Credit Rating Agencies: Opportunities at GIFT IFSC

Global capital plays a vital role in funding the long-term capital intensive and developmental projects like creation of infrastructure and setting up manufacturing units. India is expected to become the third-largest economy in the world in the next three years[2]. This article examines the critical role of Credit Rating Agencies (CRA) in global finance and explores the opportunities for CRAs at GIFT IFSC, India's gateway to international capital.

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INTRODUCTION

In the world of finance, credit ratings act as a bridge between investors and borrowers. By assessing the likelihood of borrowers repaying their debts, credit ratings help investors understand the risk involved in purchasing a particular security. Credit rating provides transparency to the investors regarding creditworthiness of borrowers, which in turn impacts the interest rates demanded by investors. CRAs assign the ratings based on various factors such as financial performance, business and industry risk, operational performance, ability to service the debt, legal and regulatory environment etc.

CRAs play a crucial role in the global financial markets by providing independent assessments of the creditworthiness of various entities, including sovereigns, corporations, and financial instruments. These assessments help investors make informed decisions, facilitate the efficient allocation of capital, and promote financial stability.

SIGNIFICANCE OF CREDIT RATING AGENCY

CRAs remain an essential part of the financial system by providing independent assessments of creditworthiness, expressed as credit ratings, which are crucial for various stakeholders:

- **Investors:** The assessment of CRA enable the investors to make well-informed decisions by evaluating the ability of borrowers, such as sovereign governments and corporations, to repay their debts. Credit ratings serve as a critical guide for investment decisions across a wide range of asset classes, from bonds to structured finance products. By offering a standardized measure of credit risk, CRAs help investors to assess the potential returns relative to the risks involved, manage portfolio diversification, and make strategic investment choices that align with their risk tolerance and financial goals.

- **Issuers including sovereign:** Credit ratings offer several benefits to issuers, including sovereign governments. A favorable credit rating from a reputable CRA enhances an issuer's ability to access capital markets more effectively, allowing them to raise funds through bonds and other financial instruments at lower interest rates. This reduces the issuer's overall cost of borrowing and signals financial stability, which can attract a broader investor base.

- **Regulators:** Credit ratings assist regulators in assessment of systemic risks within the financial system. Credit ratings can also be used to set regulatory capital requirements for financial institutions, ensuring stability and resilience in the financial sector.

IOSCO PRINCIPLES

The global financial crisis of 2008 (GFC) cast a spotlight on the critical role of CRAs and their impact on the stability of the international financial system. The crisis exposed weaknesses in the methodologies used by CRAs, particularly in their assessment of complex financial instruments like mortgage-backed securities. These instruments were often assigned investment-grade ratings despite harboring significant risk, leading to a domino effect when the housing market collapsed.

In the aftermath of the GFC, policymakers and regulators around the world have taken steps to strengthen the oversight and governance of credit rating agencies. The International Organization of Securities Commissions (IOSCO) introduced a new Principle on CRAs during the revision of Principles in 2010 stating that - *"Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision."*

IOSCO has also updated the Code of Conduct Fundamentals for CRAs[1] in 2015, which is intended to offer a set of robust, practical measures as a guide to and a framework for CRAs with respect to protecting the integrity of the rating process, ensuring that investors and issuers are treated fairly, and safeguarding confidential material information provided them by issuers.

GIFT IFSC: GATEWAY FOR INDIA

Global capital plays a vital role in funding the long-term capital intensive and developmental projects like creation of infrastructure and setting up manufacturing units. India is expected to become the third-largest economy in the world in the next three years[2]. It has one of the lowest External Debt to GDP of 18.90% when compared to other large economies like Japan (107.7%) and Germany (148.2%)[3]. This indicates that there is significant potential for India to leverage global capital to fuel the infrastructure and manufacturing growth. Thus, GIFT IFSC, maiden international financial services centre in India, can contribute significantly facilitating foreign currency inflows in India.

GIFT IFSC offers various advantages to the market participants:

- **Robust regulatory framework:** GIFT-IFSC is regulated by International Financial Services Centres Authority (IFSCA), a unified regulator in IFSC. The regulations in IFSC have been benchmarked with the other international financial centres. The aim is to bring back India related financial services and transactions that are currently being carried outside of India by promoting ease of doing business in IFSC.

