2021 FfD Forum

Panel III: Strengthening private creditor and credit rating agencies contribution to pandemic response and recovery

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14 April 2021

The multiple problems and failures, including monopoly power, conflicts of interest, procyclicality and lack of accountability - all of which have created systemic financial risks in every financial crisis over the decades.

As my colleague from the African Network on Debt and Development highlighted, during the Covid pandemic, 11 countries saw their sovereign credit rating downgraded during the first half of 2020, and 12 countries had their outlooks changed to negative.

The threat of downgrades and subsequent reputational damage, loss of market access, increased borrowing costs as well as capital outflows create a chilling cocktail of dangerous repercussions that dissuade countries from requesting private sector debt payments standstills, as well as from participating in the G20's DSSI.

Five key challenges in the business model and methodology of credit rating agencies bear salience for the debt distress many developing countries are experiencing.

First, the credit rating market is monopolized by three agencies which control more than 94 percent of outstanding credit ratings.

Second, a conflict of interest is created by the "issuer pay" model, where agencies deliver rating judgments to the very clients who pay them for their assessments. Does this not cast a looming shadow of doubt over the ability of credit rating agencies to produce objective and impartial assessments?

Third, ratings are procyclical, in that during economic upswings ratings are overly optimistic, fuelling excessive borrowing, and during economic downturns, such as in the current pandemic, ratings are bent towards downgrades at the very moment when countries require liquidity to respond to urgent national health and economic needs.

Fourth, the criterion employed in producing ratings are biased against most kinds of government intervention, and bent toward 'business-friendly' deregulation, often associating labour market 'rigidities' with output underperformance, for example. Some academics have also affirmed that credit rating agencies' methodology in sovereign ratings shows a preference for countries implementing austerity measures.

And fifth, a lack of accountability is created by the way credit rating agencies are shielded from liability by 'freedom of speech' laws, even while their speech or opinion has the power to create harmful volatility in the financial market.

Various proposals for reform and redress have been put forward from countries and institutions. Three key actions can be highlighted in the Covid context:

First, regulate and reduce reliance on credit rating agencies, including by suspending sovereign downgrades during times of debt distress to prevent the worsening of debt distress.

Second, in alignment with the UN's FfD process in the era of Covid and beyond, UNCTAD and the UN Economic Commission for Latin America and the Caribbean, create publicly owned and multilateral credit rating agencies that promote global public goods and avoid being both market evaluators and market players simultaneously.

And third, and most importantly, credit rating agencies must adopt common guidelines to incorporate SDG-aligned, social and environmental, as well as human rights and gender equality indicators into rating methodology.

In conclusion, the real risk of not addressing the failures of credit rating agency is that of a lost decade triggered by sovereign debt crisis in many countries; an outcome marked by human suffering and destructive inequality that is entirely avoidable, if long-needed reforms to credit rating agencies are acted on with an urgency that reflects current reality.

Let's not forget that systemic reforms in the international financial architecture is, after all, the original ethos of Financing for Development in the UN. And what could be more systemic than the market shaping influence of Credit Rating Agencies?

Thank you.