



Structural reforms are needed to bring accountability to the credit rating industry

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Why in News?

After the IL&FS crisis, the Securities and Exchange Board of India is now trying to increase the level of scrutiny on credit rating agencies that failed to warn investors about it.

SEBI guidelines:

- SEBI has come out with new guidelines to improve the quality of disclosures made by credit rating agencies.
- According to the new norms, credit rating agencies will have to inform investors about the liquidity situation of the companies they rate through parameters such as their cash balance, liquidity coverage ratio, access to emergency credit lines, asset-liability mismatch, etc.
- Further, rating agencies will have to disclose their own historical rating track record by informing clients about how often their rating of an entity has changed over a period of time.
- While rating agencies already make at least some of these disclosures one way or the other, mandating the formal disclosure of these facts is still welcome.
- But the latest regulations can only help to a certain extent as a lot of the problems with the credit rating industry have to do with structural issues rather than the lack of formal rules.
- The primary one is the flawed “issuer-pays” model where the entity that issues the instrument also pays the ratings agency for its

services.

- This often leads to a situation of conflict of interest, with tremendous potential for rating biases.
- Second, the credit rating market in India has high barriers to entry, which prevent competition that is vital to protecting the interests of investors.
- It is thus no surprise that even after repeated ratings failures in their long history, credit rating agencies continue to remain and flourish in business.
- Structural reform should aim to solve another severe problem plaguing the industry, which has to do with rating shopping and the loyalty of credit rating agencies in general.

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