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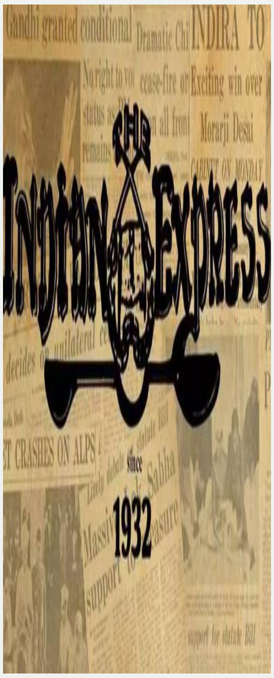
# QUALITY OF RATINGS

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Capital Market & SEBI

Recreating the classic ‘mohalle ki Diwali’ on Digital?




India’s securities market regulator, Sebi, has unveiled new rules for Credit Rating Agencies (CRAs) in an attempt to enhance the quality of their disclosures and to ensure greater transparency. The tightening of norms mirrors a pattern globally, when regulators had to step in after widespread criticism regarding their flawed judgement and ratings of firms even when the financial health of some of the borrowers was deteriorating. In India, the raters were caught napping when some of the Special Purpose Vehicles or SPVs promoted by the infrastructure developer and financier, IL&FS, defaulted, being forced to downgrade their ratings from an investment grade rating assigned till July this year, impacting mutual funds and other investors who had bought bonds of these firms. Sebi’s new rules now mandate the CRAs to disclose the name of the parent company, group or government which is expected to infuse funds to service debt if the support of the parent group is factored in the credit rating along with the rationale for the expectation.

The CRAs will also have to provide the list of all subsidiaries or group companies which are consolidated for rating purposes and the rationale for consolidation. The raters will have to focus more on liquidity to highlight liquid investments or cash balances, access to credit lines, adequacy of cash flows for servicing debt obligations which are maturing, and unutilised credit lines besides disclosing any linkage to external support for meeting short term debt obligations. They will also now be forced to provide the date on sharp rating actions in the investment grade rating category to stock exchanges and depositories to be disclosed on their websites on a half-yearly basis. Some of the new norms, specially the monitoring of liquidity, are well intentioned given the experience of many lenders who realised after the huge pile-up of bad loans in the last few years that it is important to be guided more by cash flow statements when making judgements on whether to lend to borrowers. Regulators worldwide have come down hard on rating agencies after the 2008 crisis. Yet, it is a moot point as to whether this greater oversight of CRAs will lead to a perceptible improvement in the credit rating exerciser or credit discipline without a sufficient deterrent.

That’s why Indian regulators, too, should perhaps consider imposing monetary fines or penalties, which could hurt not just banks or other financial institutions but also credit rating agencies to force a behavioural change and ensure that they carry out correctives. In turn, the regulators should help the rating agencies to better access credit information of the smaller companies. India’s debt markets will continue to be stunted if raters and their supervisors fail to lift their game. And if India’s huge infrastructure funding over the next few years has to be met by tapping into long term retirement and pension funds, much will hinge on the quality of ratings.

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