

Business Standard

Sebi should not discriminate between large and small rating agencies

New CRAs say certain practices in the industry need to be addressed

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Illustration: Ajay Mohanty

Domestic and newer credit-rating agencies (CRAs) have said certain practices in the industry need to be addressed even as the Securities and Exchange Board of India (Sebi) has sought to streamline the processes and create a level playing field.

On December 28 last year, after its final board meeting for 2017, Sebi

amended the regulations related to CRAs in the country.

The regulator has said that apart from a Rs 250 million minimum net-worth requirement, up from Rs 50 million, the promoters of CRAs need to maintain at least 26 per cent for a minimum of three years from the date of being given registration by Sebi.

Rajesh Mokashi, managing director and chief executive officer (CEO), CARE ratings, says that “because there are research-asset investments to be made by a CRA, in order to offer a certain quality of service in the market, you need a certain element of capital”.

CRA *Business Standard* spoke to said they had not received an official circular from the regulator.

Sebi's new regulation

- It is now mandatory for promoters to maintain a minimum holding of 26 % for at least three years
- CRAs holding more than 10% of the voting rights cannot hold a stake of 10% or more in another CRA
- This restriction does not extend to holdings in CRAs by pension funds, institutional investors, insurance schemes, and mutual fund investments
- Younger CRAs have said there were many difficulties they faced over the past few years in establishing themselves

Sebi has also mandated that henceforth CRAs holding more than 10 per cent of the voting rights and/or shares in a CRA cannot hold a stake of 10 per cent or more in another CRA. However, this does not apply to holdings in pension funds, institutional investors, insurance schemes, and mutual funds.

CRISIL, the S&P-owned rating agency, bought an 8.8 per cent stake in CARE Ratings in June last year from Canara Bank in a block deal. A spokesperson for CRISIL stated that the investment was within this stipulated limit.

Sukanta Nag, CEO of Infomeries Valuation and Ratings, said “if one existing and established CRA, having a good presence in the market, also has a significant stake in another CRA and gets a board representation, then in a way they would control a major part of the market. So a monopolistic system comes in, which is why Sebi issued these new conditions”.

Domestic and younger CRAs say they have faced difficulties over the past few years in establishing themselves, acquiring clients, competing with the multi-national CRAs, and in “being taken seriously”.

Sankar Chakraborti, CEO of Small and Medium Enterprises' Rating Agency (SMERA), a government CRA, says newer CRAs “bring in a sense of sanity to the industry” and that regulators, the government, and other stakeholders have to be convinced that they (new CRAs) should not suffer under changes in law.

Even with this new condition, which encourages long-term investment and commitment for anyone interested in entering the CRA industry, Chakraborti says more needs to be done to create a fair, level playing field between established and legacy CRAs and newer ones.

D Ravishankar, founding director of Brickwork Ratings India, said: “Any new CRA will have to work hard in the initial years because they have to establish their name.”

“The fact that we have already rated 19,000 companies, means that we have finally been accepted. So it's not an overnight game, it took a long time and effort to get acceptability from institutional investors,” said Ravishankar.

Chakraborti said: “I don't want regulators to step into pricing regulations, but they can create a fairer playground for newer CRAs through other means.”

“For example, there is too much influence from brokers who work between the CRAs, banks and issuers.”

“Further, this is a high-margin business, some CRAs charge margins of 60 to 80 per cent. Why should the protectionism for big CRAs continue? SMERA, being a government CRA, comes within the Comptroller and Auditor General of India’s ambit, so I am restricted in competing on margins with other established and larger CRAs.”

Chakraborti said certain discriminatory tactics had been employed in the past, and in several important cases higher net-worth CRAs inevitably got the clientele as some clients chose their CRA based on net-worth criteria. Further, he said that there was a tendency for even government entities to favour large and foreign-owned CRAs.

Mokashi said the cross-holding condition had plugged a long-standing gap in regulation because “if one CRA were to buy more than 10 per cent in another CRA, according to the Sebi regulations of 1999, it would end up being called the ‘promoter’ of the CRA. This would send the wrong message to the market that two CRAs are acting in concert.”