Credit Rating- A new order emerging

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Three firms from the BRICS bloc- Brazil's SR Rating, CARE Rating of India and GCR of South Africa are tying up with CPR of Portugal and MARC of Malaysia to form a new global credit ratings agency ARC Ratings. The new firm would provide ratings answers to the new multi-polar world economy.

In the aftermath of the financial crises starting 2008, there have been calls for more competition in the credit rating space. Many ratings assigned pre and post this period did not quite turn out right, thereby recognising the need for more credit rating agencies to make the system more robust.

The BIG 3, Moody's Investors Service, Standard & Poor's Ratings Services and Fitch Ratings control 95 per cent of the global ratings market, but some of their assessments during the financial crisis have been questioned as well as the potential impact on state sovereignty.

A protester shouts slogans during a demonstration in Spain after a credit ratings downgrade [Getty Images]

Significantly enough, the regulators in US and Europe have pitched for the same, which does open the doors of opportunity for new players which can conform to the "non-sovereign" principle.

While there have been no direct refusals for new agencies coming up based on domestic regulation, there have been entry barriers imposed by regulation. The 2008 crisis has only eased some of them, which makes it possible to add competition that in turn can take on companies which now dominate the global industry.

Credit rating, undoubtedly, is what can be described as a sticky business for both those who require the rating and those who use the rating. In this context, we have to admit, the well-entrenched old agencies have an advantage. Financial institutions and investors do fall back on these ratings because of the long built credibility of these products offered by the CRAs.

The main challenges before the new venture that is being floated is to garner the necessary level of trust as well as build a solid stock of clients in order to attest to the acceptance of mainstream investors

The 2008 crisis showed that the rating opinions of the Big 3 are not infallible [Getty Images]

However, with the crisis showing that the rating opinions of the Big 3 are not infallible and are amenable to other interpretations, we in CARE Ratings did see an opportunity and our plans did include going global. The changing global environment provided the impetus.

After the existing system failed to warn of the global economic crisis, several CRAs in emerging markets have explored common grounds for global operations.

It is here that CARE Ratings has found partners with domestic credit rating agencies in Brazil, Portugal, Malaysia and South Africa. These agencies are on the same page when it comes to the basic objective of setting up a global rating agency with robust methodologies in place. There is definitely learning to be had from the recent developments which will be imbibed in the new JV.

Given the geographies of these countries, ARC Ratings would be well represented across 4 continents. Also given that the Portuguese agency has an ESMA license, operations in Europe could begin right away.

We have often been asked about the business model for ARC Ratings. All the participating agencies in ARC Ratings are dominant players in their own markets. They do rating assignments for top companies domestically. Many of these companies also source global markets for funds where it is essential to take a rating from one of the established global credit rating agencies. Here the rating of the sovereign as well as the company matters. Today given limited competition, they are perforce going to these agencies and getting two ratings. Given our own strong relationships with these companies for domestic purpose, we could offer them a global rating through ARC which can be taken along with the rating from one of the other established CRAs. This way we would be able to scale business and build volume.

ARC Ratings would be well represented across 4 continents [Getty Images]

As this would also require giving sovereign ratings, we do have in place robust and objective criteria for evaluating nations and this is one advantage that we have – learning from past errors by other agencies.

Also it has been argued that the present way of looking at sovereign ratings does involve certain preconceived notions on how emerging markets cannot be on the same scale as developed countries. This is an area that we have explored and have strengthened our own methodology to ensure that the ratings are more efficient.

Doing such an exercise for any domestic rating agency is evidently not practical given the stickiness and credibility factor involved. By bringing together a global alliance, it is felt that the rating agency becomes more acceptable and palatable, as experiences are pooled together in ARC Ratings to provide better solutions. The idea is for ARC to serve the entire gamut of financial products so that the complete bouquet is available for potential clients.

Gaining ground in this business will be a gradual process and it could take 3-5 years for sufficient bulk to be created. The basic model takes this time frame as ARC acquires customers across the globe and builds its own reputation. Understandably, the robustness of ratings will be the ultimate test and we believe this alliance is up to the challenge.

ARC Ratings is the getting together of CRAs in like-minded countries in similar state of development.

Russia and China, from the BRICS stable, are right now not part of our alliance. However, given that the focus is on transparent methodologies which derive ratings for developing countries, we would seek to cooperate with others at a later time when there is a convergence in thought.

The emerging markets are progressively playing a dominant role in steering the global economy and hence a logical corollary would be for these countries to work together in terms of using their synergies for creating a pan-global credit rating agency.

As far as CARE Ratings is concerned, there will be a lot of experience to be gained. Presently, the global forays are restricted to a branch in Republic of Maldives and MoUs with agencies in various countries. The capital outlay is not really significant, but being a part of an enterprise that holds a lot of potential and promise is exciting, while the returns will trickle in over a period of time.

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