Civil Society FfD Group Submission to the UN Independent Expert on foreign debt and human rights report on "Debt relief, debt crisis prevention and human rights: the role of credit rating agencies"[1]

November 2020

Analysis

1. The role of CRAs in deepening the debt crisis

The operations of CRAs have long been rife with multiplicities of problems and failures, including monopoly power, conflicts of interest and moral hazard, procyclicality and the creation of systemic financial risks, failed performance and a deeply flawed business model. In the aftermath of the Global Financial Crisis 2008, there were a multiplicity of criticisms weighed against private CRAs (the big 3 of Fitch, Moodys, Standard & Poor). These criticisms included financial market volatility exacerbated through issuance of faulty public statements, ratings warnings, and downgrades; and constraints to policy space, access, inclusion and terms of engagement in the global economy (access to external finance (bigger issue of structural dependency on external finance), terms of borrowing cost, terms of domestic bond market issuance, etc.). Various systemic financial regulation was called for in the aftermath of the 2007-8 Global Financial Crisis as well as the 1997 East Asia.

Now in the context of the COVID-19 pandemic and ensuing debt crises, the role of CRAs in the context of the current sovereign debt crisis across developing countries both low- and middle-income is under scrutiny and has raised both criticism and calls for their further regulation.

Up to 11 countries saw their sovereign credit rating downgraded in the first half of 2020, according to the "Sovereign Credit Rating Review"[2] report produced by the African Peer Review Mechanism - an entity of the African Union - in collaboration with the African Development Bank and the United Nations Economic Commission for Africa. Additionally, 12 countries had their outlooks changed to negative by different CRAs, meaning their assessments were at risk of being cut. As the review states, "with the tremendous power of rating agencies to influence market sentiments and investors' portfolio allocation decisions, COVID-19-induced downgrades could have contributed to deterioration of macroeconomic fundamentals as investors immediately responded by raising the cost of borrowing and withdrawing their capital, aggravating the downside economic situation. CRA-downgrades often have a 'self-fulfilling prophecy' effect: even countries with strong macroeconomic fundamentals, once downgraded, experience a deterioration of their macroeconomic fundamentals, converging to the levels predicted by the rating model. The main impact of the downgrades and negative outlooks has been a spike in interest rate, to more than

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[1] This document has been submitted in the name of the Civil Society FfD Group (including Women's Working Group on FfD) and has been facilitated by Afrodad, Eurodad, Society for International Development and Third World Network, as a contribution to the call of the UN Independent Expert on Debt and Human Rights.
The Civil Society FfD Group is an open network of more than 800 organizations, federations and networks from diverse regions and constituencies around the world, including the Women's Working Group on FfD.

[2] African Union "Africa Sovereign Credit Rating Review". June 2020 https://au.int/sites/default/files/documents/38809-doc-final_africa_scr_review-_mid_year_outlook_-_eng.pdf

double according to the AU review, making it "more challenging for countries to mobilize resources to support the policy response to Covid-19 as investors became more risk averse"[3].

Up to 27 countries haven't requested debt payments moratorium under the Debt Service Suspension Initiative, promoted by the G20, even when they were eligible. Among the reasons for those countries not to request debt suspension from bilateral and, particularly, private creditors, we can point to the fear of the negative impact of requesting a debt standstill on sovereign ratings by CRAs and future access to financial markets.

Despite the calls on private lenders to participate in the DSSI, and given that this participation has so far remained voluntary, not a single private lender has yet offered debt payment suspension to any DSSI eligible country. The main argument from the private sector is that no one has requested it. This is however not completely true as Grenada, Chad, Zambia and Suriname have all approached private creditors with requests for debt payments standstill.

As a consequence, it is indeed unlikely that a large number of countries will request suspension of payments to private creditors, especially when considering the unlikeliness of the private sector to respond positively to those requests and the statements by CRAs, such as S&P, Moody's and Fitch about the potential of a private creditor standstill leading to a downgrade of sovereign ratings. In fact, both Zambia and Suriname saw their credit rating downgraded after requesting a debt payments' temporary suspension to private creditors.

