Aston University

BIRMINGHAM UK

Developing a Credit Rating Solution for the World's Poorest Countries: An African Focus

April 2022

This project has been funded by the Open Society Foundations (OSF). The OSF takes no responsibility for the contents of this and any other report generated by the Credit Rating Research Initiative (CRRI) and all opinions, and errors, are that of the authors of the works in question alone.

For the purposes of this brief and the associated works, the authors of the works are:

Dr Daniel Cash – Aston University

Credit Rating Analytics – Mr Saveshen Pillay; Ms Ariane Ndzignat; Mr Lebogang Moichela; and Mr Reislin Naidoo

Dr Prabesh Luitel – IESEG School of Management

The organisations associated with the authors take no responsibility for the contents of this and any other report generated by the Credit Rating Research Initiative and all opinions, and errors, are that of the authors alone.

Suggested citation:

The Credit Rating Research Initiative, *Developing a Credit Rating Solution for the World's Poorest Countries: An African Focus* (2022).

Preface

'Global cooperation during the pandemic will require finding innovative, outside-of-the-box solutions'.[1]

This suite of reports and papers has been designed to review and address what we are calling the 'credit rating impasse'. This 'impasse' is related to the dynamic whereby sovereign countries, who are in desperate need of financial assistance, are by and large refusing to engage in international debt treatment frameworks for fear of being downgraded by the rating agencies. The research report that accompanies this policy brief – entitled *Understanding the Effects of the 'Credit Rating Impasse' Upon Sovereign Debt Treatment* – examined the intricacies of that dynamic from a variety of important and relevant angles. Therefore, the background to the rating impasse will not be covered in any great depth in this brief.

There is also another issue to address here. The proposal we are advancing here to address the credit rating impasse literally has no precedent. There are some concepts that we will present that have not been suggested before, whilst some are adaptations of existing initiatives. Furthermore, and perhaps most importantly, there are a number of caveats to state. The most important caveat is that whilst the following proposal can work if implemented, there are indeed huge question marks over the will to implement anything in this space. Internationally supported debt treatment frameworks have gone nowhere. International bankruptcy frameworks that have been advanced in years gone by have been flatly rejected by leading governments. Private bodies have, to all intents and purposes, refused to be a part of anything that is not voluntary and mostly on their terms. Credit rating agencies have not even responded to calls for them to do more. There have been a

[1] Vasuki Shastry and Jeremy Mark, 'Credit rating agencies could resolve African debt impasse' (2020) Atlantic Council (Sep 8) https://www.atlanticcouncil.org/blogs/new-atlanticist/credit-rating-agencies-could-resolve-african-debt-impasse/.

number of proposals from civil society, politicians, former rating agents, and many others: nothing has happened.

However, we should not be deterred. This brief operates on a simple premise that nobody interested in promoting change to this (and any other) field should be deterred by inaction. It is vital that we keep promoting progressive change and, if nothing is taken on board and the status-quo – which is clearly causing damage – is continued, the question then becomes 'why'? Who benefits from that, and why do they do so? 'Who is preventing change, or is it systemic? 'If it is systemic, then what about the system can change and what needs to be done to change it?' This brief and the project at large may initiate some questions or it may not. Our aim, as an Initiative, is to keep asking such questions and presenting research and proposals to that end.

The Credit Rating Research Initiative

Contents

Executive Summary 1

Stage I – Private Creditors and the Credit Rating Agreement 4

Stage II – A New Approach to Rating Sovereigns in Crisis 9

Stage III – A Supplementary Advisory Service 34

The Need for Legislative Intervention 38

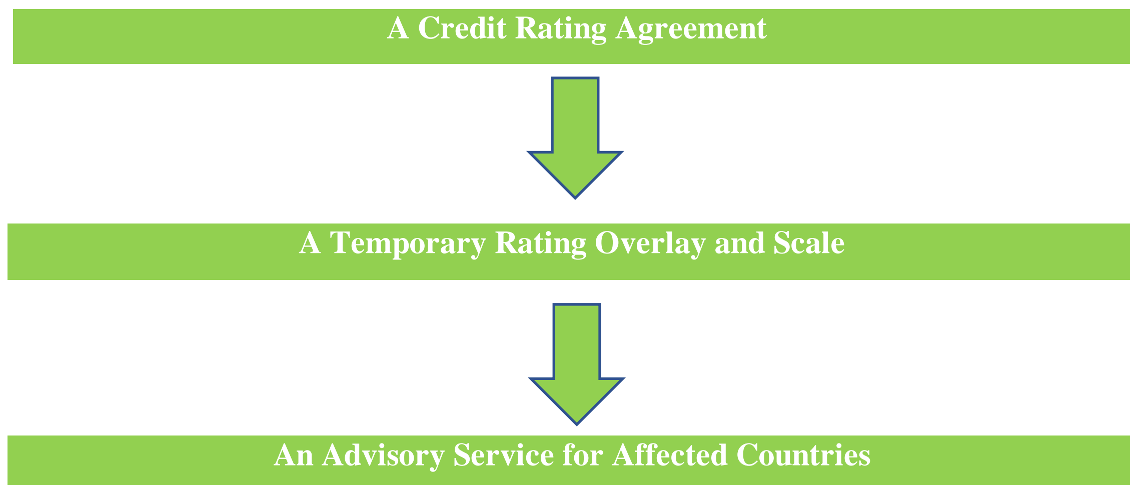
What Comes Next? 46

Executive Summary

The Covid-19 virus has spread across the globe, meaning that structural imbalances between the world's richest and poorest countries have been laid bare for all to see. In the world's poorest countries, taking on external debt is *crucial* to their survival and the health of their citizens, but this external debt burden has now left those countries with a tragic choice; either continue servicing their debts, or invest more in their health infrastructure to prevent the virus from decimating their citizens. As countries try to plot the post-pandemic future, they are equally faced with such a choice between servicing and investment. Often, they cannot do both. As preserving their access to debt financing is so crucial, a number of countries have decided that risking that access is not beneficial to them. The risk comes from the threat of being downgraded by the international credit rating agencies if they even attempt to renegotiate their debt arrangements with *private* creditors like asset managers, banks, and so on. This dynamic is what we are calling the 'credit rating impasse' and it is fundamentally blocking any progression with this debt treatment issue.

In this report, we propose a solution to that impasse. We focus mainly on African countries as they make up the majority of countries that qualify for multilateral initiatives like the Debt Service Suspension Initiative (DSSI), and the Common Framework (CF) that follows it. These initiatives have been promoted by the G20 and exist to foster frameworks from within which the world's poorest countries can negotiate freely with their creditors. However, to date, these initiatives are failing. Countries have made it abundantly clear that they will not engage fully for fear of threatening their credit status, credit rating agencies have made clear that a sovereign's attempts to engage with private creditors for negotiation of their debt arrangements will likely be met with a downgrade, and private creditors have been open about the fact that very few countries are coming forward to engage in the debt treatment process. Therefore, the credit rating impasse must be broken to proceed. Some have argued that sovereign debtors should just default on their obligations and return to the capital markets when they can, whilst others have suggested that credit rating agencies

should suspend all their credit ratings on the affected countries for the time being. **We suggest a three-stage process**:



Simply put, the process entails private creditor groups providing the impetus and their approval for credit rating agencies to change their credit rating processes in a temporary and focused manner. That new process will take into account a number of progressive and aligned (with multilateral initiatives) elements that can both allow debtor countries to negotiate with their creditors, and also become more progressive within the credit rating dynamic. This 'buffer' that the new programme proposes fundamentally turns the credit rating process into a positive, not a punitive process. If a country is allowed to engage with the model as we propose, then that country will be much better for it and its creditors will benefit in the medium- to long-term. It encourages sustainability on all sides.

This process, as we detail in this proposal report, considers a number of different elements. These include the position of the private investors, the liability exposure of the credit rating agencies, and the future of the affected countries. However, as we make clear in our partner report – **Understanding the Effects of the 'Credit Rating Impasse' Upon Sovereign Debt Treatment** – there is much more to be done. The proposals included herein are the

start of the process, not the end. More needs to be done in partnership with associated organisations (regulators/legislators, private creditor groups, credit rating agencies) to mould the idea into a realistic endeavour. Also, there needs to be a will demonstrated that we have yet to really see: more action, less words. There must be compromise at different stages of the chain if the credit rating impasse is to be broken.

For ease, the plan is for the credit rating agencies to develop a temporary and focused 'overlay' that encourages all of the elements that the DSSI and Common Framework seek to encourage, alongside climate and ESG-related developments. This overlay becomes applicable only when a country enters those (and any future) multilateral-designed debt treatment programmes, and remains in place temporarily, or for the duration. The overlay will have a credit rating symbol system attached to it which, at once, both declares to investors the country's financial health in relation to the indicators set out by the multilateral programme and the rating agencies, but also (crucially) allows the country to stave off the dreaded default grade that fundamentally kills its chances to renegotiate its debt with private investors. There are a number of protections put in place for private investors via this plan, with the increased transparency from the country and the heightened scrutiny from the agencies meaning that countries can and will be returned to the normal rating system the moment they fail to comply with the measures put in place by the programme – meaning that investors will be notified as usual if the country cannot meet its financial obligations. With the support of all the parties concerned – investors, rating agencies, American and European legislators/regulators, and vulnerable countries – there is the theoretical chance that the credit rating impasse can be broken with the proposed programme.

Stage I – Private Creditors and the Credit Rating Agreement

Since the Financial Crisis, the credit rating agencies have been extensively regulated, more than ever before. The post-Crisis investigations highlighted an almost-unregulated space that was having a huge impact on the direction of the capital markets (and further afield). To that end, the US and the EU took the lead on regulating the rating agencies. This regulatory approach, with particular regard to the corporate world, perhaps peaked with the US Department of Justice's record-breaking settlements with both S&P and Moody's (in 2015 and 2017 respectively).[2] However, they differed when it came to regulations regarding the rating of sovereign bonds. The EU took the lead in regulating this space, whilst the US have not taken such a stance.[3] This should come as no surprise, as the multi-State European Union is particularly vulnerable to the ratings of the agencies. Between 2010 and 2012, that fear was realised with the peak of the Sovereign debt crisis in the region, which became particularly impactful for the EU.

The EU responded legislatively. As part of their suite of three cumulative Regulations of the rating industry, the EU mandated that 'sovereign ratings shall be issued in a manner which ensures that the individual specificity of a particular Member State has been analysed'. Also, any deviations from the stated methodologies and approaches could only ever be allowed if the agency had to comply with a particular element of European Law.[4] In the US, there is now a greater chance of rating agencies being found liable for any consciously erroneous ratings, but there are strict requirements for the levels of information that can initiate such

---

[2] US Department of Justice, 'Remarks for Attorney General Eric Holder Press Conference Announcing Settlement with S&P' (2015) https://www.justice.gov/opa/speech/remarks-attorney-general-eric-holder-press-conference-announcing-settlement-sp; US Department of Justice, 'Justice Department and State Partners Secure nearly $864 million Settlement with Moody's Arising from Conduct in the Lead Up to the Financial Crisis' (2017) https://www.justice.gov/opa/pr/justice-department-and-state-partners-secure-nearly-864-million-settlement-moody-s-arising.

[3] Andrea Miglionico, *The Governance of Credit Rating Agencies: Regulatory Regimes and Liability Issues* (Edward Elgar 2019) 126.

[4] Regulation EU No. 462/2013, as amending Article 8 of Regulation (EC) No. 1060/2009.

processes[5] (we saw in the lead-up to the two major settlement Fitch Ratings settle with private investors for information on the Big Two, as opposed to money for this very reason). Paudyn notes that whilst the EU has been proactive in regulating this space, the European Securities and Markets Authority (ESMA) have been reluctant to interfere too much.[6]

This legal framework is vital for us to remember. This because one of the elements of our proposal involves the credit rating agencies adapting their model in a new way. This adaptation potentially, without protection, exposes the credit rating agencies to liability which they, historically, are not willing to do. Therefore, it is for this reason that the first stage of our proposal is for:

Private creditor groups to provide agreements for the credit rating agencies to allow them to adapt their credit rating models, temporarily, for sovereign states identified by multilateral initiatives.

It is worth repeating the statement in the preface here: there is no precedent for this. This 'agreement' put forward by the private creditors does not provide protection for the rating agencies from liability (as this can only be provided via legislation or case law) but it does add force to the programme. Furthermore, if there is political will to advance the idea that credit rating agencies can deviate from what is stated in their methodologies, or even change their stated methodologies in this manner with the regulators/legislators' support, then technically this first stage of the plan can be realised. The temporary nature of the proposed credit rating-based solution, and also its alignment with multilateral initiatives like the Debt Service Suspension Initiative (DSSI) and the Common Framework (CF) that is following it, could incentivise regulators and legislators to act. This would then allow the credit rating agencies to adapt the next phase as they see fit within the parameters set.

[5] Bartholomew Paudyn, *Credit Ratings and Sovereign Debt: The Political Economy of Creditworthiness through Risk and Uncertainty* (Springer 2014) 219.
[6] ibid (meaning as above) 197.

