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Debt relief, debt crisis prevention and human rights: the role of credit rating agencies

Report of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, Yuefen Li*

Summary

In the present report, the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, Yuefen Li, examines the inherent structural problems of credit rating agencies and their failure to perform well their role of assessing risk and addressing the information asymmetry for bridging investors and debtors, thus having a negative impact on debt crisis prevention and resolution. In the present report, she sheds light on how credit rating-related announcements, especially downgrades, can lead to enormous impacts on the ability and capacity of States to respect, protect and fulfil their human rights obligations. The Independent Expert refers to human rights norms and standards applicable to sovereign debt and credit ratings and to the responsibilities of credit rating agencies as important actors in the international debt architecture. A set of recommendations, including in relation to the much-needed accountability and reform of these institutions, is made at the end of the report.

* The present report was submitted after the deadline so as to include the most recent information.

Contents

I. Introduction

1. Credit rating agencies have an enormous influence on market expectations and the lending decisions of public and private investors. However, past financial and debt crises, in particular the sub-prime mortgage crisis, have exposed the inherent structural problems of credit rating agencies and their failure to perform the role they are supposed to. Even though many reform proposals have been put forward in recent decades, especially since the global financial crisis, not much progress has been made owing to resistance from these agencies and a lack of political will of States and regulators.

2. As part of international efforts to respond to the impact of the coronavirus disease (COVID-19) pandemic, some international initiatives have been introduced to address the mounting debt burden of vulnerable countries, including the endeavour to reduce the debt service burden of poor countries so as to allow them to use their limited financial resources to save lives and livelihoods. However, the fear of possible credit rating downgrades has deterred the implementation of the Debt Service Suspension Initiative of the Group of 20.[1] Some sovereign downgrades have also increased financial market volatility and the difficulty of these countries to gain access to new sources of financing.

3. To reduce the frequency of debt crises, which would always have huge negative impacts on the protection and enjoyment of economic, social and cultural rights by the population, States have resolved to reduce mechanistic reliance on credit-rating agency assessments, including in regulations, and, in order to improve the quality of ratings, to promote increased competition and measures to avoid conflict of interest in the provision of credit ratings. Moreover, States have supported building greater transparency requirements for the evaluation standards of credit rating agencies.[2] At a United Nations meeting in September 2020, the discussion groups formed as part of the United Nations financing for development process put forward proposals, including to reform credit rating agencies,[3] in the context of "the era of COVID-19 and beyond". A menu of options for consideration by Heads of State and ministers of finance resulted from deliberations over several months by States Members of the United Nations, relevant international and regional organizations, academics and civil society representatives.[4] Those proposals were aimed at addressing issues relating to conflicts of interest, which prevent credit rating agencies from performing their role properly, and regulators were requested to adopt common guidelines so as to incorporate progressively longer-term, Sustainable Development Goal-aligned, social, environmental and governance indicators into credit rating agency evaluations.

4. The relevance of this topic is in line with Human Rights Council resolution 43/10 on the mandate of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights. In the resolution, the Council noted the importance of international cooperation and assistance in addressing the debt burden and long-term debt sustainability. It also affirmed the significance of fostering debt financing, debt relief and debt restructuring, as appropriate, and of addressing the external debt of highly indebted poor countries to reduce debt distress. Furthermore, the Council noted that the debt burden complicated the numerous problems facing developing countries, contributed to extreme poverty and was an obstacle to sustainable human development, and was thus a serious impediment to the realization of all human rights. The resolution echoed the contents of target 17.4 of the Sustainable Development Goals, namely to assist developing countries in attaining long-term debt sustainability through coordinated policies aimed at fostering debt financing, debt relief and debt restructuring, as appropriate, and to address the external debt of highly indebted poor countries to reduce debt distress.

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[1] See www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative.

[2] Addis Ababa Action Agenda of the Third International Conference on Financing for Development, outcome document (General Assembly resolution 69/313, annex).

[3] See United Nations, "Financing for development in the era of COVID-19 and beyond: menu of options for the consideration of ministers of finance – part II", September 2020.

[4] For further information, see United Nations, "Financing for development in the era of COVID-19 and beyond". See also A/75/146.