1.1 Risk downgrading after standstill requests to private creditors

Risk of CRAs downgrades and the consequent limitation to market access, have been dissuading developing countries from requesting private sector debt payments standstills and as well as from requesting participation in DSSI. Even though ratings agencies claim that requesting bilateral debt suspension from official creditors through the DSSI does not constitute a credit rating event per se, the rhetoric used by some of these agencies and the representatives of the private sector, has reinforced fears among borrowing countries of a downgrade and the consequent loss of market access, especially when applying not only to DSSI but to private creditors for a similar debt service standstill. For instance, in the case of Senegal, Moody's stated that "the suspension of debt service obligations to official creditors alone would be unlikely to have rating implications; it provides liquidity relief at a time when Senegal's fiscal position is under pressure as a result of the global coronavirus shock. However, the G20's call on private sector creditors to participate in that initiative on comparable terms raises the risk of default on privately-held debt under Moody's definition"[4].

Similarly, S&P have stated that, while debt relief from official creditors will not be treated as a sovereign default on its own, a country's failure to pay its scheduled debt service would be viewed as a credit negative, which in some cases could constitute a sovereign default[5]. As a result, many

[3] Bloomberg. "*African Review Panel Slams Ratings Firms For Covid-19 Downgrades*". 29 October 2020 https://www.bloomberg.com/news/articles/2020-10-29/african-review-panel-slams-ratings-firms-for-covid-19-downgrades

[4] Moody's. "Moody's places Senegal Ba3 ratings on review for downgrade". June 2020 https://www.moodys.com/research/Moodys-places-Senegals-Ba3-ratings-on-review-for-downgrade--PR_426332

[5] White&Case "The G20 Debt Service Suspension Initiative – Reaction from Key Market Participants". June 2020 https://www.whitecase.com/publications/alert/g20-debt-service-suspension-initiative-reaction-key-market-participants

have been hesitant to engage in discussions with private creditors so far, as indeed rating downgrades would impair access to future financing and increase borrowing costs[6].

In response, the UN Department of Economic and Social Affairs has taken issue with Moody's stance, questioning the timing and basis for the rating downgrades and saying the scheme "should improve countries' debt sustainability, and therefore should not be a basis for credit downgrades".[7] It added: "Borrowing countries should come out of the programme with stronger credit than if they had not participated." World Bank president David Malpass urged the G20 to extend the debt-relief scheme to the end of 2021, adding that commercial creditors of governments taking part in the scheme should "discontinue their collection" of principal and interest.[8]

A number of African countries have also contested decisions by credit rating agencies. Some have raised objections that the rating agencies lack understanding of their economic environment.[9] Others have challenged the correctness of their ratings on the basis that the agencies had not discussed them with the country's representatives. The African Union has called for rating agencies to freeze downgrades during the Covid-19 global pandemic.[10] The European Securities and Markets Authority has cautioned agencies against deepening the coronavirus crisis through "quick-fire" downgrades of countries as the pandemic pushes economies into recession.

Rather than giving in to fear-mongering, countries' engagement with private creditors (and all creditors) to bring debts to more sustainable levels should be considered positively by CRAs in their analysis of sovereign debt risks. If successful, the debt relief and restructuring process would leave the country in a stronger position to honour its financial commitments. Debt relief should therefore be considered as *credit positive* as it could facilitate "short-run investment and bolster debt sustainability in the long term", as a Scope Ratings report concluded recently[11].

1.2 Risk premium paid by African countries

Research on African government bonds show that issuing between 2006 and 2014, the price for African bonds is about 2.9 per cent more than their macroeconomic indicators or credit risk ratings would indicate. Higher coupon payments are not explained by observable risk measures and they can only be described "as a penalty on African governments due to investor bias"[12]. This bias can be exacerbated in contexts of economic unrest like the one created by the Covid-19 pandemic[13].

[6] African Business. "Africa and creditors wake up to debt dilemma" 12 June 2020 https://africanbusinessmagazine.com/uncategorised/continental/africa-and-creditors-wake-up-to-debt-dilemma/

[7] Financial Times. "Moody's clashes with UN over G20 debt-relief efforts" July 2020 https://www.ft.com/content/7d51d373-c12e-4440-a408-e61a939e3a3c

[8] World Bank. "World Bank Group President David Malpass: Remarks for G20 Finance Ministers and Central Bank Governors Meeting". July 2020 https://www.worldbank.org/en/news/statement/2020/07/18/world-bank-group-president-david-malpass-remarks-at-the-g20-finance-ministers-and-central-bank-governors-meeting

[9] Ghana Ministry of Finance "S&P Global Ratings lowers Ghana's Long-Term Rating to B- with a Stable Outlook" September 2020 https://www.mofep.gov.gh/press-release/2020-09-14/global-ratings-lowers-ghanas-long-term-rating-to-b-with-a-stable-outlook