The idea for the 'agreement' stems from the 'Template' that the Institute of International Finance (IIF) produced on behalf of its members. The Template is reviewed in the partnering research report, but essentially it is a waiver for countries to participate in the DSSI without having particular elements of the arrangement with the creditor in question 'trigger' as a result of that engagement with the DSSI. The template letter itself is not extensive, perhaps hinting at the flexibility that is allowed for in the process.[7] In our version, the dynamic is between the credit rating agencies and the private creditors, rather than a debtor country and its creditors. As we see it, the private creditors who hold positions within DSSI-countries debt would provide support to the credit rating agencies to alter their methodological processes. There is a myriad of credit rating agencies but, in reality, there are three. With the IIF being widely considered as the face of private creditors in this space, our vision is aimed at the IIF providing support for this programme and bringing its members together for this aim. As there are a vast number of investors holding positions within DSSI-countries' debt, the problem (if there is a political and organisation will to push this forward) comes, potentially, in the form of holdout creditors who would not be willing to support such a programme. We argue that, if we are to believe the narrative of the IIF, then this holdout issue should not be a major one. They have made it abundantly clear that their members support the DSSI and CF initiatives, and are ready to act if the debtor countries finally come forward. This proposal allows for that, whilst championing the DSSI and CF causes which should promote the concept of developing more sustainable debtors, as well as hopefully avoiding a number of defaults. This contractual issue needs more research, however.

The 'agreement' itself would have to be modified for the purposes of the IIF's (and any other investor representatives') members. This would require intricate legal design which we do not offer here, although it is more than achievable if the will from the organisations exists.

[7] The template letter is available via the IIF: IIF, 'G20 DSSI Template Waiver Letter Agreement' (2020) IIF (July 10) https://www.iif.com/Publications/ID/3993/G20-DSSI-Template-Waiver-Letter-Agreement.

The aim of the 'agreement' is to allow the credit rating agencies the theoretical protection from liability that would come with changing their processes. The regulatory mantra since the Financial Crisis has been to force credit rating agencies to do as they say they do, and make this predictable. Our programme challenges that, although we strongly argue that because this is in line with multilateral objectives to allow for the re-channelling of funds to much-needed health-based investments, then the cause is worth the deviation on this occasion. ***The agreement would be used by the credit rating agencies as protection from any private creditor who sought to litigate against it on account of deviating from its stated methodologies***. This protection, together with the legislative allowances as imagined later, are arguably enough to encourage the credit rating agencies into the programme. As we shall see in the next section, which reviews the next stage of the proposal, the change to the credit rating programme is not permanent, still allows for the core purpose of credit rating agencies to be protected (to provide information to investors regarding the chances of default), and also advances the mission of the multilateral agencies to which the private investors have stated that they also support.

Stage II – A New Approach to Rating Sovereigns in Crisis

As discussed above, the credit rating agencies are bound by multiple laws and regulations that force them to both publish publicly their methodologies, and then stick to them. Almost every regulatory penalty that has been applied since the Financial Crisis in multiple jurisdictions has been concerning deviations from the agencies' stated processes (and the Financial Crisis-era penalties all concerned this too). In the previous chapter we saw how a number of elements will have to take place for our proposal to take shape, and we have started with a waiver from private creditors to both instil trust in the process, and then apply pressure to legislators and regulators to allow the credit rating agencies to alter their processes for the purposes of the multilateral-designed debt treatment frameworks. In this section, we paint the picture of what that new programme will look like. There are a couple of elements which are worth stating before that analysis begins. First, the proposed programme is **temporary** and would last for **12-month** periods as we imagine it, but could be **expanded** for the life of the initiative, if desired. The countries that this programme could be applied to are the countries that qualify for the DSSI/CF initiatives, although as we saw in the Research Report that accompanies this work here, there are strong and valid calls for that list of eligible countries to be expanded. A breakthrough in the credit rating impasse could encourage more countries to want to be involved, of course. Second, the programme makes use of the concept of an **overlay**, which credit rating agencies use often and are well equipped to utilise. The overlay is utilised alongside their usual rating frameworks and is usually qualitative in nature; it allows analysts to capture more data than the usual process may allow for. Our overlay attempts to inject more relevant sectors and areas of concern into the process, ranging from DSSI- specific objectives, elements which are critical to African countries in particular, and also wider ranging ESG-based goals (Environmental, Social, and Governance).

In addition to this, there is a scoring system that allows analysts to chart the development of a debtor and then for the agency to decide the movement of the debtor on the scale. The way we envisage this working, although if the plan is taken up there is plenty of flexibility for

altering the model to fit the realities of the rating dynamic, is that the overlay and the associated rating scale **sits on top of the usual rating scale**. This is why the support of private creditors matters so much. A country, if it meets its objectives, would elevate up the temporary scale and, potentially, up into a higher part of the normal rating scale. If it does not meet its objectives, then the debtor can fall into a lower part of the original scale, which for many African countries would be into the default category. One can think of this proposed temporary application of a new scale as being a buffer from where lowly-rated countries are at now, and the default category. We categorically believe that, in principle, this programme can both help debtors navigate this turbulent era, direct resources to their healthcare infrastructure, and also allow debtors to freely negotiate with their debtors. **To make clear**, this process does not protect debtors from defaulting. However, we strongly believe that debtors can come out of this temporary arrangement in much better shape than they would have without it, which is both positive for the debtor and the creditor. With the clear understanding that this is solely for times of crisis, the model could, if adopted, alter fundamentally the way sovereigns handle economic crises moving forward. What follows is an explanation of the proposed process as we see it.

The Credit Rating Overlay

The credit rating overlay put forward within this document can be regarded as the anchor that our overall solution has been built on. In creating the credit rating overlay we have opted to appease all parties involved and have made a concerted effort to ensure that the overlay results in enhanced credit rating outcomes for the applicable sovereign states. To achieve this, we have calibrated the metrics so that they are directly linked to the variables within the methodologies utilised by the big three rating agencies. The overlay is also aligned to the existing shortcomings within the credit rating process in Africa *(as well as emerging markets in general)* of which the authors have first-hand knowledge thereof. This innovative solution can then be viewed as one that is calibrated to Africa in particular but which can be easily applied to other emerging markets. In creating a practical, pragmatic and enforceable solution, we have been cognizant of all related parties and a summary of how the proposed overlay is relevant to each stakeholder can be depicted within the infographic below:

Investors

Investors would benefit from sovereign states being on a far superior upward trajectory in relation to their credit quality. This would have a stabilizing effect on their investments and improve the long-term prospects thereof.

Governments

Governments would benefit from not being downgraded after initiating extended terms/ the common framework.

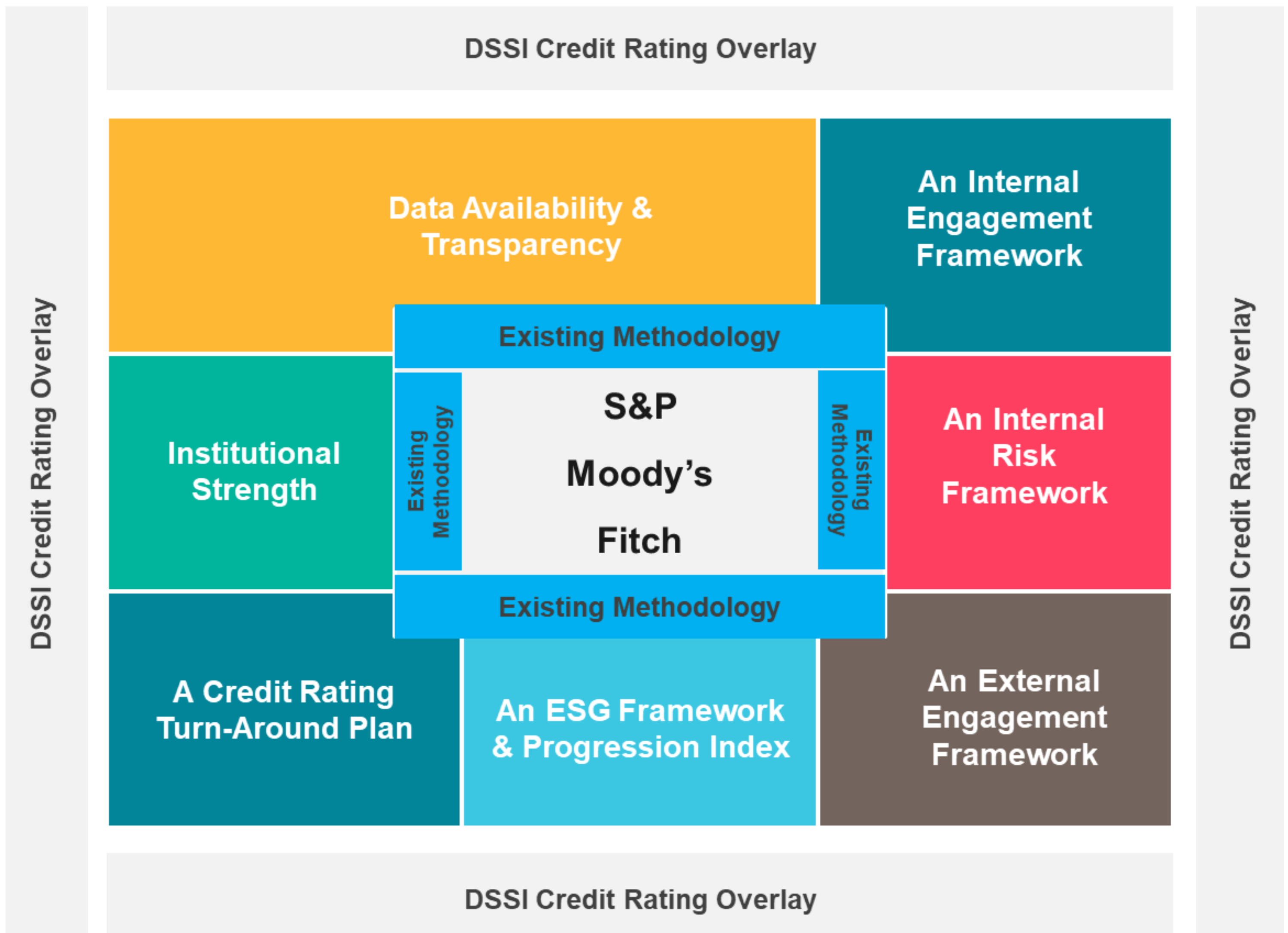
The Credit Rating Agencies

The backbone of this solution rests on obtaining a buy-in from the major rating agencies providing sovereign ratings on the continent. It is in our opinion that the rating agencies will benefit from this solution in relation to the improved credit rating outcomes of rated states as well as the upward trajectory that the overlay will enable. They will also benefit from the enhanced credit rating engagements & processes that would ensue after the overlay has been adopted.

The African And Global Economy

Both the African and global economy would benefit from a much more stable economic environment. This should persist after the overlay is implemented due to the continued upward trajectory that the overlay will promote.

The infographic below highlights the variables that will be included within the credit rating overlay:



As per the infographic above, the existing methodologies will continue to run in the background and remain unchanged. The only difference is that these countries will not be automatically downgraded on the signalling of their intent to partake in the associated

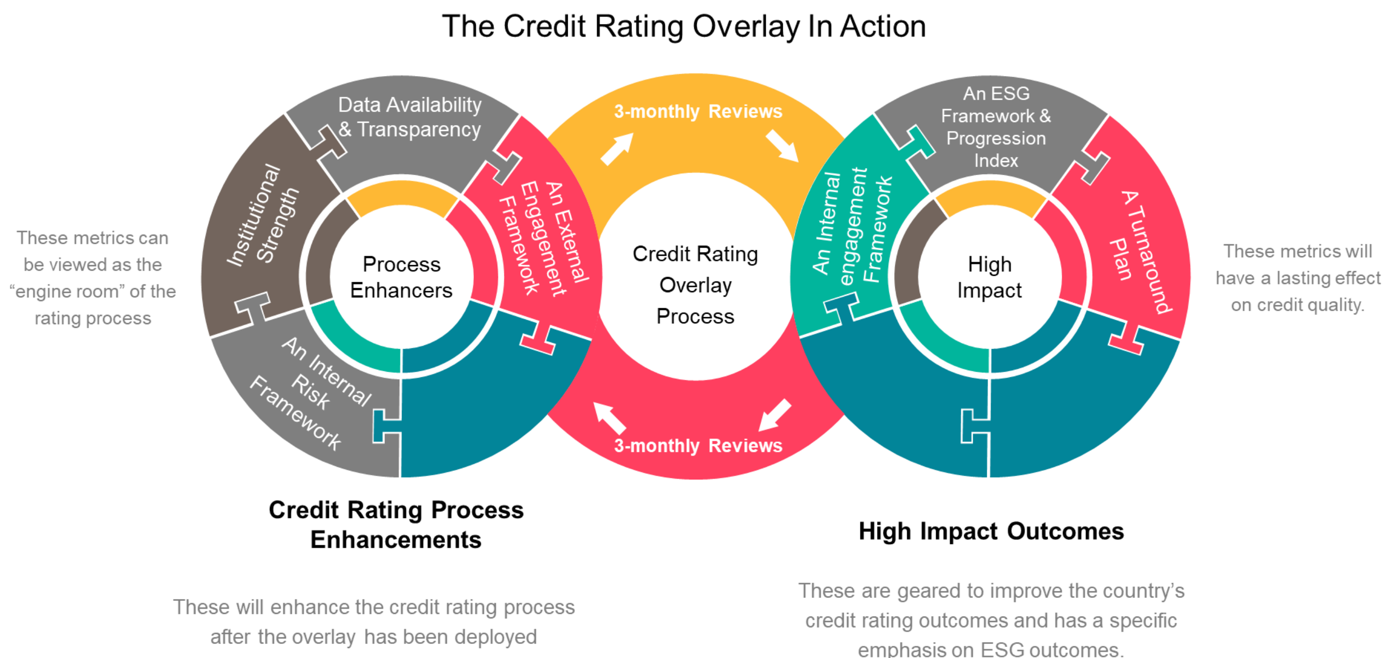
programs. Any downgrades/ upgrades *(if applicable)* that are not linked to participation in these programs will still occur and is not related to the overlay in any way. The country reviews will also continue unchanged throughout this solution and there will be no interruption around the existing credit rating process.