> GIFT IFSC presents a compelling opportunity for CRAs to expand their reach and cater to a global audience. By establishing a presence here, CRAs can leverage international best practices, attract new clients, and offer a wider range of services to the world. This will not only strengthen their reputation but also contribute to the development of GIFT IFSC as a leading international financial center, fostering a more transparent, efficient, and inclusive financial ecosystem.

- **Competitive tax regime:** Government of India has provided certain tax benefits in form of capital gains tax exemption for non-resident for trading on securities on the stock exchanges in IFSC, 10-year tax holiday for the entities in IFSC, lower rate of withholding tax on interest from bonds listed on IFSC exchanges etc.

- **Access to Indian market:** GIFT-IFSC provides a platform for the foreign investors and NRIs to access foreign securities by Indian issuers under the regulatory ambit of IFSCA.

REGULATORY FRAMEWORK FOR CRAs IN IFSC

The regulatory framework for CRAs has been specified IFSCA (Capital Market Intermediaries) Regulations, 2021[4]. These regulations provide a regulatory regime for the all the capital market intermediaries in IFSC such as Broker-Dealers, Clearing Members, Depository Participants, Investment Bankers, investment Advisors, credit Rating Agencies etc.

The regulations provide the requirements for grant of recognition by IFSCA, net worth requirements, fit and proper criteria, obligations and responsibilities, risk management, code of conduct and other requirements to be followed by the CRAs in the IFSC.

OPPORTUNITIES FOR CRAs IN GIFT IFSC

GIFT IFSC offers an attractive business proposition for CRAs seeking to expand their footprint and cater to a diverse range of clients. GIFT IFSC can provide the opportunities in various sectors:

1. *https://www.iosco.org/library/pubdocs/pdf/IOSCOPD482.pdf*
2. *https://pib.gov.in/PressReleseDetail.aspx?PRID=2001124*
3. *CEIC Data*
4. *https://ifsca.gov.in/Document/Legal/ifsca-capital-market-intermediaries-regulations-2021-as-amended-up-to-july-3-202320072023040848.pdf*

CAPITAL MARKETS

a) **Debt Listing:** CRAs play a critical role in listing of debt by assigning the credit rating to companies seeking to raise capital. In IFSC, credit rating is proposed to be made mandatory for the debt issuances. This will provide transparency to the investors regarding creditworthiness of borrowers, facilitating the investment at appropriate interest rate.

b) **Initial Public Offerings:** Listing of Indian companies on the stock exchanges in GIFT IFSC will provide the opportunity to CRAs for providing credit ratings for IPOs. Further, CRAs can also play the role of Monitoring Agencies for monitoring use of proceeds.

BANKING

a) Commercial Loans & Syndicate Loans: For commercial loans and syndicated loans offered by banks at GIFT IFSC, CRAs can assign ratings to both the borrower and the loan itself. This transparency is crucial for banks to attract lenders and for borrowers to secure loans at competitive rates.

b) Trade Finance: CRAs can offer ratings for trade finance instruments like letters of credit which will enhance confidence in trade transactions and facilitate cross-border trade.

c) **CDs (Certificates of Deposit)**: CRAs can provide credit ratings for CDs issued by banks operating within GIFT IFSC. These ratings will help investors assess the creditworthiness of the issuing bank and make informed decisions about investing in these short-term debt instruments.

d) Structured Finance Products: CRAs can also play an important role by providing ratings for structured finance products like asset-backed securities or collateralized loan obligations assisting the investors to understand the risk profile of these complex products.

Other services: CRAs can also extend other services in IFSC as permitted by IFSCA.

CONCLUSION

GIFT IFSC presents a compelling opportunity for CRAs to expand their reach and cater to a global audience. By establishing a presence here, CRAs can leverage international best practices, attract new clients, and offer a wider range of services to the world. This will not only strengthen their reputation but also contribute to the development of GIFT IFSC as a leading international financial center, fostering a more transparent, efficient, and inclusive financial ecosystem.