[10] African Union. "Africa's Governance Response to Covid-19 | Preliminary Report 2020"" https://au.int/sites/default/files/documents/38893-doc-covid_19_final_english.pdf

[11] Reuters. "Private creditor debt relief for Africa may be long-term positive -rating agency". 3 september 2020 https://lta.reuters.com/article/idAFKBN25U17X-OZABS

[12] Olabisi, Michael; Stein, Howard (2015) Sovereign bond issues: Do African countries pay more to borrow?, *Journal of African Trade* 2:1-2, 87–107, DOI: http://dx.doi.org/10.1016/j.joat.2015.08.003

[13] African Business. *"Credit rating agencies' harsh stance is hurting Africa".* 8 October 2020 https://africanbusinessmagazine.com/african-banker/credit-rating-agencies-inflexible-stance-is-hurting-africa/

1.3 Premium on climate vulnerable countries

According to research commissioned by UN Environment, public debt interest rates for the V20 group of systemically climate vulnerable countries[14] are higher than they should be if only macroeconomic and fiscal indicators are considered, and this is due to climate vulnerability.[15] The research estimates that exposure to climate risks has already increased the cost of debt for V20 countries by 117 basis points, on average, which can be "translated into more than 40 billion in additional interest payments over the past 10 years on government debt alone". If we include also the private sector, the V20 economies would have been paying over US$ 62 billion in higher interest payments. The projections made by the researchers set the additional costs over the next decade at between US$ 146 – 168 billion.

The link between debt vulnerabilities and borrowing costs was also corroborated by a recent IMF working paper, which analyses the effects of climate change on sovereign risk as measured by government bond yields and spreads in 98 developed and developing countries during the period 1995–2017. The research concludes that "climate vulnerability has a highly significant effect on the cost of government borrowing, even after controlling for conventional macroeconomic and institutional determinants of sovereign risk". The impact of climate vulnerabilities in borrowing costs is "greater in developing countries with weaker capacity to adapt to and mitigate the consequences of climate change" according to the paper authors[16].

Similarly, a recent report prepared by the SOAS Centre for Sustainable Finance at SOAS University of London, the Asian Development Bank Institute, the World Wide Fund for Nature Singapore and Four Twenty Seven, concludes that higher climate risk vulnerability leads to significant rises in the cost of sovereign borrowing, particularly in the Global South. According to this research "premia on sovereign bond yields amount to around 275 basis points for economies highly exposed to climate risk", but exposure to climate risks is not statistically significant for the group of advanced economies included in the study. Furthermore, the study signals six different transmission channels through which climate change "can amplify sovereign risk and worsen a sovereign's standing: the fiscal impacts of climate-related disasters; the fiscal consequences of adaptation and mitigation policies; the macroeconomic impacts of climate change; climate-related risks and financial sector stability; the impacts of climate change on international trade and capital flows; and the impacts of climate change on political stability"[17].

This situation leads to a vicious circle, since, as borrowing costs increase due to climate vulnerabilities, countries find themselves having to devote more resources to repay their debts and

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[14] The Vulnerable Twenty (V20) Group of Ministers of Finance of the Climate Vulnerable Forum (http://www.thecvf.org/) gathers a group of economies systemically vulnerable to climate change. More information: https://www.v-20.org/about/

[15] Buhr, Bob; Volz, Ulrich (2018) *Climate Change and the Cost of Capital in Developing Countries. Assessing the impact of climate risks on sovereign borrowing costs.* UN Environment, Imperial College Business School and SOAS University of London. July 2018 https://www.soas.ac.uk/economics/research/grants/climate-change/

[16] Cevik, Serhan, and Tovar, Joao (2020) *This changes everything: Climate shocks and sovereign bonds*. International Monetary Fund, Working Paper, Washington D.C., June 2020 https://www.imf.org/en/Publications/WP/Issues/2020/06/05/This-Changes-Everything-Climate-Shocks-and-Sovereign-Bonds-49476

[17] Volz, Ulrich; Beirne, John; Ambrosio Preudhomme, Natalie; Fenton, Adrian; Mazzacurati, Emilie; Renzhi, Nuobu; and Stampe, Jeanne (2020) *Climate Change and Sovereign Risk.* London, Tokyo, Singapore, Berkeley: SOAS University of London, Asian Development Bank Institute, World Wide Fund for Nature Singapore, Four Twenty Seven. https://eprints.soas.ac.uk/33524/

therefore these extra costs undermine their capacity to invest in climate mitigation and adaptation and to address loss and damage. As they can't invest enough in climate adaptation nor mitigation, their climate vulnerabilities increase, and so do the borrowing costs.