The overlay above will then complement the existing methodologies by incorporating pre-dominantly progressive elements that will result in enhanced credit rating outcomes. Each of the variables will be scored accordingly and the countries in question will be required to improve these metrics to a pre-determined level, this is done to ensure that the outcomes attached to these metrics result in tangible benefits to all stakeholders involved. A retraction in these variables during the quarterly reviews will result in the overlay being null and void and countries being potentially downgraded as per their pre-overlay participation *(non-negotiable).* Lastly, Institutional strength which is a significant issue on the continent is included as a 'hazard variable'; this is due to the fact that general deterioration of this metric can result in instant changes in the fundamentals of a country (please refer to the section below for more information in this regard). An overview of each of the 7 variables within the overlay is found in the infographic below:

The framework is broken up into the following 8 variables:

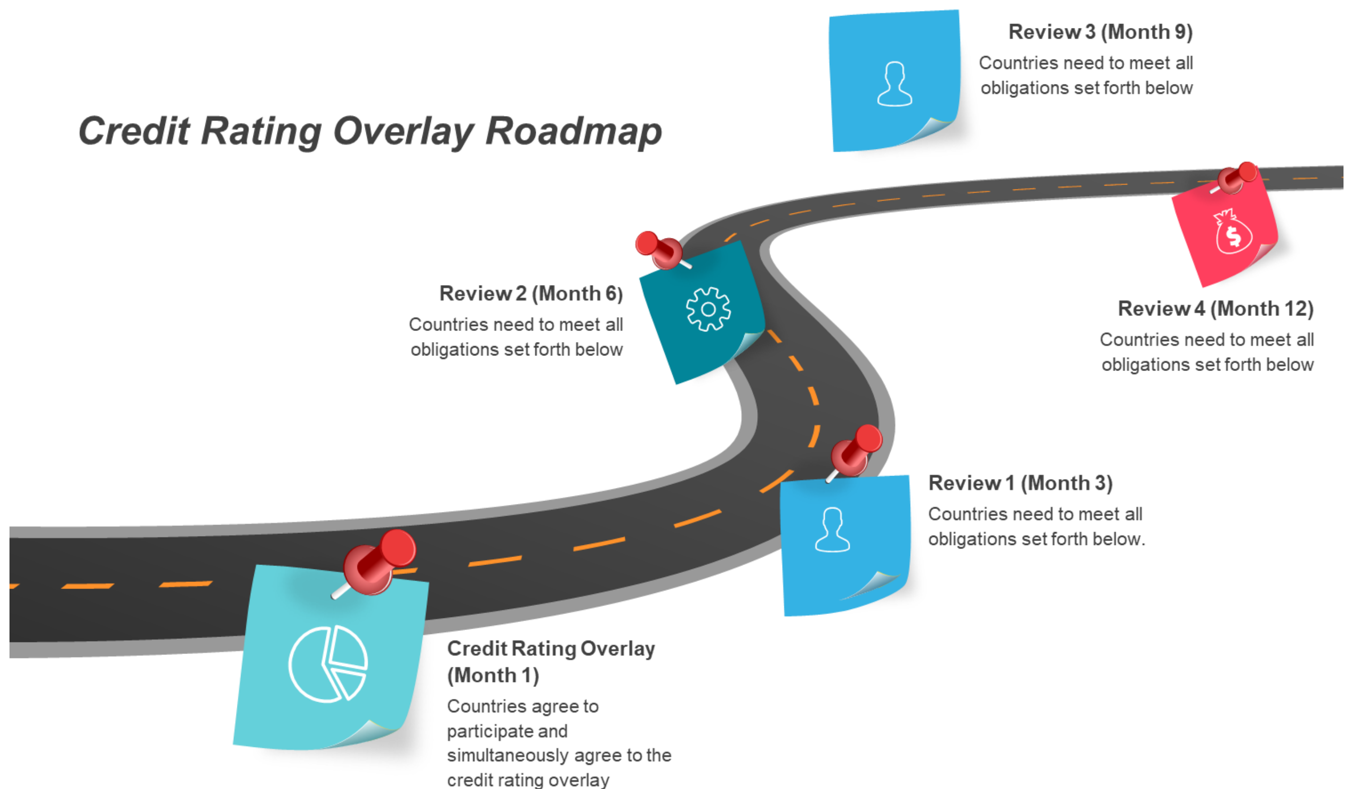
The above infographic provides a brief overview of the seven variables contained within the Credit Rating Overlay Framework. The variables are grouped into two distinct categories of 'high impact outcomes' and 'process enhancers'. We have specifically selected these variables based on the current shortcomings within the credit rating process in Africa and view the 'high impact' variables as metrics that could translate into credit rating notch adjustments over the medium- long term. Furthermore, although there are just three variables within the 'enhancer' section, the credit rating turnaround plan, in particular, will house a substantial number of underlying variables that will effectively improve the overall outcomes. *(This turn-around plan is housed within a portion of the consulting offering that was unpacked within a different section of this document.)*

The manner in which these seven variables interact with each other after being segregated into the two distinct components are depicted within the infographic below:



Each of the 7 variables above will be measured over a 12-month period with 3 reviews at each 3-month interval.

The roadmap below highlights how this will work in practice:



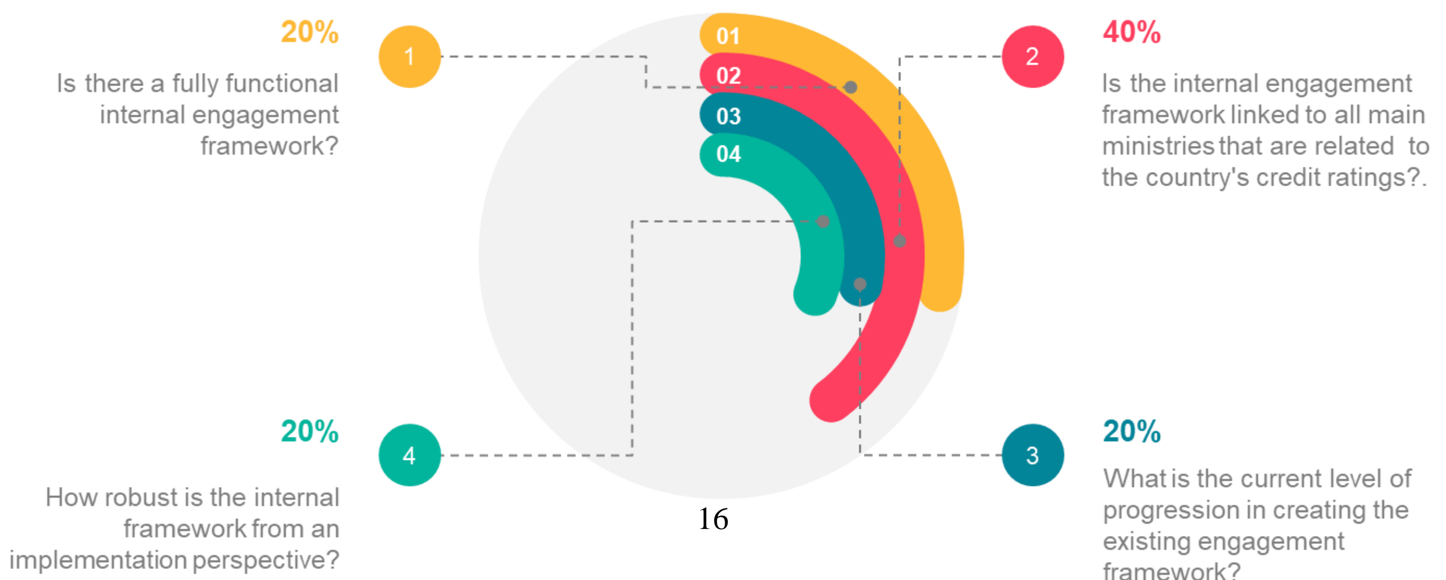
The duration of the proposed solution is not linked to the term of a participating program but is rather a fixed-term 12-month engagement that countries would enter into after initiating either the DSSI initiative/ extended terms or the common framework. This then means that a country entering one of the programs in June 2021 will then be obligated to commit to the overlay for the subsequent 12-month period leading up to June 2022, our objective with this is for countries to partake in the full benefits that the overlay will provide

to all related stakeholders. A brief description of each of the seven variables housed within the two components of the overlay are as follows:

High Impact Outcomes

An Internal Engagement Framework

The lack of a clear cut and operational internal engagement framework is probably the main reason why countries do not attain their desired credit rating outcomes. This is a phenomenon in most countries but can be a larger contributing factor for countries in Africa/ EM in particular. The internal engagement framework is essentially the internal mechanism that dictates and coordinates the communication, engagements and implementation of strategies amongst ministries that are linked to the country's credit ratings. Many countries experience negative outcomes in general which are not due to not having comprehensive development and turn-around strategies but rather by not having the correct mechanisms that facilitate the implementation of these policies. The internal engagement framework solves this by creating a vibrant internal mechanism that will facilitate a robust and coordinated approach by all credit rating-related stakeholders to ensure that the sovereign state firstly maintains its existing credit ratings and subsequently improves these to their desired levels. The scoring system that we have derived for the internal engagement system is as follows:



Each sovereign state will be scored as follows with regard to the above-mentioned variables:

- An Internal Engagement Framework
- A Credit Rating Turnaround Plan
- An ESG Framework & Progression Index
- Data Availability & Transparency
- An Internal Risk Framework
- An External Engagement Framework

Institutional Strength

Metric / Score	1	2	3	4	5	6	7	8	9	10
Is there a fully functional internal engagement framework?		✓								
Is the existing internal engagement framework linked to all related ministries?				✓						
What is the current level of progression in relation to creating the internal engagement framework?		✓								
How robust is the internal framework from an implementation perspective?		✓								
Total										✓

A breakdown of the scoring metrics above are as follows:

1. Is there a fully functional internal engagement framework?
   - Yes = 2
   - No = 0

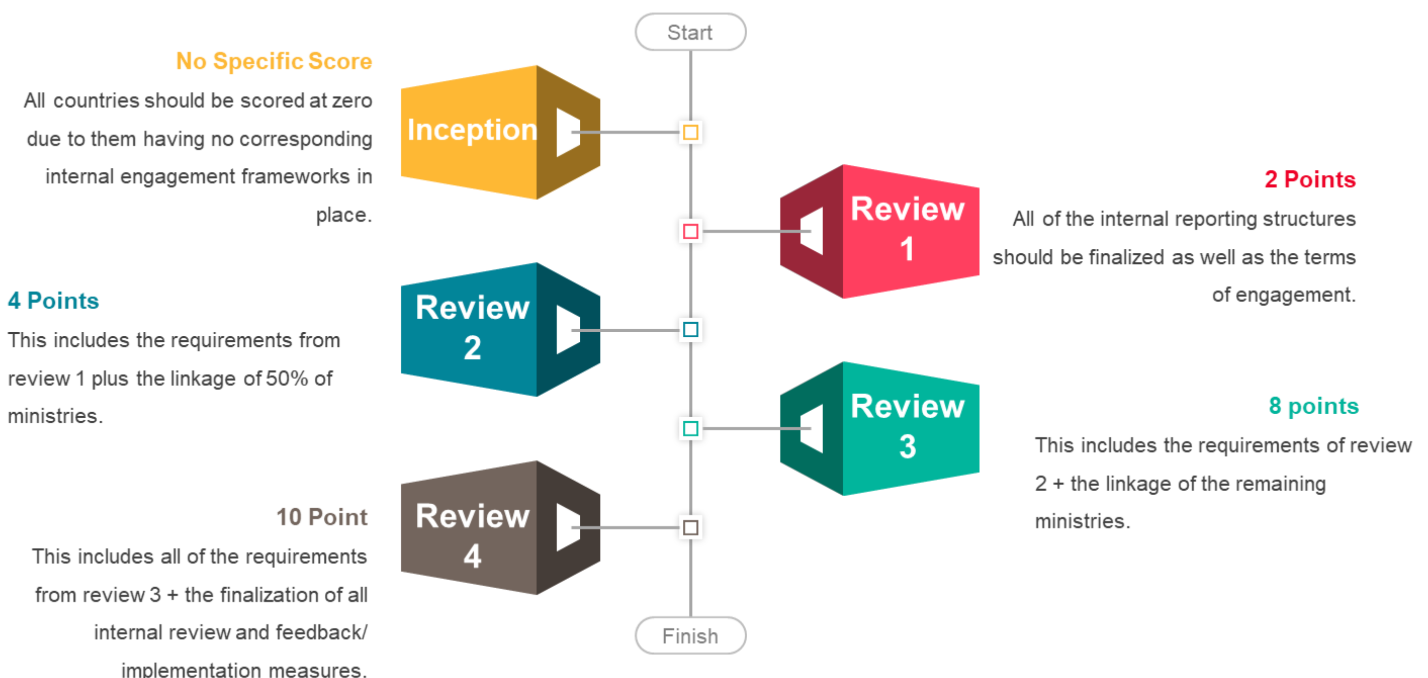
2. Is the existing internal engagement framework linked to all ministries? **=4 Points**

   We would need to first determine all ministries that are linked to the country's credit rating and then calibrate it accordingly. The scoring will be as follows:
   - 100% of the main ministries are linked = 4 Points
   - 75% of the main ministries are linked = 3 Points
   - 50% of the main ministries are linked = 2 Points
   - 25% of the main ministries are linked = 1 Points
   - 0% of the main ministries are linked = 0 Points

3. What is the current level of progression in relation to creating the internal engagement framework? = **2 Points**, the following will need to be considered to attain 3 full points:
   - The overall reporting structure between all ministries is complete.
   - The internal reporting structure for each ministry is complete.

