

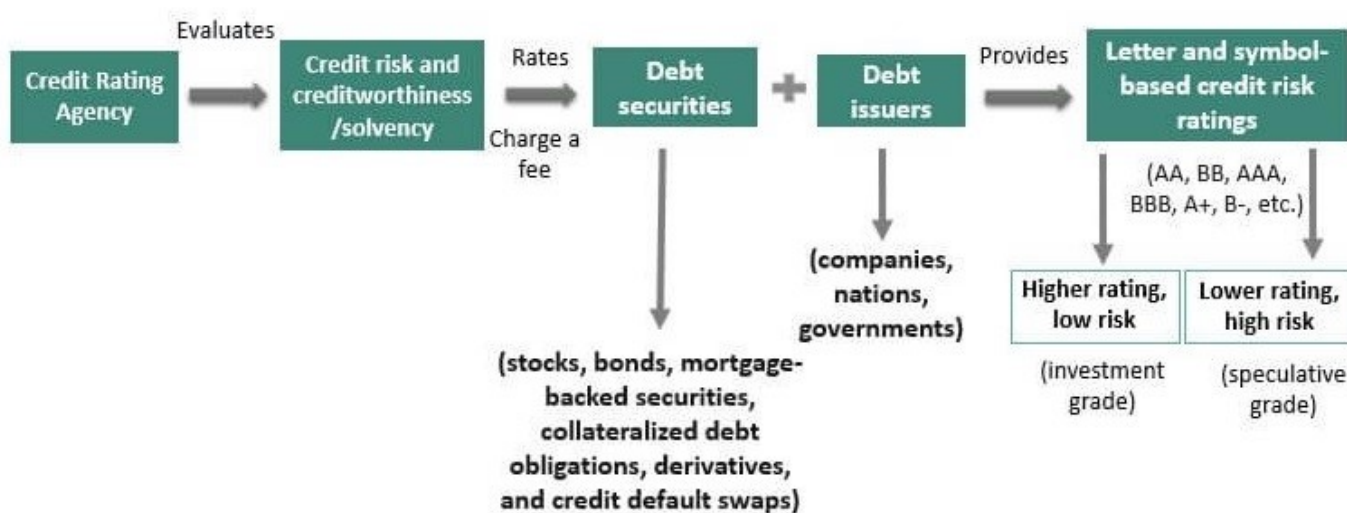
## India's Review of Credit Rating Agencies

### 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 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.

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](#)