In fact, since 2014 rating agencies, including Standard & Poor's, Moody's and Fitch group have been indirectly looking at climate vulnerabilities in their sovereign ratings. Standard & Poor's identified already in 2014 climate change as one of the global mega-trends impacting negatively sovereign creditworthiness.[18] Moody's has also stated that, although their "sovereign bond rating methodology does not account separately or explicitly for the credit risks posed by climate change, climate risks are already broadly captured in the four key risk factors we use in our analysis – economic strength, fiscal strength, institutional strength and susceptibility to event risk – either directly or indirectly through a variety of indicators"[19]. Climate vulnerabilities impact on sovereign's credit profiles, according to Moody's, through four channels:

1) the potential economic impact (for example, weaker activity due to a loss of agricultural production);
2) damage to infrastructure assets as a direct result of the physical destruction incurred from climate shocks;
3) rising social costs brought about, for example, by a health crisis or food security concerns;
4) population shifts due to forced displacements resulting from climate change.

As a consequence, Moody's analysis concludes that "sovereigns' ratings are quite strongly correlated with their susceptibility to climate change"[20]. Moody's also recognizes that, in a number of cases, they make explicit downward adjustments to their assessment for sovereign ratings "to account for sovereigns' vulnerability to environmental considerations and climate change". These cases include a number of small islands, such as the Maldives and the Solomon Islands, economies concentrated in sectors reliant on weather, like agriculture – examples include Ethiopia, Kenya, Rwanda, Cambodia- or tourism – such as The Maldives and Seychelles-. [21]

1.4 World bank refusal to provide debt relief and CRAs

In addition to its role at discouraging developing countries to request for a private debt payments standstill and the impact on increased borrowing costs, CRAs ratings are also at the centre of the argument of multilateral development banks, and particularly the World Bank, for refusing their participation in a multilateral debt service[22] suspension or cancellation. The argument stated by the

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[18] Kraemer, Moritz (2014) *Climate Change Is A Global Mega-Trend For Sovereign Risk.* Standard&Poor's Ratings Direct. May 2014 https://www.maalot.co.il/publications/GMR20140518110900.pdf
[19] Moody's (2016) *How Moody's Assesses the Physical Effects of Climate Change on Sovereign Issuers.* Moody's, Report number 1039339. November 2016 https://www.eticanews.it/wp-content/uploads/2017/01/Moodys-climate-change-and-sovereigns-November-7.pdf
[20] Moody's (2016)
[21] Moody's (2018) *Environmental, social and governance risks influence sovereign ratings in multiple ways*. Moody's, Report number 1113476. June 2018 https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1113476
[22] Reuters. "EU watchdog cautions rating agencies over knee-jerk downgrades in pandemic" April 2020 https://www.reuters.com/article/health-coronavirus-eu-regulator-idUSL5N2BX383

World Bank is that this would jeopardise the credit-worthiness of the institution, unless its participation is fully compensated by new shareholder contributions.

For David Malpass, delivering a debt standstill to developing countries facing a catastrophic economic and social situation would harm the Bank's rating and as a consequence, reduce its ability to front-load assistance. Indeed, the World Bank raises financial resources from bond markets in order to then lend these resources to developing countries[23]. For instance, the very same day of the G20 agreement, 15 April 2020, the World Bank raised $8 billion from international investors in financial markets, in the largest ever US dollar denominated bond issued by a supranational[24]. The International Bank for Reconstruction and Development (IBRD), which is the arm of the Bank that finances low- and middle-income countries has had a triple-A credit rating since 1959, which allows it to borrow capital at low rates. This history indicates that previous participation of the Bank in debt relief efforts did not change the credit rating of the institution, for example after the Bank participated in the Multilateral Debt Relief Initiative (MDRI) in 2005 after the G8 Gleneagles Summit.

Rather than being driven by market considerations, the World Bank should commit to providing debt relief to the many countries in need and explore together with the IMF and other MDBs, the many possibilities to protect their concessional lending capacity while doing so. A debt cancellation mechanism or trust fund, similar to the IMF Catastrophe Containment and Relief Trust (CCRT) – fully funded by donor contributions – or as the debt relief trust fund set up for the MDRI, could be explored. In the case of MDRI, a trust fund to compensate the multilateral institutions for their losses was created and funded through donor contributions, sale of gold reserves from the IMF and allocation of IBRD savings[25].

