

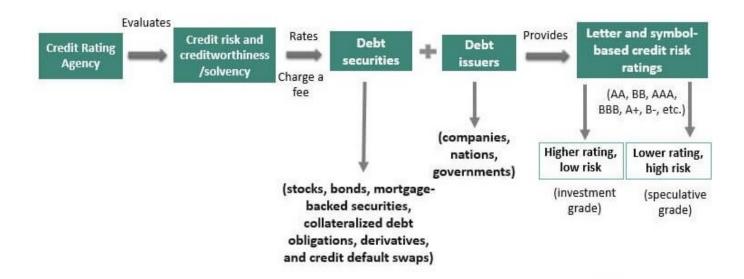
# **India's Review of Credit Rating Agencies**

#### 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 <u>private companies that</u>
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?

- <u>Sovereign credit ratings predate the Bretton Woods institutions</u>, i.e., the World Bank and the International Monetary Fund.
- 3 main agencies <u>Moody's, Standard & Poor's and Fitch</u> are globally recognised credit rating agencies.
- *Moody's is the oldest* which was established in 1900 and issued its 1<sup>st</sup> 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.

#### 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 <u>World Bank's Worldwide Governance Indicators (WGI)</u> 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