- The terms of engagements between ministries have been agreed upon and signed.
- All of the internal related ministries have been briefed and are on board with the terms of the internal framework.

4. How robust is the internal framework from an implementation perspective? = **2 Points**
    - Are there scheduled monthly meetings between representatives from the relevant ministries?
    - Is there an implementation feedback mechanism in place measuring policy implementation?
5. The participating countries will need to achieve certain scoring metrics at specified review intervals to ensure that the overlay continues and the country does not revert to the pre-overlay default status.
6. In reference to the internal engagement framework, the requirements are depicted within the delivery schedule below:

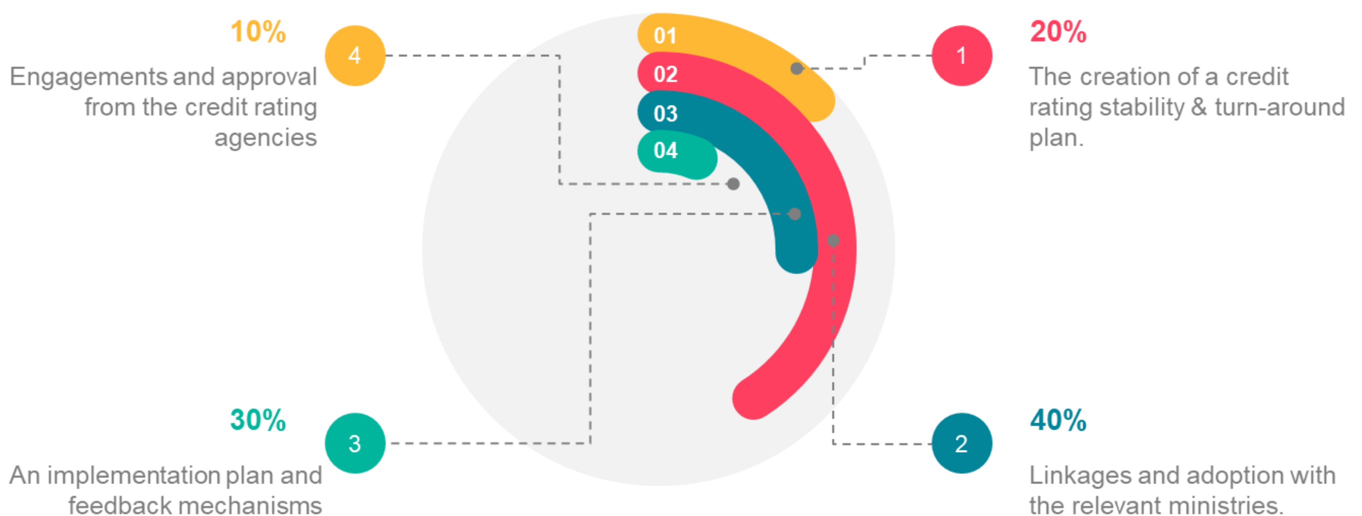


The reviews above will take place at every 3-month intervals

It should be noted that not all metrics below will need to achieve a full score, we foresee the internal engagement framework as being one of the most important and thereby resulting in participating countries needing to adhere to all metrics and achieve a full score at each interval.

A Credit Rating Turn-Around Strategy

The credit rating turnaround strategy can be viewed as the roadmap and the primary mechanism that will facilitate the betterment of the credit ratings over the medium-long term. The turnaround strategy is created and implemented via the advisory offering and this component of the credit rating overlay will measure both its development and execution. This metric can be considered progressive and regarded as the impetus for participating countries to both design and implement a turnaround strategy. This strategy will culminate in the majority of tangible outcomes of the overall solution and should manifest over the medium-long term with some solutions having a quicker response time. More details around the variables that are focused on within the turnaround strategy can be found within the section dealing with the credit rating advisory offering. The measurable metrics within the credit rating turnaround plan are as follows:



We will measure this metric as follows:

- An Internal Engagement Framework
- A Credit Rating Turnaround Plan
- An ESG Framework & Progression Index
- Data Availability & Transparency
- An Internal Risk Framework
- An External Engagement Framework

Institutional Strength

Metric / Score	1	2	3	4	5	6	7	8	9	10
Has the sovereign state started the process of creating a credit rating turnaround plan, either via the advisory offering or internally?		✓								
Is the turnaround plan linked to the major themes on the relevant methodologies?				✓						
Has the creation of an implementation plan and feedback mechanism been completed?			✓							
Has the credit rating plan been presented and accepted by the rating agencies?										
Total	✓									✓

A further breakdown of the scoring model is as follows:

Has the sovereign state started the process of creating a credit rating turnaround plan, either via the advisory offering or internally? **= 2 Points**

Is the turnaround plan linked to the major themes on the relevant methodologies *(Economic growth, Institutional strength, External Strength etc.)*?

100 % (of all themes)	**= 4 Points**
75%	**= 3 Points**
50%	**= 2 Points**
25%	**= 1 Point**
0%	**= 0 Points**

The themes might vary between 4-5 different themes per rating agency but the central themes are generally the same.

Creating an implementation plan and feedback mechanism

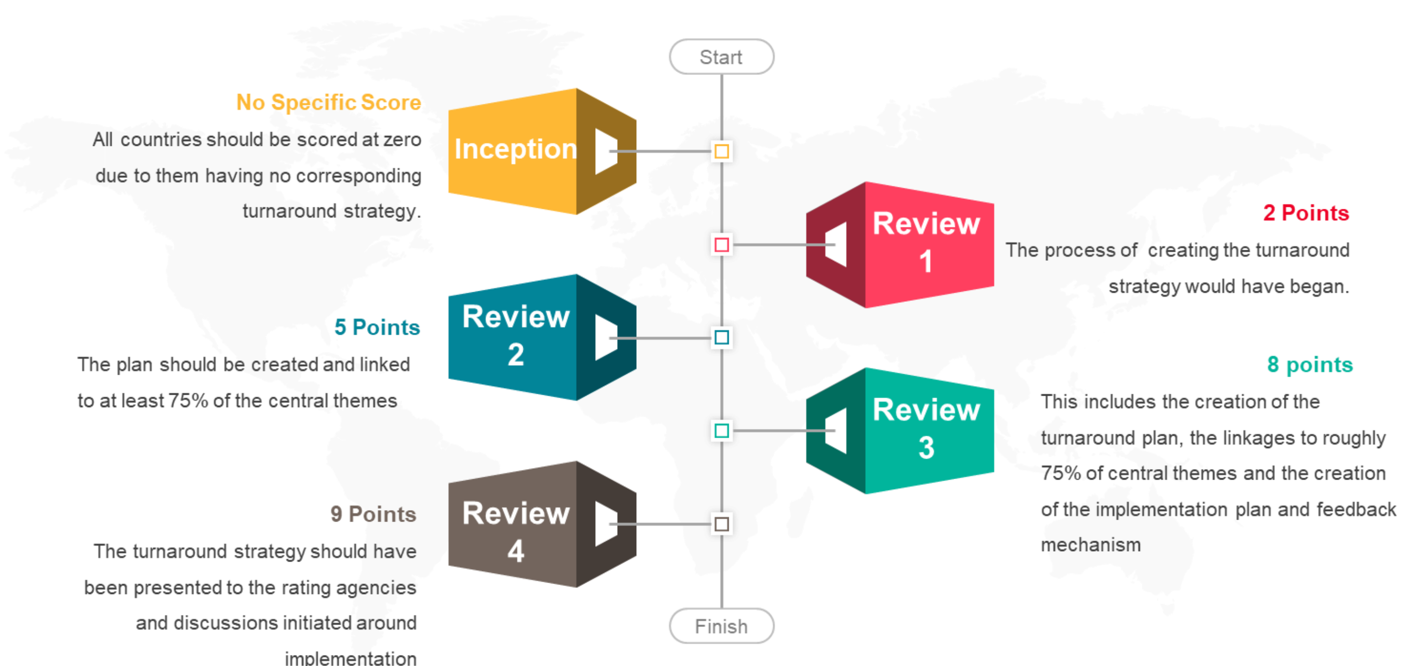
This metric will be scored as follows:

- Is there a mapped-out roll out strategy related to internal and external stakeholders *(the other ministries & the rating agencies)?* ***= 2 Points***
- Is there a feedback mechanism in place relating to implementation progress? *(which has been validated by all relevant stakeholders)* ***= 1 Point***

Has the credit rating plan been presented and approved by the rating agencies? ***1 Point***

Creating a turnaround plan via the advisory solution will result in the consulting firm managing this process on behalf of the sovereign state.

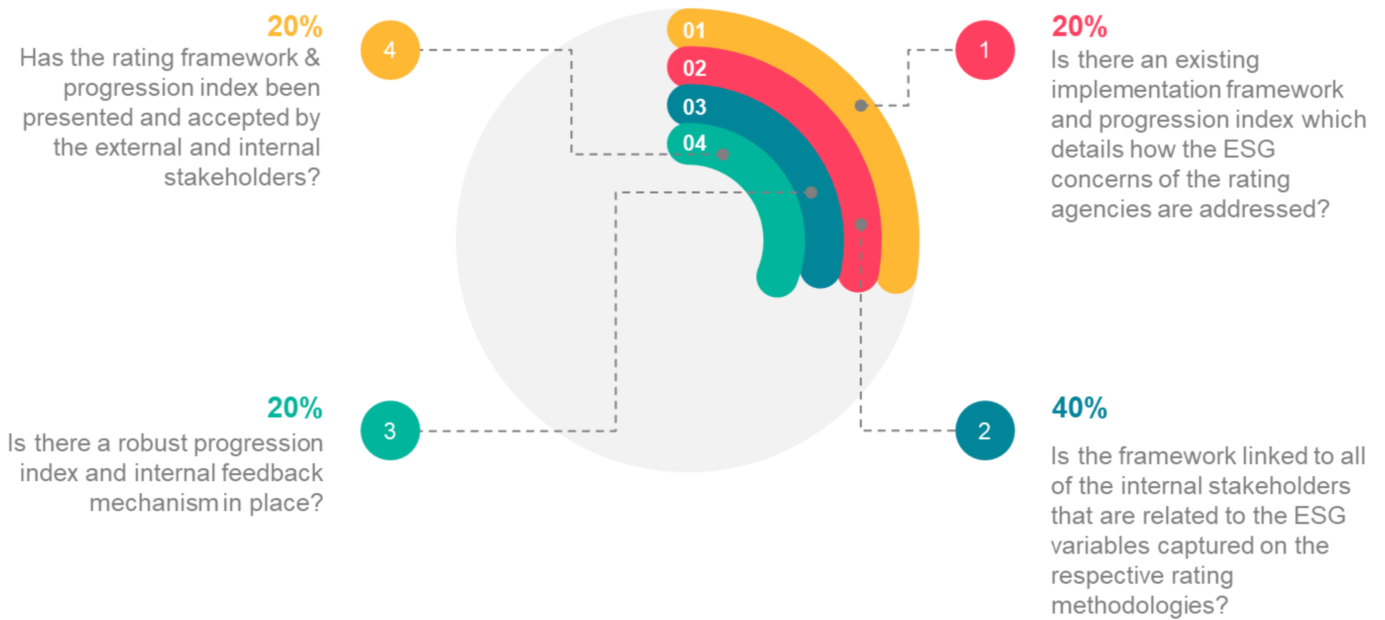
This metric will have the following delivery schedule:



Due to the dynamics on the African continent, some of the themes are difficult to address, this is in specific reference to political instability which the turn-around strategy will not be able to address or have a meaningful effect on, the scoring requirement is therefore 9 (to account for this) and not a full 10.