As data provided by Jubilee Debt Campaign UK prove[26], There is no doubt that a combination of funds from SDR allocation and IMF gold sales, together with use of reserves and donor contributions in addition to existing Official Development Assistance (ODA) commitments, could extensively cover the multilateral debt relief that many countries urgently need. However, instead of exploring these and other possibilities, the World Bank continues to reinforce the excessive power of CRAs rather than challenging it.

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[23] World Bank Group President David Malpass: Remarks to G20 Finance Ministers. 15 April 2020 https://www.worldbank.org/en/news/statement/2020/04/15/world-bank-group-president-david-malpass-remarks-to-g20-finance-ministers?cid=SHR_SitesShareTT_EN_EXT

[24] World Bank Raises Record-breaking USD8 Billion from Global Investors to Support its Member Countries. 15 April 2020 https://www.worldbank.org/en/news/press-release/2020/04/15/world-bank-raises-record-breaking-usd8-billion-from-global-investors-to-support-its-member-countries

[25] Kaiser, Jürgen (2020) 20 years after the Cologne debt initiative: What became of the HIPC Countries? September 2019 http://library.fes.de/pdf-files/iez/15693.pdf

[26] According to Jubilee Debt Campaign calculations, "cancelling all debt payments to the IMF and the World Bank by DSSI countries from October 2020 to December 2021 could be funded by the profit from selling just 6.7 per cent of the IMF's gold", which could provide as much as $8.2 billion for the most impoverished countries. Moreover, the Bank and the Fund could explore the reallocation of Special Drawing Rights (SDR) to cover the costs of multilateral debt relief. The new Jubilee Debt Campaign report claims that a new SDR issuance of $1 trillion could pay for the cancellation of all multilateral debt payments by DSSI countries from October 2020 to December 2024 with just the reallocation of less than 9 per cent of the resources that would correspond to rich countries and China, a total of $70 billion. See: JDC (2020*) How the IMF Can Unlock Multilateral Debt Cancellation.* October 2020 https://jubileedebt.org.uk/wp-content/uploads/2020/10/IMF-and-World-Bank-debt-cancellation_10.20.pdf

2- CRAs and the promotion of austerity

The measures adopted to tackle the ongoing economic downturn fall far short of the effort needed to meet the current scale of need in the global south, not only in relation to the scale of the stimulus packages needed in the global south or the insufficient action in relation to the debt crisis, but also given the dangers of a new wave of austerity. CSOs have been alerting on the overly restrictive medium-to-long-term fiscal targets included in ongoing and recently approved financing agreements[27.]

A Eurodad recent review[28] of IMF staff reports for 80 countries - prepared as part of the process of approval for financial assistance between March and September of 2020-, reveals an inadequate response to the Covid-19 pandemic which will lock a large number of countries in a decade-long crisis of debt and austerity. The review finds that all 80 countries receiving IMF financing in 2020, in the case of following the Fund's advice, would be implementing austerity measures equivalent to 3.8 per cent of GDP between 2021 and 2023. The need to protect and increase investment to achieve the Sustainable Development Goals (SDGs) and a fair and green recovery features in every public intervention by IMF officials. However, these commitments are difficult to find in IMF program design. IMF programs are on track to arrest development efforts in the next decade.

As it happened in previous crisis, particularly in the European debt crisis, CRAs play a role in boosting the austerity wave. According to some academics[29], CRAs methodology in sovereign ratings shows a preference for countries implementing austerity measures. Efforts to endorse fiscal consolidation, decrease spending and, therefore, reduce debt, are seen as credit positive. While stimulus packages that can in the short term increase fiscal deficits and eventually cumulate further debt levels, would be seen as credit negative. The message CRAs portray is that more austerity leads to better ratings and therefore cheaper market access. Austerity is in fact seen as a signal to capital markets that a government is willing to honour its debt obligations. Some have even called this the "downgrade-austerity vicious-circle" [30].

In the present context, where CRAs have been placing numerous developing countries on negative watch for a downgrade, this could also be seen as a signal that "spending what is needed on pandemic response could invite ratings downgrades"[31]. Once again, this could prompt the acceleration and worsening of negative economic dynamics and impacts of the present economic crisis.