5. Since taking up her functions in May 2020, the Independent Expert has discussed the reasons behind the fear of credit downgrades that has led many States eligible for the Debt Service Suspension Initiative and in acute need of financial resources to choose not to participate in the Initiative. This fear has increased at a time of high fiscal deficits, heavy debt service burdens and urgent needs for financing to save lives and livelihoods in these countries. Along these lines, in her note of August 2020 on options to consider for human rights-based debt relief during COVID-19 for developing countries [5] and her other interventions at various international meetings, the Independent Expert raised concerns about the role that credit rating agencies have played in their credit risk assessments and related activities. In her report to the General Assembly, she also made recommendations relating to how credit rating agencies could contribute to financial market stability and debt crisis resolution.[6]

6. The debt situation is going to be even more challenging in 2021 than it was in 2020, when most countries suffered negative gross domestic product (GDP) growth, exploding fiscal deficits, rising unemployment and rocketing debt levels. Developing countries, in particular low-income countries, are at greater risk of defaulting on their sovereign debt and over 50 per cent of low-income countries are assessed to be at high risk of or in debt distress according to the joint International Monetary Fund–World Bank Debt Sustainability Framework for Low-Income Countries.[7]

7. There are currently unprecedented possibilities of several defaults taking place in parallel; meanwhile, countries’ ability to use fiscal and monetary expansionary tools has become much more constrained. Increasing levels of private debt have been a challenging problem for developing countries, including low-income countries, for some years already. During a health and economic crisis, the possibility of this kind of debt turning into a contingent liability would increase, adding a debt burden to sovereigns.

8. The COVID-19 pandemic has once again reminded the international community of the urgent and critical need to reform credit rating agencies in order to reduce the possibilities of a debt crisis. Implementing structural reforms to credit rating agencies, as an element of the international debt architecture, would also contribute to mitigating the negative social and economic impact of these crises, which can lead to reversals of social and economic progress almost overnight, bringing immense suffering to a vast part of the population of a country. Debt crises often affect most people living in poverty, especially women, indigenous peoples and informal workers, as well as small enterprises and small-scale farmers, adding millions of people to the ranks of the unemployed. A social fabric already weakened by the pandemic, with widening income and gender inequalities, is bound to suffer considerably from an added debt crisis.

9. The reform of credit rating agencies should be part of the reform of the global financial architecture. Credit rating agencies should play a gatekeeper role for debt crisis prevention instead of contributing to the debt crisis. A more effective human-based international financial architecture is required now more than ever in order to respond to the socioeconomic downfall resulting from the global pandemic. In a time of profound urgency to address debt crises and to ensure the investment of limited financial resources in the realization of the human rights of millions of people in despair, it is essential to address the need for accountability, transparency and regulation of these agencies. The international community has repeatedly highlighted that the role of credit rating agencies, in the context of debt crisis prevention and resolution, deserves closer attention, notably to allow States the fiscal space and financial resources necessary to provide for the rights to health, education, food and social protection of their populations, and to tackle the increases in poverty and inequality.

10. In this context, the Independent Expert, in her first report presented to the Human Rights Council, examines the inherent structural problems of credit rating agencies and their

[5] See www.ohchr.org/EN/Issues/Development/IEDebt/Pages/IEDebtIndex.aspx.

[6] A/75/164.

[7] Ceyla Pazarbasioglu, “Current sovereign debt challenges and priorities in the period ahead”, International Monetary Fund, 16 November 2020. Available at www.imf.org/en/News/Articles/2020/11/16/vc111620-current-sovereign-debt-challenges-and-priorities-in-the-period-ahead.

failure to perform well their role of assessing risk and bridging the information asymmetry for investors and debtors, which have had negative impacts on debt crisis prevention and resolution. In the present report, the Independent Expert sheds light on how credit rating-related announcements, especially downgrades, can lead to enormous impacts on the ability and capacity of States to respect, protect and fulfil their human rights obligations. She illustrates some human rights norms and standards applicable to sovereign debt and credit rating and to the responsibilities of credit rating agencies as important actors in the international debt architecture. A set of recommendations, including in relation to much-needed accountability and reform of these institutions, is given at the end of the report.