An ESG Progression Metric

We have included the ESG metric due to both the direct socio-economic benefits as well as its ever-increasing level of importance on the methodologies of the international credit rating agencies. Our approach to the ESG concept is predominantly linked to how the rating agencies measure these variables and is more inclined to implementation mechanisms that will ensure that all of the ESG concerns are properly addressed. The measurement metrics that will be used to capture this are as follows:



Each sovereign state will be scored as follows with regard to the above-mentioned variables:

- An Internal Engagement Framework
- A Credit Rating Turnaround Plan
- An ESG Framework & Progression Index
- Data Availability & Transparency
- An Internal Risk Framework
- An External Engagement Framework

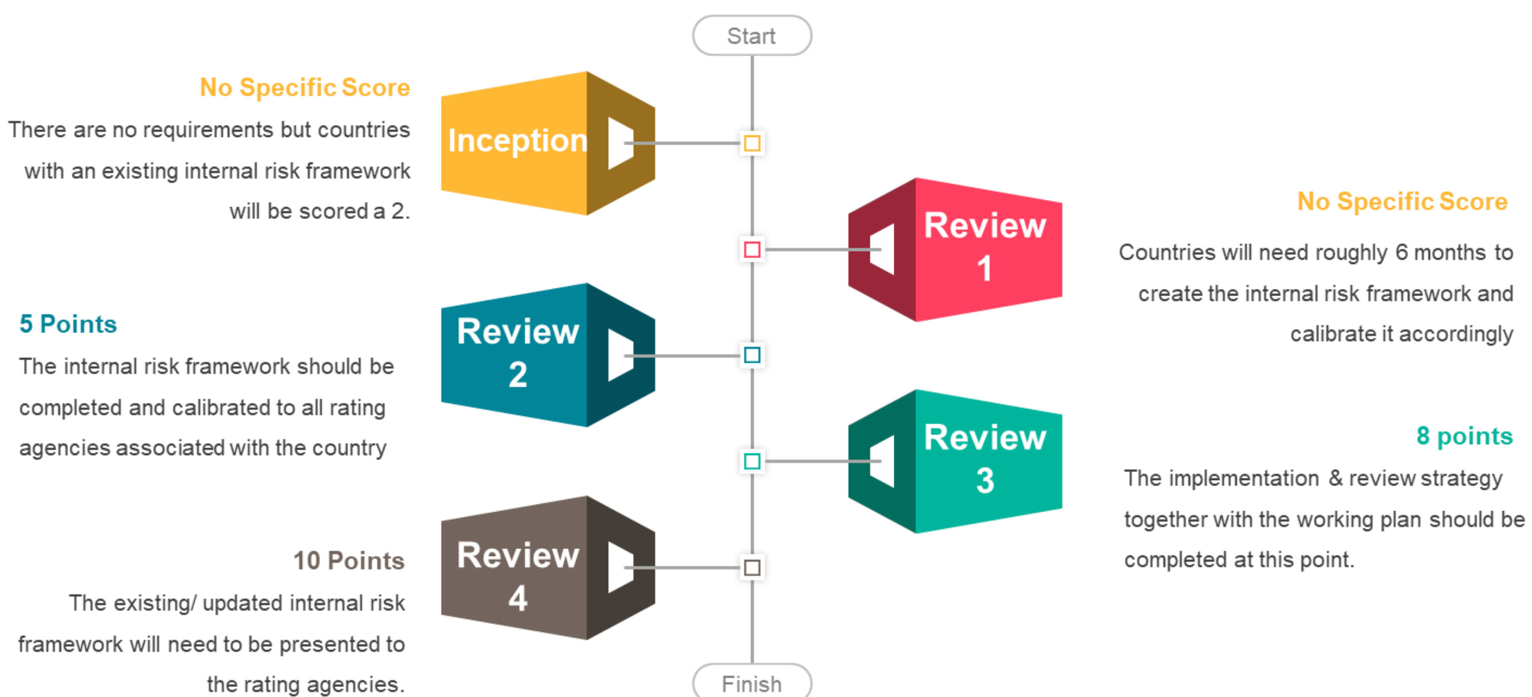
Institutional Strength

Metric / Score	1	2	3	4	5	6	7	8	9	10	Total
Is there an existing implementation framework and progression index in place?		✓									
Is the framework linked to all of the internal stakeholders that are related to the ESG variables captured on the respective methodologies?				✓							
Is there a robust internal feedback mechanism in place?		✓									
Has the progression index been presented and accepted by the rating agencies as well as the related internal stakeholders?		✓									
Total											✓

A further breakdown of the metrics above are as follows:

- Is there an existing implementation framework and progression index in place? = **2 Points**
- Is the framework linked to all of the internal stakeholders that are related to the ESG variables captured on the respective methodologies? = **4 Points**.
- Is there a robust internal feedback mechanism in place? = **2 Points**
- Has the progression index been presented and accepted by the rating agencies as well as the related internal stakeholders? = **2 Points**

The deliverable schedule of the attached will be as follows:



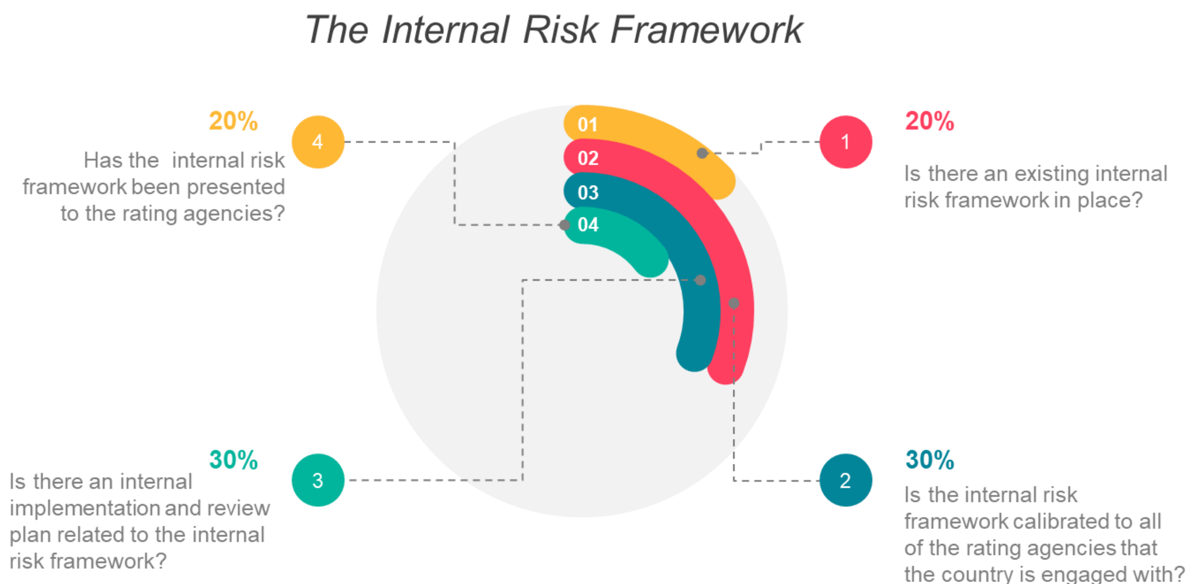
Due to the importance of the ESG concept and Africa's slow adoption of many of the corresponding metrics, we have included it as one of the high impact outcomes. If properly implemented, we foresee this variable having a tremendous benefit to the future prospects of the African continent.

Credit Rating Process Enhancers

The Internal Risk Framework

It is the opinion of the authors that the internal risk framework forms the basis of an efficient and proactive relationship between sovereign states and credit rating agencies. This framework is generally calibrated to the rating methodologies associated with the country. It is created with the intent of proactively identifying areas of concern and addressing this prior to engaging with the respective rating agencies via the bi-annual reviews. There are countries on the continent that currently do not have robust internal risk frameworks in place and this metric aims to measure this as well as to ensure that a comprehensive framework is created.

The countries will be measured as follows with regard to this metric:



The internal risk framework will be scored as follows:

- An Internal Engagement Framework
- A Credit Rating Turnaround Plan
- An ESG Framework & Progression Index
- Data Availability & Transparency
- An Internal Risk Framework
- An External Engagement Framework

Institutional Strength

Metric / Score	1	2	3	4	5	6	7	8	9	10
Is there an actual risk framework in place?		✓								
Is the internal risk framework calibrated to all three rating agencies respective methodologies?			✓							
Has an implementation and review plan been implemented?			✓							
Has the internal risk framework been presented and approved by the rating agencies?		✓								
Total										✓

The actual scoring with regard to the internal risk framework will be as follows:

Is there an actual risk framework in place? = **2 Points**

Is the internal risk framework calibrated to all three rating agencies respective methodologies?

All rating agencies = **3 Points**

50-66% = **2 Points**

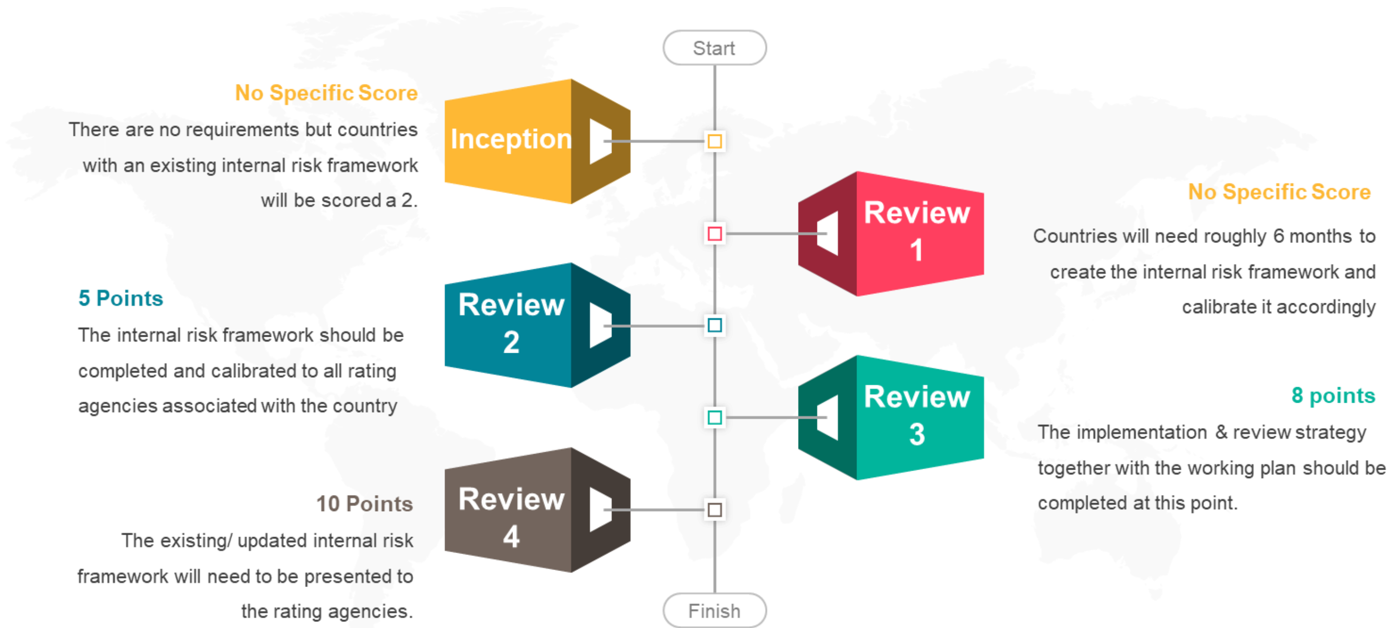
33% = **1 Point**

Scored as such due to there generally being three rating agencies.

