Statement of H.E. Mr. Vuk Jeremić, President of the 67th Session of the General Assembly, at the Thematic Debate on the Role of Credit Rating Agencies in the International Financial System

Mr. Under-Secretary-General, Distinguished Deputy Foreign Minister of the Russian Federation, Esteemed Guests, Excellencies, Ladies and Gentlemen,

It is my distinct honor to welcome you to the thematic debate on the Role of Credit Rating Agencies in the International System, pursuant to resolution 67/437 entitled “External Debt Sustainability and Development.”

Today’s event represents the first time this critical economic governance issue is being debated in the global setting provided by the United Nations, within the framework of the sovereign equality afforded by the General Assembly.

Thanks to the unique convening power of this Organization, Member States—in particular those from the developing world—will have an unprecedented opportunity to publically exchange views with high-level credit rating agencies executives, and other critical stakeholders in the financial services industry.

I look forward to a spirited and constructive discussion, and thank all of our invited guests, moderators and speakers for their participation.

Excellencies, According to a recent UN report, the main objective of Credit Rating Agencies is to “reduce informational asymmetries between lenders and borrowers, by determining the ability and willingness of potential borrowers to meet their debt servicing obligations.” In making such assessments, CRAs lower the cost of intermediation, thus supporting economic and development activities.

Over the past several decades, the importance of CRAs has grown immensely. One reason is that the rating service they provide has become increasingly embedded, or ‘hard-wired’, into investment mandates, banking rules, and securities regulations across the globe.

CRAs are, uncontestably, an established and integral part of the international financial landscape, whose function is designed to heighten predictability and reduce risk.
As the scale and intricacy of financial intermediation has grown, so too has the demand for information. CRAs are no longer primarily concerned with sovereign and corporate bonds, but now earn a large share of their income from rating and consulting on the design of complex assets. Their assessments can make or break a deal—or at least significantly influence the costs and risks of its financing.

Excellencies,
As the role of CRAs has expanded, the scope of the criticism of the industry has followed suit. A number of concerns have been voiced as to the extent to which they can have a serious impact on financial stability.

For example, some say that they didn’t exactly foresee Mexico’s 1994 devaluation, which had profound consequences throughout Latin America, nor did they adequately assess the financial conditions that led to the Asian tumults of the late-1990s. In the latter case, some have argued that the CRA’s subsequent over-reaction—its steep downgrading of the sovereign debt of Asian countries most affected by the crisis—only made matters worse. Similar critiques were leveled during the recent Eurozone crisis.

Governance issues have also been raised, with certain commentators making the point that lending and borrowing incentives were distorted by the CRAs, such as the “issuer-pays” model of remuneration, leading to the creation of too much cheaply-available credit prior to the 2008 global economic crisis.

Excellencies,
Other assessments of the role of Credit Rating Agencies point to the erosion of trust and reputational capital elsewhere in the financial system. The alleged instability created by CRAs is thus viewed more as a reflection of the failure of some Governments to properly regulate the marketplace. Irrespective of the fact that some authority was transferred to private firms, States nevertheless remain ultimately responsible for the consequences of the actions of the CRAs.

As profit-making enterprises by construction, a financial services company cannot be expected to take into account the adverse public-policy consequences of their business decisions—particularly if this is due to regulators “hard-wiring” ratings into the capital lending architecture in the first place. As the Committee on the Global Financial System has made clear, CRAs are supposed to support investor due diligence, not replace it.

Excellencies,
Such differing points of view underscore the need for an objective review of the future role of the CRAs in the global financial system.

Numerous measures have been proposed. For instance, the Financial Stability Board, the leading international body of central bankers and finance officials, has made detailed recommendations, including those focused on reducing regulatory reliance on the ratings produced by the CRAs.
Thus while the Third Basel Accord, for instance, retains key roles for CRA’s in the risk-weighting of bank capital, it now allows for the recognition of country risk assessments produced by Export Credit Agencies using OECD methodology.

Basel III also requires that the general procedures, methodologies and assumptions for arriving at assessments are made publicly available, thereby increasing transparency in the ratings process—another FSB recommendation.

In the opinion of many economists and financial analysts, however, much more needs to be done.

Excellencies,
Each economic cycle is unique; and each downturn produces new surprises—two important reasons why CRAs may remain as vulnerable to making mistakes as the rest of the financial services industry.

Nonetheless, the status quo is hardly sustainable. It is incumbent for us to consider how one can improve the way CRAs operate, or at least discuss how to mitigate the potential consequences of lapses a CRA could make in the future.

The concept paper to this thematic debate posed a number of points at issue that I hope will be addressed during our deliberations.

I would like to bring to the General Assembly’s attention additional questions I believe should be considered.

First, does making the choice to reduce dependence on CRAs require a fundamental change in financial regulatory mechanisms?

Second, is the governance structure of the CRA industry adequate, given its central role in financial regulation? Has an implicit conflict of interest been built into the current “issue pays” model, which creates less incentive for CRAs to provide clients with proper early warning of potential credit risks down the line?

Lastly, how does the current CRA system affect developing countries? Many do not have ratings at all. As a consequence, the pool of eligible investors is reduced: individuals may be put off by the difficulties of obtaining accurate information, while some larger ones, such as pension funds, are prohibited from holding such assets, due to risk-mitigation clauses in their investment charters. Those who can invest are able to extract substantial risk-weighting penalties from unrated assets, furthering unfavorable market distortion policies, which disproportionally affect the Global South.

Excellencies,
This thematic debate is taking place against the backdrop of ongoing efforts to define the parameters of the post-2015 agenda.
In June 2012 in Rio de Janeiro, world leaders tasked the General Assembly to define the Sustainable Development Goals, put forth options for financing them, and lay out a workable intergovernmental arrangement for monitoring their implementation.

According to the terms of the Rio+20 concluding document, policies designed to foster economic growth are to be integrated into the other two dimensions of sustainable development—namely social and environmental. In addition, it underscores the need for “continued and strengthened cooperation [...] in the area of finance, debt, [and] trade, [as well as] capacity-building, transparency and accountability.”

For a single, inclusive, and fully coherent post-2015 agenda to emerge over the next nine hundred days, sustained efforts will be required to ensure the activities of key economic and financial industries complement those taking place at the UN.

The policies and actions of CRAs could have a critical impact on the General Assembly’s mandate to conceptualize a universal transition to sustainability. In my view, greater consultation and coordination is a strategic necessity.

Excellencies,

Today’s thematic debate is a welcome first step.

I believe the United Nations could play a role in helping to establish the basis for an objective and reliable international rating system. In a recent report to the General Assembly, Secretary-General Ban Ki-moon proposed the “creation of a United Nations observatory of credit rating service providers,” which would, inter alia, “certify credit rating products and build consensus on [common] standards for rating methodologies.”

I sincerely hope Member States will seriously consider this proposal, and that today’s participants will examine its merits in the time to come.

Such an initiative could foster a more coherent global response to the problems associated with international financial intermediation, while ensuring that adequate investment can reach worthwhile, creditworthy development projects throughout the world.

As we reflect on the steps we need to take to redress the failures that led up to the world economic crisis, let us have the courage to conceive meaningful reform to the system of global economic governance, ever mindful of our responsibilities to each other in the Age of Sustainable Development.

Thank you for your attention.