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[27] Civil Society Organisations' statement against continued IMF austerity. October 2020 https://www.eurodad.org/civil_society_organisations_open_letter_to_imf_austerity

[28] Munevar, Daniel (2020*) Arrested Development: International Monetary Fund lending and austerity post Covid-19*. Eurodad. October 2020 https://www.eurodad.org/arrested_development

[29] Luten, Leks (2016) Credit Rating Agencies: Do the notorious big two influence domestic austerity policies?. Leiden University – Master's Thesis. August 2016 https://openaccess.leidenuniv.nl/bitstream/handle/1887/54340/2016_Luten_PA_IEG.pdf?sequence=1

[30] Sager, Fritz; Hinterleitner, Markus (2016). *Austerity Programs and their Assessment by Credit Rating Agencies during the European Debt Crisis – An Implementation Perspective*. https://www.semanticscholar.org/paper/Austerity-Programs-and-their-Assessment-by-Credit-%E2%80%93-Sager-Hinterleitner/56e860cbdba738c4fc101824f231b3ff5544200e#paper-header

[31] Financial Times. "*Rating agencies owe the market more transparency*". 20 July 2020 https://www.ft.com/content/2a0bffc7-e925-4df8-ba9c-2bf9dda579b3

Recommendations

1. Further regulation of CRAs

CRAs measure the financial strength of sovereigns on the basis on the ability to meet debt obligations without defaulting or making late payments. The higher the risk of default might be - no matter the reason - the higher the interest payment investors require to compensate for the risk they take. This generates two main issues. Firstly, CRA assessments have been short-sighted and narrowly focused on short-term economic growth trends, failing to integrate a wider-set of considerations that could contribute to reduce the systemic risk and facilitate longer-term economic viability and sustainability. Secondly, the reasons for default should actually matter. If the delayed or defaulting payments are due to one country prioritizing its human rights obligations – which are binding international laws – over the reimbursement of private creditors in the context of a systemic crisis (i.e., extreme weather events, health pandemic), it would be heavily unfair to penalize the borrowing country without acknowledging the shared responsibility of lenders and borrowers in the particular systemic context.

CRAs should therefore be required, through binding regulations rather than voluntary frameworks, to incorporate longer-term human rights-based, gender-sensitive, SDG-aligned, social and environmental indicators into their ratings in order to provide a more comprehensive and fairer picture of the development trajectory of countries being rated. Many have pointed out that including these additional indicators without proper regulatory frameworks could have an adverse effect, by geniting increased risk premium on developing country borrowing. On the contrary, countries that embark on socially, gender and ecologically-just economic development trajectories should be rewarded with lower risk premiums, even if their expended fiscal proceedings might be lower than countries with predatory and unsustainable economic strategies.

Together with further important reforms in the international financial architecture, including advancing towards a multilateral framework for sovereign debt resolution under the auspices of the UN, challenging the role of credit rating agencies is particularly critical for the fair resolution of the unfurling debt crisis and to ensure developing countries have access to the resources they need to guarantee economic, social and cultural rights and fulfil their commitments regarding the achievement of SDGs, gender equality and Paris Agreement. States have binding human rights obligations and cannot circumvent their responsibilities in ensuring their fiscal space is not constrained in providing for rights to food, health, education etc.

While improving the quality of CRAs rating methodologies is a critical issue, CRA regulation would also need to focus on issues such as addressing conflicts of interest, promoting alternative market structures to increase competition, and tackling excessive reliance of investors on ratings.

This call for stronger regulatory frameworks for CRA is not new. For many years, numerous officials and analysts have called for the effective regulation of CRAs, in order to curtail the adverse impacts of their operations. The demands for increased regulation and transparency of CRAs are based, among others, on concerns around the accuracy of their analyses and their role in initiating and accelerating economic and debt crises – as exemplified even in the euro-zone sovereign debt crises, among many other sovereign payment crises.

We also take note of the fact that these calls for greater regulation have been attempted for years, including during the subprime crisis. For instance, the conclusions of the “Commission of

Experts of the President of the UN General Assembly on Reforms of the International Monetary and Financial System" (known as Stiglitz Commission) called in 2009 for the "reform of the Credit Rating System", including as action items: "Adopt one or more regulatory options to address conflicts of interest and incentives" and "Reform the quasi-public role of nationally recognized statistical rating organizations and consider creating a Credit Rating Review Board.". The report concluded that "the credit rating system is ineffective and plagued with conflicts of interest".