Has an implementation and review plan been implemented? = **3 Points**

Has the internal risk framework been presented and approved by the rating agencies? = **2 Points**

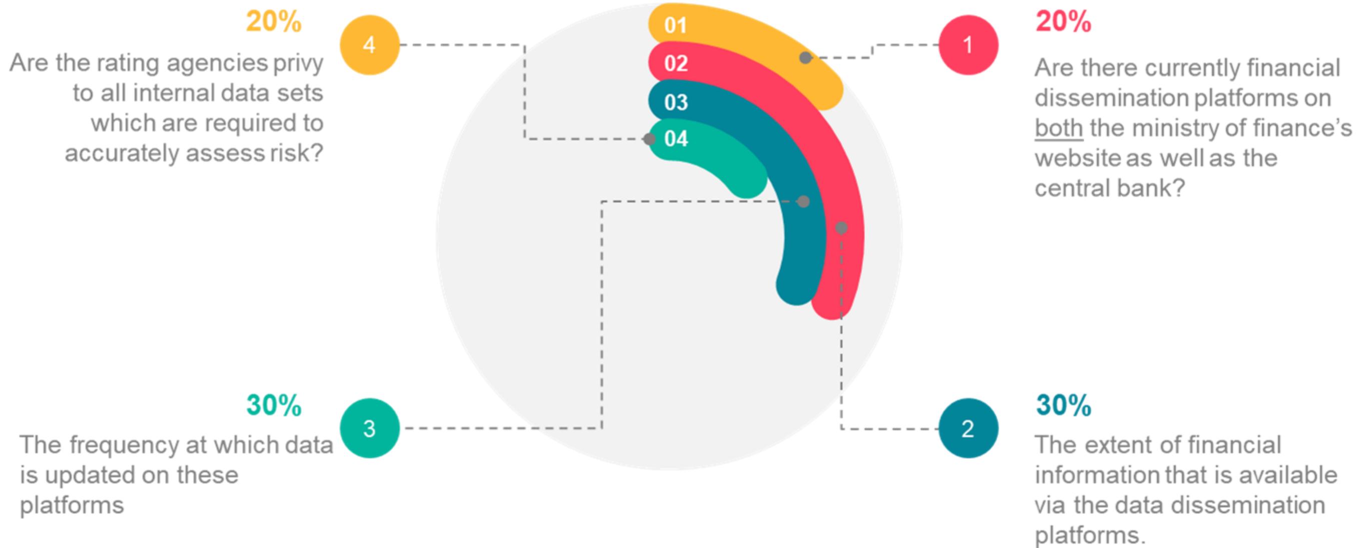
This metric will have the following delivery schedule:



Data Availability, Transparency and Accuracy

The availability and consistency of important financial and economic data remain a major challenge for many African countries and this has a knock-on effect on both the inputs used within credit ratings as well as on potential investors that utilise this information for investment allocation decisions. Rectifying and improving this metric could then have far-reaching effects on the countries in question and even assist from an 'investor relations' perspective. We have identified areas of weakness with regard to data availability, and have tried to capture this to allow for improvements via the progressive measurement scale. Countries will be measured in the following way:

Data Availability and Transparency



The data availability and transparency metric will be measured as follows:

- An Internal Engagement Framework
- A Credit Rating Turnaround Plan
- An ESG Framework & Progression Index
- Data Availability & Transparency
- An Internal Risk Framework
- An External Engagement Framework

Institutional Strength

Metric / Score	1	2	3	4	5	6	7	8	9	10
Are there statistical (financial, economic and related) data dissemination platforms on the ministry of finance and central bank's website?		✓								
The extent of financial information that is available via the dissemination platforms?				✓						
The frequency at which data is disseminated and updated on these platforms.		✓								
Are the rating agencies privy to all internal data sets that are required to conduct accurate assessments on the country in question?		✓								
Total										✓

The variables above are broken up as follows:

1. Are there statistical *(financial & economic)* data dissemination platforms on the ministry of finance and central bank's website? *(Either is welcomed but both would be recommended*) = **2 Points**

2. The extent of financial information that is available via the dissemination platforms?

2.1 A breakdown of government spending as proposed in the country's annual budget (broken down per line item) and a database of historic government budgets as well. The spending should be broken down per line item and at the national and provincial level.

2.2 A breakdown of government revenues & tax collection projections (broken down per line item) and a database of historic government revenue & tax collection figures, broken down per line item. 2.1 + 2.2 = **1 Point**

2.3 The inclusion of bond & switch auction data sets indicating the bid-to-cover ratios and amounts raised on local and international markets. = **1 Point.**

2.4 Details of existing and historical bond investor base (inc interest rates, term and type of instrument), whilst this might not name or list the actual shareholders, the data set could include investor classification (Banks, bi-lateral, multi-lateral, etc) and be further broken down as international or local. = **1 Point.**

2.5 Details of the leading economic indicators such as in-depth GDP figures, employments & labour market statistics, balance of payments/ trade data, key financial/ banking sector metrics, economic indicator details (PMI, Consumer confidence, etc). = **1 Point.**

3. The frequency at which data is disseminated and updated on these platforms.

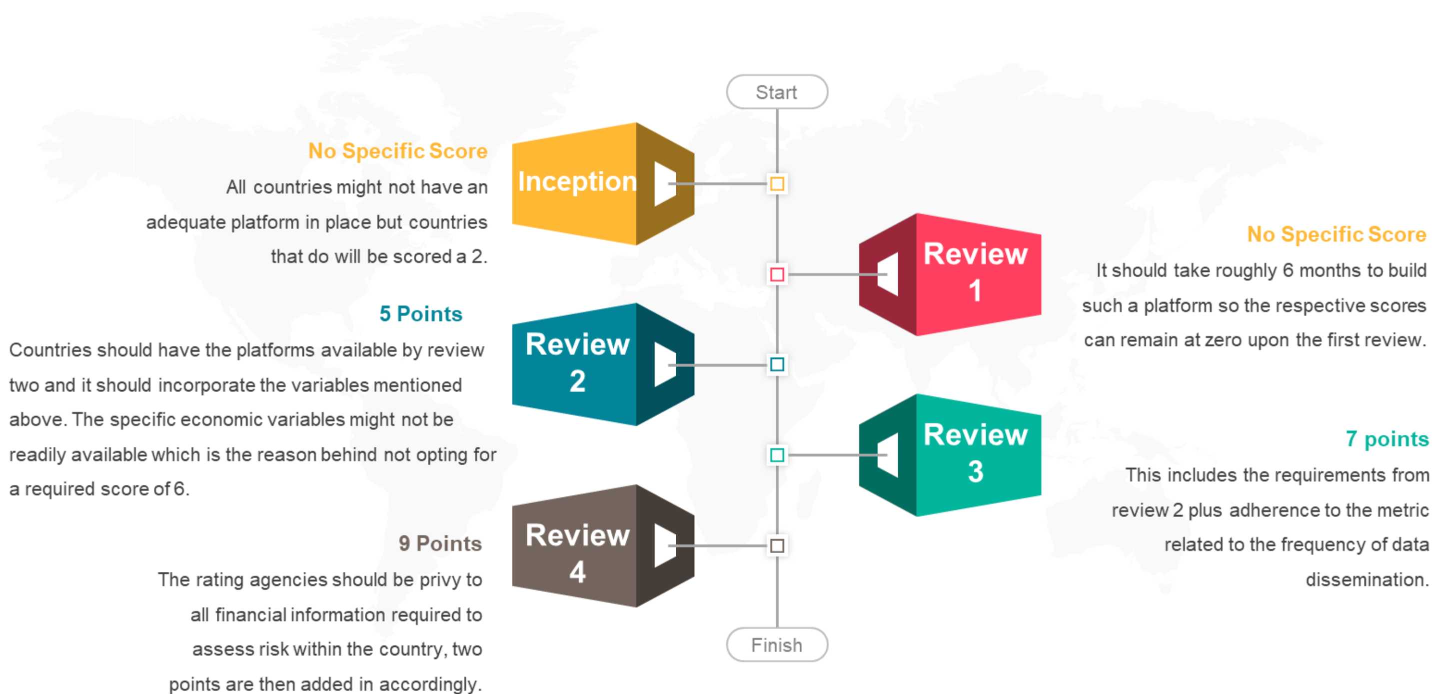
Data is only relevant if it is frequently updated and consistent in this regard. From a credit rating perspective, whilst historic data might be useful at times, current and up to date data is most frequently used as inputs into the related credit rating methodologies. In this regard, we measure countries within the overlay as follows:

3.1. Is there a specific plan which outlines how, when and by whom data is updated onto the respective data dissemination platforms? =**1 Point**

3.2. Is the data disseminated within a week of it being publicly available? =**1 Points**

Are the rating agencies privy to all internal data sets that are required to conduct accurate assessments on the country in question? *(this needs to be an affirmative answer from all rating agencies covering the country)* = **2 Points**

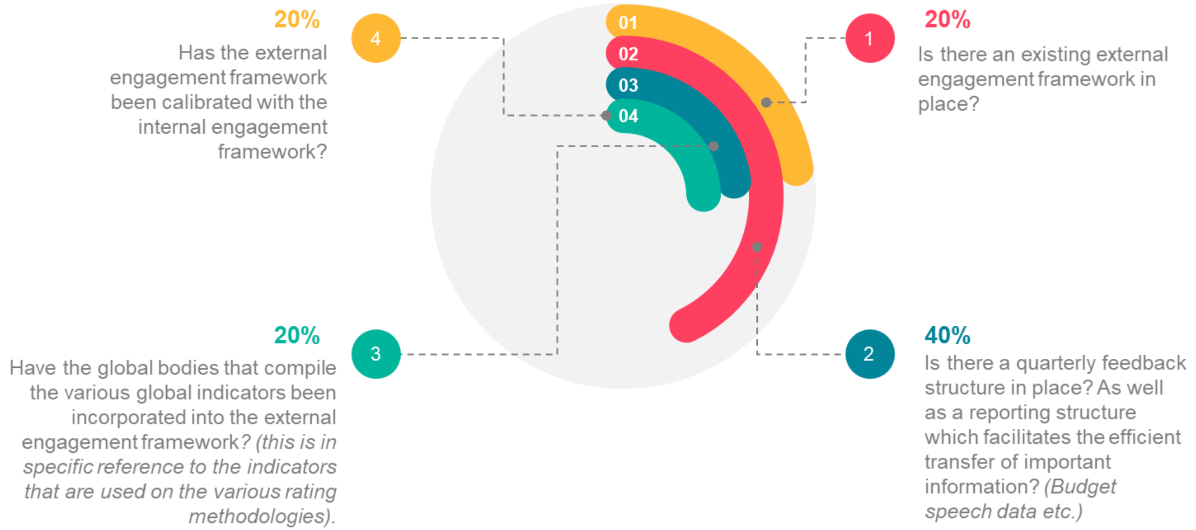
This metric will have the following delivery schedule:



An External Engagement Framework

The external engagement framework is the mechanism around which the dialogue with the rating agencies is built. Based on the context of this solution and the turn-around strategy promoted within the overlay, the frequency and intensity of engagements would be much higher. There then needs to be an engagement framework put forward which specifies the dates, stakeholders involved, feedback mechanisms and implementation discussions that will result in an efficient implementation of the specified turnaround plan. This section provides the measurement metrics involved that will ensure that countries build up robust external engagement frameworks; the associated scoring criteria and delivery schedule will be as follows:

An External Engagement Framework



This metric will be scored as follows:

- An Internal Engagement Framework
- A Credit Rating Turnaround Plan
- An ESG Framework & Progression Index
- Data Availability & Transparency
- An Internal Risk Framework
- An External Engagement Framework

Institutional Strength

Metric / Score	1	2	3	4	5	6	7	8	9	10
Is there an existing external engagement framework in place?		✓								
Is there a quarterly feedback structure in place? (this is in reference to the credit rating turnaround strategy				✓						
Have the global organizations that compile the various global indicators been incorporated into the external engagement framework?		✓								
Has the external reporting framework been incorporated with the internal engagement framework?		✓								
Total										✓

A further breakdown of the variables above are as follows:

1. Is there an existing external engagement framework in place? = **2 Points.**
2. Is there a quarterly feedback structure in place? (this is in reference to the credit rating turnaround strategy) = **2 points**

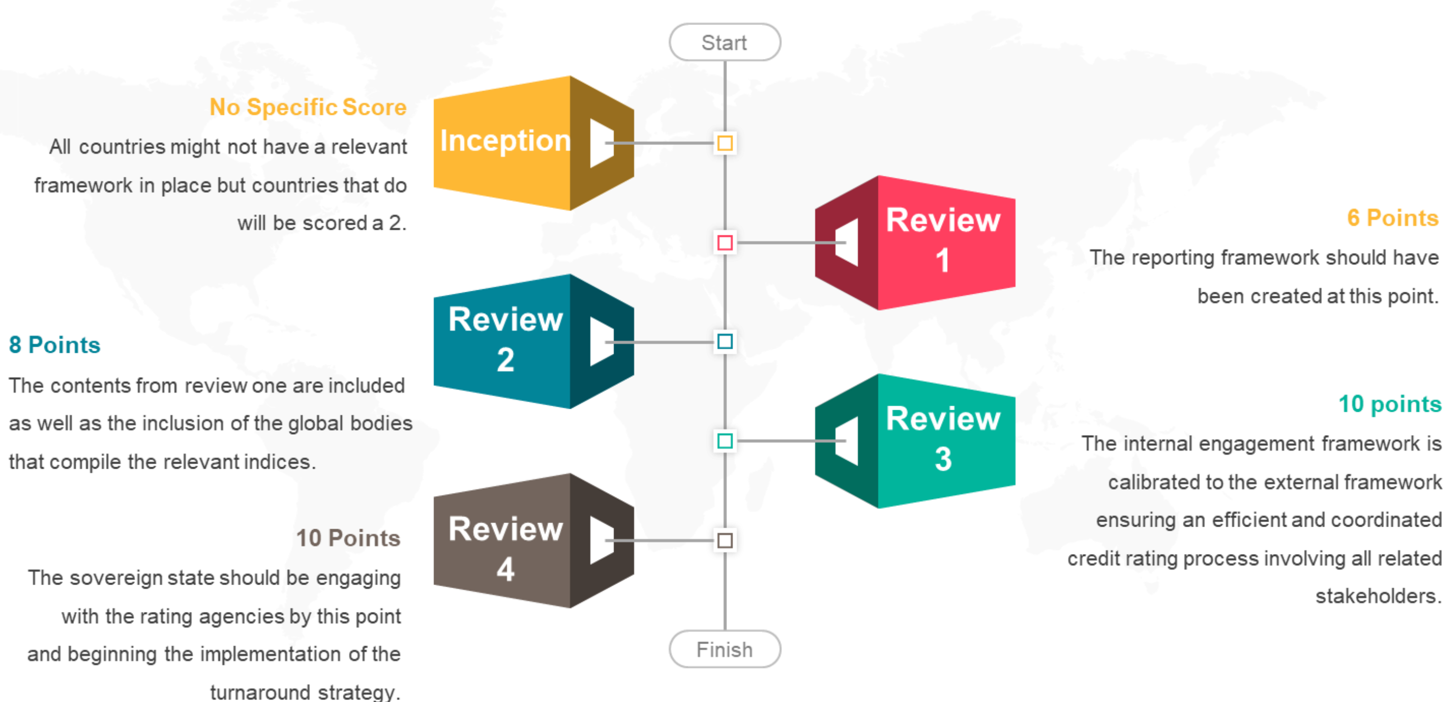
   As well as a reporting structure that facilitates the efficient transfer of important information? (this is in reference to important data releases which are linked to the country's credit ratings) = **2 Points.**

3. Have the global organisations that compile the various global indicators been incorporated into the external engagement framework? = **2 points**

   The advisory offering attempts to incorporate these variables to a certain extent and engagements with these institutions is captured to relay progress around the variables that the country aims to improve via the advisory offering.

