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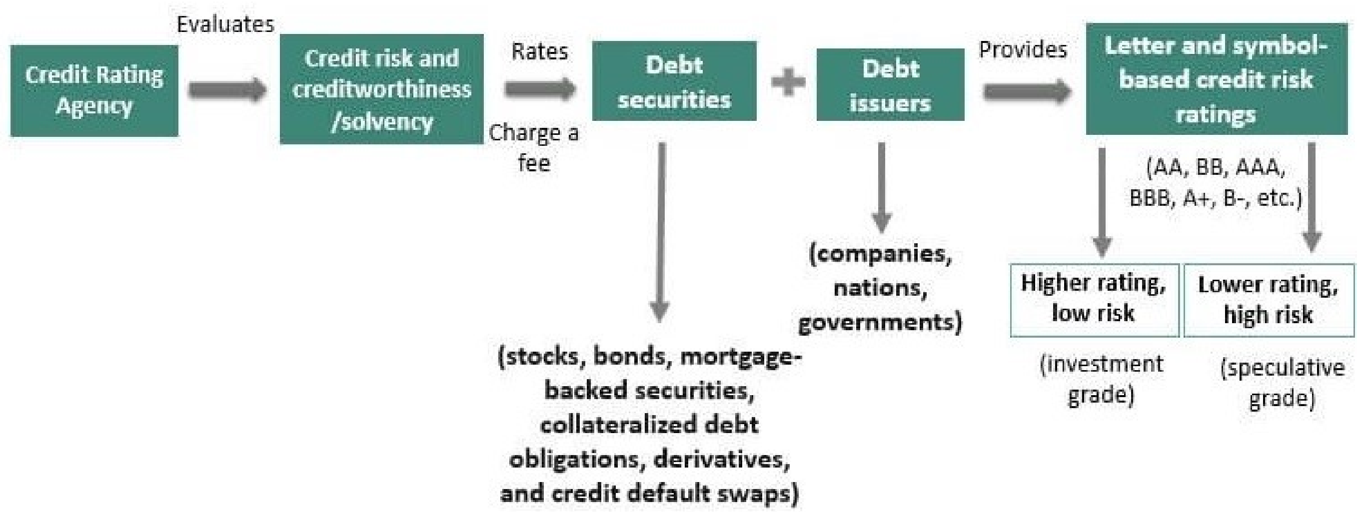
India's Review of Credit Rating Agencies

Why in news?

Recently, India released a document titled 'Re-examining Narratives: A Collection of Essays' to present alternate perspectives on economic policy that have long-term implications for India's growth and development priorities.

What are credit rating agencies?

- **Credit Rating Agencies (CRA)** – According to IMF, they are *private companies that assess credit risk* of borrowers that seeks loans and issue fixed-income securities, such as bonds.



- **Beneficiary** – Individuals, corporation, State or provincial authority, or sovereign government.
- Prospective borrowers often must obtain a credit rating before they try to raise money in capital markets.
- **Lending parameters** – Ratings contributes to the determination of the interest rate, or price, the borrower must pay for financing.
- In India, CRAs are regulated by ***SEBI (Credit Rating Agencies) Regulations, 1999*** of the Securities and Exchange Board of India Act, 1992.

6 Credit Rating Agencies (CRA) registered under SEBI are CRISIL, ICRA, CARE, SMERA, Fitch India and Brickwork Ratings.

What is sovereign credit rating?

- An independent assessment of the *creditworthiness of a country or sovereign entity*.
- **Determining factors**
    - Per capita income
    - GDP growth
    - Rate of inflation
    - Short-term external debt as a % of GDP
    - Economic development
    - History of defaults
    - Political stability.
- By allowing external credit rating agencies to review its economy, a country shows that it is willing to make its financial information public to investors.

Why do sovereign ratings matter?

- **Marker for investors** – They provide about the creditworthiness of governments around the world and their ability and willingness to pay back debt.
- **Impact borrowing capacity** – A poor sovereign rating can inhibit the country's ability to borrow money from rich investors.
- Governments with lower sovereign ratings have to pay higher interest rates when they borrow.
- **Influence businesses** – If the sovereign rating of a country's government is low, the businesses of that country end up with even higher interest rate when they borrow from global investors.
- **Supports development** – A good rating can make developing countries (which lack capital) easier to become more productive and remove mass poverty.

Which are the main rating agencies?

- *Sovereign credit ratings predate the Bretton Woods institutions*, i.e., the World Bank and the International Monetary Fund.
- **3 main agencies** – ***Moody's, Standard & Poor's and Fitch*** are globally recognised credit rating agencies.
- ***Moody's is the oldest*** which was established in 1900 and issued its 1st sovereign ratings just before World War I.
- In the 1920s, Poor's Publishing and Standard Statistics, the predecessor of S&P, started rating government bonds.

While S&P and Fitch rate India at BBB, Moody's rates the South Asian country at Baa3, which indicates the lowest possible investment grade, albeit with a stable outlook.

- While the US and European countries have enjoyed a good record, ratings have been *affected by global events*.
    - For instance, sovereign defaults spiked during the 1930s Depression, and most ratings were downgraded.

To know more about CRA, click here

What is the government's criticism?

- The Finance Ministry has pointed out ***issues with the methodologies*** used by the rating agencies.
- **External influences** - According to the document from 'Fitch', the rating agency takes comfort from high levels of foreign ownership in the banking sector
- **Bias over public banks –** It discriminates developing countries where the banking sector is primarily run by the public sector.
- It also ignores the public banks' welfare and development functions including their role in promoting financial inclusion.
- **Opaqueness** – Non transparent manner of selection of the experts consulted for the rating assessments.
- **Weightage issues** – Agencies do not convey clearly the assigned weights for each parameter considered.
- Composite governance indicator (weight of 21.4) is only based on the *World Bank's Worldwide Governance Indicators (WGI)* that uses indices such as freedom of expression, freedom of media, rule of law, corruption, quality of regulation, etc. but does not capture hard economic data.

What lies ahead?

- ***Enhanced transparency*** in credit rating may compel the use of hard data and likely result in credit rating upgrades for a good number of sovereigns.
- This will help them access private capital, which has been assigned the central role by G-20 in addressing global challenges such as climate change and supporting the energy transition.

References

1. The Indian Express| India criticizes methodologies of global CRA
2. Live Mint| Need to reform CRA
3. DEA| Re-Examining Narratives: A Collection of Essays

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