# A MULTILATERAL CREDIT RATING AGENCY (MCRA)

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UNCTAD WORKSHOP

JULY 6 AND 7, 2022

# A MCRA

- 2 key objectives:
  - Improve (and stabilize) credit risk assessments of sovereigns, particularly EMDEs.
    - Validate the current methods and revisions used by credit rating agencies;
    - Lengthen time horizons.
  - Facilitate sustainable development goals (SDGs)
    - The achievement of SDGs is contingent on how climate change unfolds.
    - Importance given to climate conditions as they relate to industrial configuration and performance of firms.

*These key objectives must be accomplished in the context of climate change.

# TIMELINE PROBLEM

## Credit rating agencies create information for investors.

- Their target audience is professional investors, not mom & pop investors.
- And, not just professional investors, but investors with 3-5 year horizons for their investments.

## The “long-term” ratings of the agencies employ timelines of 3-5 years in length.

- There are investors who are interested ratings with longer-term horizons, such as pension funds, hedge funds, and insurance companies. (Infrastructure projects)
- Investors with longer time horizons do what they can in-house and cross-check as best they can.

# *CHALLENGES OF LONGER HORIZONS*

- Moving towards a rating scheme for sovereigns with longer horizons…
- Suggestion from DESA - Extend horizons of current methods through fan charts and scenario analysis.
- A good start – however, this suggestion is contingent on agreement on the underlying equations and assumptions involved in the creation of fan charts and analyses.
  - For example, the IMF's framework for evaluating *public debt dynamics under uncertainty* may not be suitable for EMDEs.
  - Should the equations and assumptions vary to suit EMDEs, the associated ratings scale must differ from the scale for advanced economies.
    - Otherwise, EMDEs are disadvantaged.

# *ORIENTATION OF A MCRA*

The orientation of the MCRA is novel in that the environment is given a prominent role.

- In this way, attention is focused on how climate change has been/is/will be influencing the performance of firms, their industries and *sovereigns*.
- The achievement of sustainable development goals can be addressed more directly.
- The orientation could easily accommodate approaches to economic development.
  - Note, Jeffrey Sachs recent comments about ratings (UN DESA, YouTube, March 2022)

# *FUNDING THE MCRA*

Initial funding of the MCRA could be raised through grants from the United Nations and contributions of sovereigns and central banks.

The MCRA needs to shift quickly towards a self-sustaining state.

The MCRA could shift towards self-financing by reverting to the old subscription model rating agencies used to rely on for revenue.

The fee for a subscription could be set on a sliding scale according to firm or stakeholder size and locale.

The key to funding is to create a body of work that could be used as the basis for a subscription service.

# INTERNATIONAL NON-PROFIT CREDIT RATING AGENCY (INCRA)

- Non-profit rating agency created by the *Bertelsmann foundation in* 2012 as an alternative to private credit rating agencies.
- The idea was to improve ratings accuracy by reducing the influence of conflict of interest in the issuer-pays model.
- Its funding was structured as an endowment sourced from contributions by governments, NGOs, civil society foundations and financial services industries.
- Funding could not be maintained.
- One of the problems was its ratings were not distinctive enough from the ratings of the credit rating agencies.

# *FUNDING EXAMPLE*

- One of the stakeholders of the MCRA is the insurance industry.*
- As per Statista, in 2019 there were nearly 6000 insurance companies in the United States and nearly 7000 in Europe; approximately 13,000 total.
- If the average, annual subscription rate – for an annual report, quarterly updates, and a newsletter – was US$2,500, the revenue from the US and Europe, alone, would amount to US$26,000,000.
- The costing of a skeletal structure for a MCRA is estimated at US$5 – 7,000,000; the next level of expansion is US$24 – 26,000,000.

*Other stakeholders: sovereigns, banks, pension funds, hedge funds, mutual funds and other financial services.  Any entity that needs credit risk assessment for or related to a sovereign and its debt issues.

# *CHALLENGES*

Financing structure

Support innovative ways to service government debt

Regulatory capture

Convincing governments and other stakeholders to incorporate its evaluations in their analyses and guidelines