4. Has the external reporting framework been incorporated with the internal engagement framework? = **2 Points**

   The delivery schedule for these metrics are as follows:



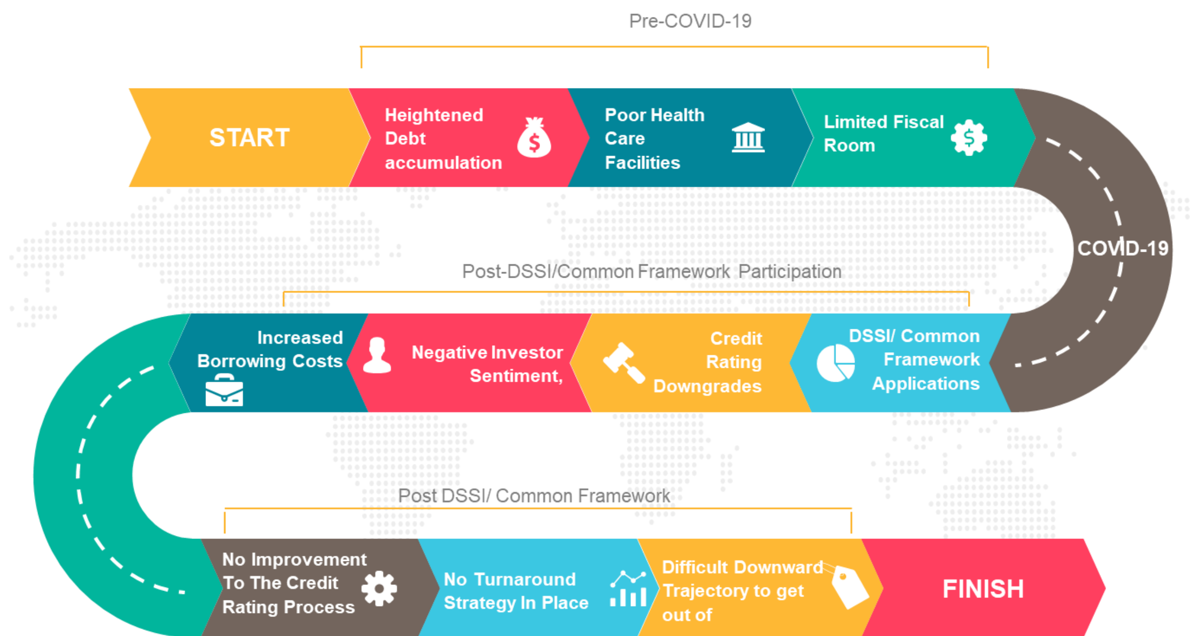
Institutional Strength (Hazard Variable)

Institutional strength has been added in as a hazard variable, this means that a significant deterioration of this metric will result in an automatic cancellation of the overlay. The reason for its inclusion is due to the sometimes volatile fluctuation of this variable within emerging markets which does translate into significant fluctuations in related variables. The metric is linked back to the variables used by the rating agencies to measure institutional strength. Occurrences such as the sudden firing of central bank governors or the reshuffling of the cabinet members for politically related reasons would result in trigger events within this metric. Due to the broad amount of factors covered under this category, we would leave it to the rating agencies to determine what would constitute a sudden deterioration in this metric. A confirmatory indication of significant institutional decline by at least one rating agency will be sufficient to trigger the cancellation of the credit rating overlay.

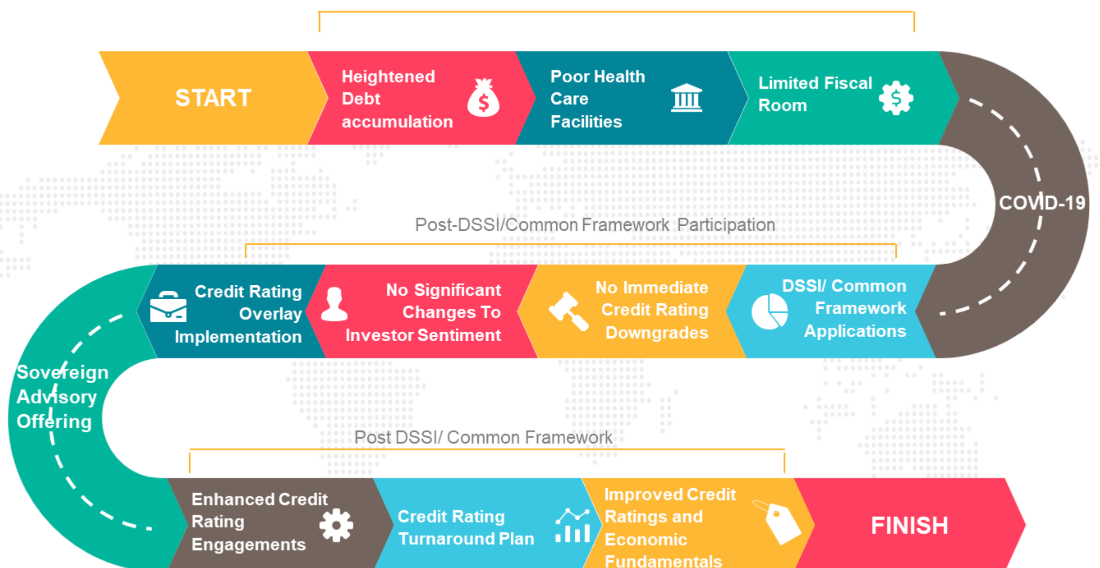
The rationale behind including this metric is due to the significant impact that such events have, for example, the sudden change of a central bank governor would result in instant and significant fluctuations in a country's currency. Its inclusion also promotes stability throughout the overlay and attempts to prevent rash decisions that will affect the institutional strength of a subject country.

The authors are of the view that the credit rating overlay will be highly beneficial to the recipient countries and its associated design promotes tangible outcomes during and at the end of its implementation. In the opinion of the authors, the benefits of opting for the credit rating overlay vs 'letting the normal course of events' plan out is as follows:

Countries Without the Credit Rating Overlay



Countries With the Credit Rating Overlay



Stage III – A Supplementary Advisory Service

There are advisory offerings being built on the African continent as we speak, and Credit Rating Analytics (a partner in this project) are developing their own service in this regard.[8] Nevertheless, we offer here some principles that need to be established as part of our three-stage plan. We offer no preference or particular support for any specific offering. The point we make here is that by adjoining an advisory service that focuses particularly on the region in question – and this is not specific to Africa; for example, a South American-focused offering could be equally as impactful – there exists an opportunity to both build trust with the credit rating process by the sovereign debtors in that region, but also allows for targeted and concerted advice and support which can have a tangible effect upon the near- and long-term credit ratings on the said sovereign debtor.

There are a number of aspects that such an advisory service must consider, and we break those down here.

An Initial Assessment of the Fundamentals

The need to consider a sovereign's financial and nonfinancial fundamentals is key to starting the advisory process. This allows for a multi-level approach to be considered by those providing the advisory services; a focus on what can be done in the immediate term, and then further into the future. This assessment can then set forth the pathway forward for the sovereign and can immediately start impacting their short-term credit ratings.

Assessing (and potentially developing) an Operational Credit Rating-based Framework for the Sovereign

Not all vulnerable countries have credit ratings. Those that do not will need to have an effective operational framework developed so that they can predict, and react to credit rating

[8] Their brochure for their service is included in our website alongside the report. It can also be viewed by the website of Credit Rating Analytics at https://creditratinganalytics.com/index.html.

decisions better. For those already have operational frameworks in place for liaising with credit rating analysts, it may be beneficial to first assess, and then provide for a new approach. This can be done by examining which ministries and internal departments are set up to liaise with external rating analysts, and at what point they are to engage (i.e. pre- or post-rating). It could be that rating decisions can be anticipated better by other ministries or departments, or that there needs to be synergies between existing elements. Also, in terms of implementing the advisory service's recommendations, it may indeed be the case that a new internal infrastructure needs to be developed to better coordinate the recommendations.

Encouraging Anticipation

While not advertising one service over another, there are software packages being developed that allow for the prediction of credit ratings. This software closely correlates the rating methodologies of the major credit rating agencies and allows for a number of variables to be integrated, which then allow for a predicted rating to be obtained. The key is to provide rating assessments internally within the sovereign debtor, by way of an advisory service, between rating assessments from the external rating agencies i.e. within the bi-annual schedule that is predominant with the external agencies. This then allows the sovereign to get ahead of the rating schedule and, theoretically, take pre-emptive action. With the right amount of disclosure from the sovereign debtor, there are a number of particular data sets that can be used to develop efficient and progressive investor-relations regimes, including: related fiscal information, information regarding the wider investor base related to the country's debt environment, balance of payments and trade information, and tax collection information.

Examining the Country in relation to the Credit Rating Environment

In relation to credit rating agencies, all are not created equal. Different credit ratings have different process, methodologies, and historical track-records when it comes to lower- and emerging-economies. To understand this and then apply it to a particular country can be an important element. For example, if a country is looking for a credit rating, requesting a credit rating from one rating agency over another, based on their methodological processes and their traditional approach to the region can be very beneficial if one selects correctly, or

detrimental if they do not; the advisory service is perfect for providing this researched support and targeted advice.

Comparing to those in the Region

Lastly, it is absolutely acknowledged that not every country in a continent so diverse as Africa is the same. However, there is rich information to be gleaned from those either around a country, or perhaps which are similar in nature (perhaps also reliant on the export of natural resources, for example). The advisory service should therefore rely on this rich information and utilise the historical data of their credit rating histories and trajectories to inform the advice given to the sovereign debtor in question.

The Devil is in the Detail

What is contained within this report is an outline, or a suggestion to underlying principles, which should, or at least could be integrated in advisory service. It is worth reiterating the need for an advisory service in this particular arena. There have been multiple instances of research finding that credit rating agencies display a bias towards countries in the identified categorisation. But, there have also been many observations that the countries perhaps do not disclose as much information as they should, or at the very least do not engage with the credit rating agencies and their analysts as much as they perhaps should. This could be for many reasons, ranging from historical issues to organisational issues. Irrespective of the reasoning, there is a fundamental need for the countries to engage better with the rating process because the vast majority of them will be impacted by it regardless of their participation. We argue that it is vital they are better equipped to engage with that process which, as we are seeing now and many interested parties have identified for a long time, has such an incredible impact on their ability to develop, and also weather storms. The provision of an advisory service both allows countries to engage better, but also allows for more trust to be witnessed when it comes to investing in countries in a particular region, for example. It could lead to lower interest rates, better terms of debtors, and potentially higher quality creditors. It is crucial that the knowledge, experience, and forethought that protects a number of countries on the world stage is extrapolated to all corners of the world. The aim, as we

have made repeatedly clear, is to promote a long-lasting and sustainable credit rating environment. A developed and focused advisory service for those in affected regions can certainly help with this. We therefore call on interested parties – whether in a private or perhaps public manner – to develop such a service. We also call on sovereign states to consider this option (especially considering such options are already being developed) as it can have an incredible impact upon one's credit standing on the world stage.

The Need for Legislative Intervention

For the proposed programme to come to life, a number of players in the credit rating impasse will need to act. One of those actors, legislators, have a key role to play. The credit rating agencies have been clear that the reason for their decisions regarding countries even contemplating joining the DSSI, and especially the Common Framework because of its insistence on 'comparable treatment' between official and private creditors, is that there are ratings processes that demand the agencies follow a specific order of action. That order of action is now, since the Financial Crisis, underpinned by clear legislative guidelines. The aftermath of the Financial Crisis brought with it the development of extensive legislative frameworks in the US and the EU that govern not only the technical aspects of the credit rating agencies' worlds, but the underlying sentiment. These frameworks have thus developed something that the credit rating agencies are acutely aware of; there are now clear pathways to litigation for investors. The record settlements between first S&P and then Moody's with the US Department of Justice (on behalf of a number of investors, mainly CalPERS) has rationally made credit rating agencies even more aware than usual of their exposure to liability.