We therefore strongly support the call by the UN Independent Expert on Debt and Human Rights on the urgency of addressing the need for accountability, transparency and regulation of credit rating agencies. However, a key challenge from a developing country perspective has been that much of these regulation discussions are taking place in bodies where they are not represented or inadequately represented (e.g.: G20, FSB, Basel Committee, etc.). **We therefore recommend that the United Nations take up the question of regulating CRAs.**

2. United Nations should lead on regulating CRAs

We recommend that a universal, intergovernmental Commission under the ECOSOC be convened with a timeline to examine needed international institutional innovations, including in the UN, required to correct and avert the adverse impacts of CRAs on international finance. Such a commission could immediately start to follow-up on the UNGA thematic discussion in 2013 on 'The Role of Credit Rating Agencies in the International Financial System'[32] to take stock of progress (or lack thereof) in regulation of CRAs since the last financial crisis to agree on next steps. Several commitments that were made then, including to reduce reliance and references to CRA ratings in legislation and regulation, need to be part of such a stock-taking exercise to ensure there are lessons being learnt and decide next steps.

G77 and China in their statement in 2013 on 'The Role of Credit Rating Agencies in the International Financial System' called for the need for "a more transparent international credit rating system that fully takes into account the needs, concerns, and peculiarities of developing countries."

We further recommend efforts for such a UN commission to study the potential for and facilitate the start-up of the following options, as appropriate:

- **United Nations observatory of credit rating service providers:** The Secretary General's report to the UNGA in 2013 called for the consideration of establishing a United Nations observatory of credit rating service providers[33]. It was noted that this UN observatory could among other things "certify credit rating products and build consensus on common standards for rating methodologies."

- **Publicly-owned credit rating agencies**: This recommendation featured most recently in the 'menu of options' resulting from the process on 'FfD in era of COVID-19 and Beyond' led by the UN Secretary General, Jamaica and Canada. The document recommends the '*Creation of publicly owned credit rating agencies, so that agencies are not both market evaluators*

[32] UN "General Assembly Examines Growing Role of Credit Rating Agencies as Arbiters of Risk, while Speakers Call for Common Standards, Objectivity, Reforms" September 2013 https://www.un.org/press/en/2013/ga11409.doc.htm
[33] https://www.un.org/development/desa/en/news/financing/global-credit-rating-system-2.html

and market players as at present. (page 18)". Such a public utility reconstruction has the significant potential of facilitating the reduction of CRA monopoly power as well as their ability to constrain policy space for developing countries through their embedded procyclicality, particularly in the context of a pandemic and economic recession. Importantly, public ownership of CRAs widens the possibility of integrating human rights-based and gender-sensitive criterion in the indicators and assessment frameworks of CRAs. Ratings of these public CRAs should provide the benchmarks for portfolio investments of national pension and insurance funds, in order to become relevant.

- **International credit rating agency at the UN:** Susan Schroeder, University of Sydney has suggested that such an international agency could "*act to validate the work performed by national agencies and private assessors. Its presence would act to counterbalance the influence that private credit rating agencies have over the state of fiscal budgets. Attempting to reduce fiscal deficits during recessions, in response to potential or actual sovereign downgrades, has a tendency to weaken effective demand and economic growth. An international credit rating agency could, conceivably, call a moratorium on downgrades in order to enable governments to stimulate growth and enhance economies' shift to recovery*" [34]

Conclusion: Need for broader financial regulation

It is important to see the regulation of CRAs within a broader framework for regulation and supervision of financial instruments, actors, hedge funds etc. This should be done through a UN framework so all developing countries are also at the table in negotiating such regulation to ensure their interests are represented.

The Covid-19 led economic crisis is also symptomatic of systemic challenges that the current global financial architecture poses. The debt crisis is revealing the interconnectedness between the role of CRA and FDI in the form debt issuance, capital flight, and undermining of the Domestic Resource Mobilisation (DRM) agenda. The architecture continues to perpetuate extractive practices in the pursuit of profit, all at the expense of people and the environment. There is a complicity of CRAs activities in the undermining of Human Rights and the responses to the current crisis should strengthen the resolve of UN member states to provide a genuine alternative to the present architecture.

[34] World Economics Association "The case for public credit rating agencies" October 2015 https://www.worldeconomicsassociation.org/newsletterarticles/public-credit-rating-agencies/