non-cooperation by the Issuer has not been disputed by the Respondent and therefore the charge of not following a proper rating process or failed to exercise due diligence is not proved.

9. The other two allegations regarding failure to follow proper rating process are with regard to seeking feedback from the Bankers and the period of review of rating criteria. The impugned order holds that sufficient documentary evidence was not produced by the Appellant to indicate that all out efforts were made to obtain Bankers feedback. Noting that feedback from Bankers is an important step for credit rating, the Appellant should have maintained records to prove that efforts were made by them. Regarding period of review of rating criteria we note that the Appellant had reduced the period to three years from five years.

B. FAILURE TO ENSURE PROPER MAINTENANCE OF RECORDS TO SUPPORT ITS RATING.

10. The WTM has held that the Appellant has been careless in following the obligations cast upon it while maintaining records on account of two instances of missing signatures on the minutes of meeting, two instances of incorrect recording of attendance of committee members and one instance of not recording discussion about reduction in fees in the Minutes of Rating Committee Meeting. While confirming the violations pointed out by the WTM, we note that signatures on Minutes have been obtained. We also note that there are routine operational errors which have unnecessarily been escalated to regulatory proceedings.

C. DELAYED DISSEMINATION OF INFORMATION WITH RESPECT TO MONITORING OF RATING AND FAILURE TO FOLLOW AN APPROPRIATE RATING PROCESS.

11. We note that admittedly there was delay on part of the Appellant in disclosure of rated pool performance (September 2019 quarter – 15 days delay) in recognition of default by Issuers (Sintex and Reliance Capital Ltd.), review of rating of NCDs (IKF Finance Ltd.), disclosing material events (SREI Infrastructure Finance Ltd. – 7 days delay) and publishing press release (Venus India). Appellant is thus in violation of

Regulations 15(2) and 24(2) of CRA Regulations, Clauses 6.4.2 and 7 of SEBI Circular dated May 3, 2010 and Clause 2 of SEBI Circular dated June 30, 2017.

D. FAILURE TO COMPLY WITH TIMELINES AS PER INTERNAL MANUAL FOR COMPLETION OF RATINGS.

12. The WTM found that the appellant had failed to comply with the timelines as per internal manual of completion of ratings in more than 75% of the cases and therefore violated the Circular dated November 1, 2016. In this regard we are of the opinion that the indicative timeline in an operational manual cannot be elevated to a statutory requirement and non-compliance of the timelines indicated in the internal manual cannot be a ground to impose a penalty. Further, the timelines are indicative in nature. They are not cast in stones and the completion of ratings depends on various factors which are supplied by third parties over whom the appellant has no control. These aspects have not been taken into consideration by the WTM. The Circular of 2016 does not stipulate any timeline for completion of ratings but merely requires the analysts to adhere to timelines. In view of the aforesaid, no

penalty could be imposed for failure to adhere to the timelines.

E. FAILURE TO ADDRESS THE ISSUE OF CONFLICT OF INTEREST.

13. The WTM has pointed out two violations regarding allegations of conflict of interest – IDFC First and IL&FS Group Entity. However, with regard to the IL&FS Group Entity, the WTM has decided not to draw an adverse inference. Thus, the allegation with regard to conflict of interest in the case of IDFC First only remains out of four violations pointed out in the third inspection. In case of IDFC First, the WTM has drawn adverse influence based upon a meeting between the management of IDFC Bank with the Business Development Team of the Appellant which was also attended by the Founder Director (FD), who was also part of the Rating Committee. At the meeting a decision for reducing the fee was also taken. The contention of the appellant, that the FD was there for a courtesy meeting as the MD of IDFC bank was also present and therefore the Code of Conduct was not violated, is erroneous. We find that FD was part of the rating committee and also had access to fee details leading to a conflict of interest. We therefore find that the conclusion

reached by WTM in this single instance does not suffer from any error of law.

F. FAILURE TO MAKE CORRECT DISCLOSURES IN PRESS RELEASES (PRs).

14. Two instances (Coffee Day and Reliance Home Finance Ltd.) have been cited to allege that the Appellant failed to make reference to appropriate rating criteria in the PRs. While admitting to these omissions, the Appellant has stated that the spirit of SEBI Regulations and Circulars were adhered to. In the circumstances, the findings of the WTM need no interference though we are of the opinion that the violation is trivial.

15. To conclude, with respect to findings of WTM regarding violations noticed during third inspection, we find that two findings (A & B) are partly sustained and three findings (C, E & F) are fully sustained. The findings in (D) are not sustained.