Therefore, legislators are the only real way to unlock the credit rating impasse. The 'agreement' proposed here from creditors is to provide the programme with support and add an extra layer of protection for credit rating agencies deviating from their stated sovereign rating methodology. The proposed methodological overlay is a way providing routes for sovereigns to be rewarded, for the multilateral initiatives to be advanced more than they have been, and for the concept of sustainability to be incorporated in the sovereign sector more. However, they all rely on the reduction of liability for credit rating agencies. Without that reduction, there is stasis in the marketplace and nothing can change. Yet, a reduction in liability is not politically palatable since the devastating effects of the Financial Crisis, with the feeling being that *de*-regulation is being proposed. **That is not the case**. What is being proposed here is a legislative *re*-regulation to fit the needs of the developing world. The post-Crisis legislative rigidity introduced made absolute sense to

guard against the clear iniquity presented by the credit rating agencies in the Financial Crisis. It is for this reason that we propose here a targeted, and limited reduction in liability for the credit rating agencies relating *specifically* to participation in the multilateral sovereign debt treatment initiatives.

Therefore, it is not necessary to write new legislation to replace the relevant sections of the Dodd-Frank Act, or the three major credit rating Regulations in the EU (and relevant directives). What is needed are sharpened statutory instruments to inject flexibility into specific areas of the legislation for the purposes of this programme and the multilateral initiatives that the same governments have put forward. The relevant areas of the respective law on either side of the Atlantic Ocean relate to two key areas: methodological consistency and transparency, and sovereign ratings (specifically in the EU legislative framework).

Before we look at those areas, there is an additional element that needs to be considered. One thing that would really help the programme is for credit rating agencies, if they were to adopt the plans, to establish new rating symbols for the credit ratings applied to sovereign debtors taking part in the initiatives. In the aftermath of the Financial Crisis, it was decided by both legislative frameworks (eventually, in the case of the US) that there needed to be more differentiation between credit ratings for different products, specifically between structured finance products and normal credit ratings. Therefore, the EU mandated, and now the credit rating industry has made standard practice, that all credit ratings for structured finance products have a 'sf' moniker attached to the ratings. This makes clear to the investors that the ratings have been developed with a very different methodology than the traditional methodologies used to develop corporate bond ratings, for example. This was seen as important in terms of transparency for investors, and was welcomed. The same would need to apply for the programme proposed here. The credit ratings for sovereigns in the programme would be decided very differently to normal sovereigns, with a number of extra and different factors being considered in the 'overlay'. As a result, this needs to be made clear to investors, and it is proposed here that the moniker 'CF' be applied to the

ratings of sovereigns in the programme, to signify they are taking part in the Common Framework, for example. The EU provides for this option,[9] as do the US,[10] as long as there is consistency amongst the class of ratings. As long as the inclusion of a new rating signifier is accompanied by extensive explanation from the agencies, then the adoption of an initiative-relevant rating symbol should be seamless.

Returning to the relevant sections of the two legislative frameworks, the US legislative framework is relatively less complicated to amend than the European framework, purely because the US framework does not deal with sovereign ratings specifically (it has no real need to, unlike their European counterparts). The Dodd Frank Act, in section 932, states the following in relation to methodological integrity:

> 932 (r) - *The Commission shall prescribe rules, for the protection of investors and in the public interest, with respect to the procedures and methodologies, including qualitative and quantitative data and models, used by nationally recognized statistical rating organizations that require each nationally recognized statistical rating organization—*
>
> (1) to ensure that credit ratings are determined using procedures and methodologies, including qualitative and quantitative data and models, that are—
>
> (A) *approved by the board of the nationally recognized statistical rating organization, a body performing a function similar to that of a board*; and

---

[9] The first of the three Regulations, in 2009, stated in Article 10 (3) that 'when a credit rating agency issues credit ratings for structured finance instruments, it shall ensure that rating categories that attributed to structured finance instruments are clearly differentiated using an additional symbol which distinguishes them from rating categories used for any other entities, financial instruments or financial obligations'.

[10] Dodd Frank Act 2010, s. 938(a)(2) says: agencies needed to 'clearly define and disclose the meaning of any symbol used by the NRSRO to denote a credit rating', and that (3) the agencies have to 'apply any symbol described in paragraph (2) in a manner that is consistent for all types of securities and money instruments for which the symbol is used. The Act continues by stating that 'nothing in this section shall prohibit an NRSRO from using distinct sets of symbols to denote credit ratings for different types of securities or money market instruments'.

(B) *in accordance with the policies and procedures of the nationally recognized statistical rating organization for the development and modification of credit rating procedures and methodologies*;

(2) to ensure that when material changes to credit rating procedures and methodologies (including changes to qualitative and quantitative data and models) are made, that—

(A) *the changes are applied consistently to all credit ratings to which the changed procedures and methodologies apply*;

(B) to the extent that changes are made to credit rating surveillance procedures and methodologies, the changes are applied to then-current credit ratings by the nationally recognized statistical rating organization within a reasonable time period determined by the Commission, by rule; and

(C) *the nationally recognized statistical rating organization publicly discloses the reason for the change; and ''(3) to notify users of credit ratings—*

(A) of the version of a procedure or methodology, including the qualitative methodology or quantitative inputs, used with respect to a particular credit rating;

(B) when a material change is made to a procedure or methodology, including to a qualitative model or quantitative inputs;

(C) when a significant error is identified in a procedure or methodology, including a qualitative or quantitative model, that may result in credit rating actions; and

(D) of the likelihood of a material change described in subparagraph (B) resulting in a change in current credit ratings.

You can see from the emphasised sections that the aims of the Act are to enforce integrity within the ratings, but also make the process as transparent as possible for the users of those ratings. The sections above would not necessarily need to be altered, but there may need to be a small addition to the section so that the programme is recognised legislatively.

The focus on transparency is key to the programme just as much as it is to the legislative framework, so nothing should really be removed for the purposes of the programme. This would be for the legislative decision-makers to decide on how to inject the programme and its aims into the legislative framework, but it is clear that the sentiments of the legislation and the programme align in many respects. Perhaps just the recognition of the programme via a statutory instrument would suffice for those tasked with interpreting the law (i.e. judges).

Whereas in the US the key is on transparency and articulating any changes clearly to the investing public, the European framework has more complex issues in it to overcome. This is because, in the aftermath of the Financial Crisis, the European Union was unique in that it was subjected to a 'Sovereign Debt Crisis', with the credit rating agencies at the heart of it. The agencies downgraded a number of European Member States at the same time, leading to high levels of contagion in the bloc. As a result, the EU initiated the second of the three Regulations, in 2011, that put the newly-formed ESMA (European Securities and Markets Authority) at the centre of the European regulatory framework, and in doing so they developed new rules for the credit rating agencies to guard against further instances of credit rating agency-inspired contagion (like the timing of rating releases etc.)

However, consistency and predictability are key facets of the European approach, and that may prove problematic for the programme and require particular intervention from European legislators. For example, in Article 8 (6) of the 2011 Regulation, it states that:

> When methodologies, models or key rating assumptions used in credit rating activities are changed, a credit rating agency shall:
>
> (a) immediately, using the same means of communication as used for the distribution of the affected credit ratings, disclose the likely scope of credit ratings to be affected;

(b) review the affected credit ratings as soon as possible and no later than six months after the change, in the meantime placing those ratings under observation; and

(c) re-rate all credit ratings that have been based on those methodologies, models or key rating assumptions if, following the review, the overall combined effect of the changes affects those credit ratings.

It is easy to see why this may be problematic for the programme. What is being proposed here is, essentially, a new methodology to be applied to particular sovereigns. There is no legislative room for that to take place in the European legislative framework. The Article states that credit rating agencies shall only use methodologies that are 'rigorous, systematic, continuous, and subject to validation based on historical experience, including back-testing'. Not only is this not possible with a newly-imagined rating methodology, the proposed approach of relating to only some of the sovereign rating space means the methodology cannot be systematic, unless it is considered systematic in relation to the multilateral initiative the programme has to be attached to. We can see here the grey-area that the legislators would need to me abundantly clear, and only legislative intervention could achieve that; the risk of allowing for litigation through this section of the legislation is too substantial for credit rating agencies to accommodate. However, in the 2013 Regulations, the EU did make comment on rating methodology changes, stating that any proposed material changes would need to be subject to public consultation of more than a month, and articulated to the market via ESMA. Yet, there are more issues. The 2013 Regulation, in attempting to learn the lessons of the sovereign debt crisis, prohibited the rating agencies from rating 'groups of countries', as well as the imposition of a 'ratings calendar' to be published in advance of a given 12-month period, articulating the pre-described dates for rating actions and unsolicited ratings.

The European legislative framework would need to be amended more than the American legislative framework for this programme to be considered. That is not surprising, given the legislative reaction to the agencies in the wake of the Sovereign Debt Crisis. For the Europeans, it is likely that a stand-alone legislative amendment would need to be created to

accommodate the programme, whilst the American approach could accommodate the programme even through regulatory instruments via the SEC, really. The respective legislative/regulatory bodies would need to accommodate the programme into its framework in its own images, and it should do this; by allowing the programme into the framework but in one's own way allows for the flexibility from the legislative framework, as well as the credit rating agencies, but also allows it to be legislatively palatable with the region-specific protections still in place.

However, this is not the end to the story. In reality, the sovereign ratings of the international rating agencies fall between the cracks of localised financial regulations. The EU, for example, will not be minded to interfere in the ratings that apply to third-party countries i.e. countries outside of the EU, even if the ratings came from entities based within the EU. If this credit rating impasse was affecting European countries, then that may be a different story. Yet, as we sit, there is no unified global financial regulatory framework that could be targeted for a proposal such as this, and any other. The sovereign ratings for countries in places like Africa, the majority of Asia, and South America sit in a regulatory 'no-man's land' because only national regulations could affect the ratings, and the rating agencies are not stationed in those countries. An international rating agency may have an office in a particular country, but its headquarters or established bases operate far outside of the national boundaries of, say, Angola. Therefore, it is necessary to take a step back before coming forward in terms of legislating for this proposed plan. The common development of key rating-related legislation is usually begun by IOSCO, or the International Organisation of Securities Commissions. IOSCO has been responsible for setting international Codes of Conduct for the rating agencies, which national regulators (like ESMA and the SEC) then adapt, if those practices are not already a part of their regulatory arsenal. A good and current example is the Final Report that was published by IOSCO in November 2021 that concerned itself with the burgeoning ESG rating industry and the potential need for

regulations in that space.[11] Now, just six months afterwards, the EU has launched a major consultation on how it can best build a regulatory framework for ESG rating entities.

What is interesting for us is that there are a number of DSSI-eligible and Common Framework-eligible countries that are members of IOSCO, and one that sits on the Board (Pakistan). Therefore, the call in this proposal is for those countries to first consider this proposed plan and adapt it as they see fit, but then to push this plan onto IOSCO to be considered at the trans-national level. IOSCO can be the birthplace of the legislative effort needed to inject targeted and purposeful flexibility into the credit rating process so that vulnerable countries can be better considered by the machine that often sees them suffer, unnecessarily.

[11] IOSCO, *Environmental, Social and Governance (ESG) Ratings and Data Products Providers: Final Report* (2021) https://www.iosco.org/library/pubdocs/pdf/IOSCOPD690.pdf.

What Comes Next?

As part of this and the associated pieces in this project, the only conclusion that one can come to is that there are only really a few options available. One could be to do nothing, and once the countries inevitably start defaulting if the situation continues as it is, then those countries will continue to be regarded as they have been over the past few decades (and beyond). If they do not default, their citizenry will suffer and the response to the post-pandemic era will be limited and stunted, placing affected countries at risk of defaulting at any point into the future. Another option is for a debt jubilee, which will enable funds to be utilised for more important purposes but, yet again, does not suggest a progressive future for the affected countries. Another suggestion that has been put forward is for the credit rating agencies to suspend their credit ratings on affected countries, although as we know from the two reports, this is simply impossible given the rating dynamic that exists. There have been other suggestions, like the increased allocation of SDRs and for the distribution of those SDR shares to go from the richer countries to the poorer countries. This proposal is currently being considered and could either provide for shallow assistance, or tremendously impactful assistance if the richer countries forego their share. What we call for is a reimagining of the credit rating process, so that it becomes a *progressive* process rather than a punitive one.

However, we are not idealists. We understand, absolutely, that what we are calling for has no precedent. We understand, absolutely, that a whole host of systemic changes would need to be made for this proposal to be realised. Laws would have to be changed, contracts drawn up and observed, and new realities faced by participants ranging from credit rating agencies to private investors. Understandably, these organisations would not be particularly overjoyed to see their roles altered or their exposures changed. However, there is a need now to think longer-term and if the market participants are really supportive of the idea of *sustainability* being fundamentally introduced into financial thinking, then proposals like ours and any others that put the future of the affected countries higher up on the agenda

should be, at least, considered. We understand the importance of that sentiment, absolutely.