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Evaluate rating agencies on basis of how often they are right rather than wrong: Rajesh Mokashi, CARE Rating

BY ET NOW | NOV 14, 2018, 09:51 AM IST

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*Sebi has brought out the point about the sharp deviation in bond spreads. In an indirect way, it is a reflection of the credit quality, **Rajesh Mokashi**, MD, CARE Rating, tells ET Now.*

Edited excerpts:

Sebi has tightened norms for many of the rating agencies on account of the IL&FS fallout. What is your view?

These are regulations which are meant to increase transparency and better disclosures so that there is better awareness of the ratings. Basically Sebi is insisting that much more clarity be given to certain aspects of the rating in public domain regarding holding company as well as parent subsidiary relationship.

An interesting aspect brought out by Sebi has been about the sharp deviation in bond spreads. In an indirect way, it is a reflection of the credit quality and that could be a useful input from a rating analysis.

When you see an episode like IL&FS, it makes you wonder about the accountability of the rating agencies.

I strongly believe rating agencies should be evaluated on the basis of how often they are right rather than when they are wrong. Rating companies come to limelight only when one-off issues crop up.

If you see the track record of rating agencies for the last several years, a fair bit of utility has been served to the marketplace. So yes, episodes like these definitely call for an introspection to see how things could be analysed in a better way so that the predictive powers of rating companies continues to be very high.

One has to look at Sebi's evaluation of this whole instance where they have gone into great detail and come out with more clarity. Better disclosures and analysis in terms of certain evaluation of criteria can help in improvement of transparency in the rating process. As such, ratings convey probabilities of default and if you look at the history of rating agencies, the Indian agencies generally have done fairly well in terms of the PD curve, inverted PD curve and other parameters that are used in international domain.

How accurately can rating agencies indicate or disclose liquidity condition of a company?

It is a very challenging perspective as to how to publicly express liquidity in terms of the rating because liquidity disclosures in the public domain appear on the 31st March annual report and that is one number of say liquid assets held by the company.

Eventually we have to rely on the cash flows which are going to come in the future because rating is about a prognosis about whether somebody can pay the bonds in the future or not and that is driven by expected cash flows. There will be elements of liquidity reserves which companies will want to have on a consistent basis.



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Some of these disclosures can definitely enhance transparency but yes, liquidity can be sometimes very volatile and even systemic issues can suddenly shift liquidity in such a manner that the lines of credit which are available on a consistent basis can dwindle suddenly. Those risks will remain, but nevertheless, there will be a utility in terms of better disclosure on certain liquidity indicators which Sebi has rightly pointed out.

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