Search for quality: on credit rating agencies

Credit rating agencies may be in for a tough ride as the Securities and Exchange Board of India continues to tighten the screws on them. The market regulator has released a consultation paper seeking feedback on a new set of rules drafted to improve “market efficiency” and enhance “the governance, accountability and functioning of credit rating agencies”. Among them are provisions to restrict cross-shareholding between rating agencies without regulatory approval to 10%, and increase the minimum net worth requirement for existing and new agencies from 5 crore to 50 crore. Another mandates at least five years’ experience for promoters of rating agencies. SEBI has proposed disclosure norms to improve investor awareness about the operations of rating agencies. The spin-off of non-core operations of rating agencies will allow SEBI to focus on regulating just their credit rating operations. SEBI has spelt out its rationale for proposing each of the rules. SEBI’s predominant concern, apart from improving the information available to investors, seems to be to prevent rating agencies from resorting to collusion in reaching decisions. This effort is in line with SEBI’s crackdown on the agencies after the default in 2015 of a highly-rated debt issued by Amtek Auto.

SEBI tightens P-Note rules

The new rules, if they come into force, may not have any substantial impact on the quality of credit rating in India. *Prima facie*, the intended effects of the rules sound convincing. What is unclear are their unintended effects on competition in the rating space. Also, how the rules will address the problem of “rating shopping” that plagues the business of credit rating in the country is unknown. The present business model of rating agencies is seen to allow considerable room for issuers of securities to shop for a favourable rating or avoid negative ratings by severing their ties with these agencies. Prudential regulation is thus justified to tackle this problem. This criticism, however, ignores the reputational damage these agencies suffer after each corporate default. Repeated failures have not affected the business of rating agencies, primarily due to the lack of alternative service providers who can help out investors. Individual creditors have thus had to trust the ratings of the existing rating agencies at their own peril, even after repeated crises. As is well-known today, the Indian credit rating market is an oligopolistic one due to the high barriers to entry. SEBI’s proposed move to impose further quality requirements on rating agencies is unlikely to change things for the better, or raise further barriers. The way forward lies in making it easier for new players to enter the credit rating space and compete against incumbents. This will go a long way towards making credit rating agencies actually serve creditors rather than borrowers.

Rajasthan’s ordinance shields the corrupt, threatens the media and whistle-blowers

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