**HOLDING RATING AGENCIES TO ACCOUNT**
**IMPERATIVES OF RBI INTERVENTION**

**A POLICY NOTE TO RBI**

Government and RBI have recognised that all is not well with the way Rating Agencies do their work. The damage done to the financial system and cost to the country has not been fully counted although ILFS issue has brought to fore the grave concerns of quality and compromise in ratings. What started as a matter of opinion, reference point for public issues (of equities and debts) for the investors at large has pervaded into the whole of financial system. It is a matter of high disquiet that Banks have come to rely on ratings instead of rigorous of in-house appraisal of the credit proposals. It has been widely acknowledged that the dramatic increase in NPA has to do with the decline in quality of appraisal and too much reliance on the ratings.

Post global financial crisis in 2008, there were enough cues that part of the problem lies with the Rating agencies and there have been hefty penalizing too. In hindsight, we could have taken the cues from the fallacious track record/failures of the Rating agencies (who are the major shareholders of Rating Agencies in India too) and brought them under rigorous regulatory scrutiny. Banks and NBFCs are entrusting their borrower clientele to different Rating agencies even for uncomplicated proposals. As Banks are increasingly influenced by ratings of their constituencies instead of independent professional appraisal while taking credit decisions, there is a clear moral hazard. The methodology and the parameters have been opaque. The rating induced laxity puts public deposits at peril over time.

There is, therefore, a legitimate intervention compulsion for RBI to stipulate what is the non-negotiable basis for rating including criteria/parameters, methodology and process involved. It is high time, RBI initiates a process of dialogue with the stakeholders on rating methodology and parameters that need to be applied for the clients seeking credit facilities from entities regulated by RBI, be it Banks or NBFCs, etc. Left to Banks, even after harmonizing the risk weight of assets for capital charge whether rated or unrated, regardless of the value and complexity of the proposal rating is continue to be embraced by the Banks rather than relying on rigorous in-house appraisal. This calls for a threshold stipulation beyond which ratings could be optional. After finalizing the rating matrix, methodology process, RBI need to issue regulatory directive to the entities regulated by RBI - Banks/NBFCs and also to the Rating Agencies to adopt the rating system evolved by RBI, although rating agencies are under the overall regulation of SEBI.

Other important issue of the concern is the payment of fees to the Rating Agencies. So long as the rated entities are required to pay, there is always the risk of compromise in ratings by the Rating Agencies. RBI examines this issue too.

Well, given the global and our country experience, it is important to recognize that rating is too important a public good to be left to the Rating Agencies and there has to be a periodical regulatory/public scrutiny of the Rating Agencies and RBI would do well to respond with a policy framework.

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