16. With regard to the question whether the Cancellation of Registration of the Appellant is justified, the relevant Regulation 27 (pre-amended) of Intermediaries Regulations is as following:-

“Action in case of default

27. After considering the representations, if any, of the noticee, the facts and circumstances of the case and applicable provisions of law or directions, instructions or circulars administered by the Board the designated authority shall submit a report, where the facts so warrant, recommending,-

- (i) suspension of certificate of registration for a specified period;*
- (ii) cancellation of certificate of registration;*
- (iii) prohibiting the noticee to take up any new assignment or contract or launch a new scheme for the period specified in the order;*
- (iv) debarring a principal officer of the noticee from being employed or associated with any registered intermediary or other registered person for the period specified in the order;*
- (v) debarring a branch or an office of the noticee from carrying out activities for the specified period;*
- (vi) warning the noticee.”*

17. The WTM has decided to take action under Regulation 27(ii) as he arrived at the conclusion that “strict regulatory action, in my considered view, is required at this juncture to address the issue and protect the market eco system”. The issue being “repeated lapses, noticed across multiple inspections conducted by SEBI, shows that governance changes recommended in earlier inspections, and monetary penalties imposed have not proved effective or deterred the

Noticee (Appellant) in addressing very basic requirements of running a CRA”.

18. In our view, the repeated violations, which remain after this Tribunal’s order in Appeal no. 439 of 2018 (1st inspection), Appeal no. 475 of 2020 (2nd inspection) and this order, are basically two, namely, delay in recognition of default of NCDs (one instance each in three inspections) and conflict of interest issues due to non-segregation of roles (in 2 out of 3 inspection). In these circumstances, imposition of the most-severe penalty possible under the Regulations is not commensurate with the violations affirmed.

19. We are further of the opinion that the violations as found by the WTM and found by us are routine operational errors which have unnecessarily been escalated to regulatory proceedings. Some of the violations are trivial in nature. Isolated instances by not meeting the rating criteria, not reviewing the rating criteria for shorter period than 3 years / 5 years, not signing the minutes of the meeting, not recording the names of the attendees of the meeting of the rating committee, failure to comply with the timelines specified in the appellant’s manual are such violations which do not warrant cancellation of the license of the appellant. Even the

charge of conflict of interest is not that serious which by itself could warrant cancellation of the license of the appellant.

20. Considering the totality of the violations found we are of the opinion that the alleged violation of routine matters is not deliberate or fraught with malafides or fraud and therefore cannot result in the cancellation of the license. Regulation 26 and 27 of the Intermediaries Regulations requires the Competent Authority to pass appropriate orders and some of the measures have been indicated in Regulation 26. There is not even a whisper in the impugned order as to why these measures are not adequate or commensurate with the alleged violation. In our opinion proportionality in punitive measures is a vital facet of Article 14 and a disproportionate punitive measure which is not commensurate with the violation would be totally violative of Article 14 of the Constitution of India as held by this Tribunal in *Jindal Cotex Limited & Ors. vs SEBI, Appeal no. 76 of 2023 decided on February 23, 2023*. Thus, in our opinion the order of cancellation of the license for the violations committed by the appellant is unjustified and is not commensurate with the alleged violations.

21. Further, in paragraphs 12.6 to 12.9, the WTM has mentioned (i) historical average ratings transition rates across

various CRA (Source : Appellant's website), (ii) data on probability of Default Benchmark by SEBI as Appellant's actual default rates (Source : Appellant's website) and (iii) the fact that a fourth inspection of the Appellant has taken place wherein-

“the prima facie observations emanating from the 4th Inspection, are also similar in nature to those contained in 1st and 2nd Inspection as well as the 3rd Inspection inter alia involving (a) failure to document meetings with management / undertake site visits, (b) failure to undertake independent analysis of projection provided by the Issuer, (c) delay in default recognition, (d) material event delay, (e) Conflict of interest, etc.”

Though, the WTM terms these as “merely incidental observations” which have not been considered against the Appellant in these proceedings, the fact that these were mentioned in the impugned order indicates that these observations have impacted the decision taken by the WTM, that is, cancellation of Registration of the Appellant as CRA. The fourth inspection report which is not part of the SCN cannot be taken into consideration.

22. In view of the aforesaid, while partly affirming the violations noted in the third inspection, paragraph 13.1 of the impugned order cancelling the certificate of registration as CRA is quashed. The appeal is allowed. The matter is remitted to the Respondent to pass a fresh order on the

quantum of penalty other than the order of the cancellation of the license in the light of the observation made above and in accordance with law after giving an opportunity of hearing to the appellant. In the circumstances, parties shall bear their own costs. While considering the quantum, the respondent will take into consideration the interim order passed by this Tribunal wherein the appellant was restrained from taking new clients as a mitigating factor.

23. This order will be digitally signed by the Private Secretary on behalf of the bench and all concerned parties are directed to act on the digitally signed copy of this order. Certified copy of this order is also available from the Registry on payment of usual charges.

Justice Tarun Agarwala
Presiding Officer

Ms. Meera Swarup
Technical Member

06.06.2023
msb

Digitally signed by
MADHUKAR SHAMRAO BHALBAR
Date: 2023.06.06
15:35:30 +05'30'