11. The present report benefited from submissions by States, civil society, regional commissions and international financial organizations, as well as from a consultation with civil society organizations, various responses to a call for contributions issued by the Independent Expert and a number of discussions with relevant stakeholders.[8] The Independent Expert is grateful for all of the contributions and information received.

II. Coronavirus disease (COVID-19) and the rising risk of a systemic debt crisis

12. Far from abating, the COVID-19 pandemic has intensified in 2021 with a rapid resurgence of cases in some countries and, worse still, with new and more contagious virus strains. As a result, many countries around the world have reintroduced lockdowns and travel restrictions. Although vaccines have brought a glimmer of hope, the Director General of the World Health Organization, on 18 January 2021, expressed distress about equitable access across countries, noting that “more than 39 million doses of vaccine have now been administered in at least 49 higher-income countries. Just 25 doses have been given in one lowest-income country. Not 25 million; not 25,000; just 25.”[9] It seems that, to pin hope on ending the pandemic swiftly thanks to vaccines, is like a dream or a mirage, at least for poor countries.

13. Towards the end of 2020, the negative effects of the pandemic on world economic and social conditions had already reached an alarming level. Millions of people saw the enjoyment of their economic and social rights deeply compromised. The pandemic had not only created millions of vulnerable individuals and communities, but had also exposed existing inequalities, especially in access to health and social protection. As noted by the World Bank, the pandemic “has knocked more economies into simultaneous recession than at any time since 1870. It has ended a two-decade streak of steady global progress in poverty reduction, pushing up to 150 million people into extreme poverty by 2021.”[10] Some figures on the extent of the lives lost and on the health and socioeconomic impacts are stark: as of 7 February 2021, there had been over 105 million confirmed cases of COVID-19 and the number of deaths reported to the World Health Organization had surpassed 2.3 million.[11] In November 2020, the World Food Programme had projected a doubling of its estimations of hungry people pre-COVID-19, to 265 million people facing crisis levels of hunger unless direct action was taken. The International Labour Organization highlighted that the pandemic had also caused the disappearance of almost 500 million jobs globally during the second quarter of 2020 alone and had harshly affected many of the 2 billion workers in informal employment.[12] It also estimated that labour income losses (before taking into account income support measures) during the first three quarters of 2020 amounted to $3.5 trillion, or 5.5 per

[8] For details and access to contributions, see www.ohchr.org/EN/Issues/Development/IEDebt/Pages/CreditRatingAgencies.aspx.

[9] See www.who.int/director-general/speeches/detail/who-director-general-s-opening-remarks-at-148th-session-of-the-executive-board.

[10] See World Bank, *International Debt Statistics 2021* (Washington, D.C., 2020).

[11] See https://covid19.who.int/ (accessed on 8 February 2021).

[12] Guy Ryder, Director General of the International Labour Organization, “Restore progress towards attaining the Sustainable Development Goals”, statement at the annual meetings of the World Bank and the International Monetary Fund, Washington, D.C., 15 October 2020. Available at www.ilo.org/global/about-the-ilo/newsroom/statements-and-speeches/WCMS_758222/lang--en/index.htm.

cent of global GDP for the same period in 2019. Labour income losses were estimated to be the highest in middle-income countries, reaching 15.1 per cent in lower-middle-income countries and 11.4 per cent in upper-middle-income countries.[13]

14. New waves of lockdowns and the prolonged duration of the pandemic have given rise to deepening inequalities within and across countries. As reported by Oxfam, "worldwide, billionaires saw their wealth increase by a staggering $3.9 trillion between 18 March and 31 December 2020. Their total wealth now stands at $11.95 trillion, which is equivalent to what G20 governments have spent in response to the pandemic."[14] Concerns about the greater risks of a systemic debt crisis for developing countries have escalated. As pointed out in the Independent Expert's report to the General Assembly, the people who have suffered the most from lockdowns are those who cannot work remotely from home and those in the informal sector. Those who have to remain present in their jobs would have higher exposure to the COVID-19 virus and, together with those from the informal sector, have less job security.

15. With extraordinary fiscal and monetary expansionary policies having been adopted by central banks and fiscal authorities worldwide, 2020 did not see a systemic debt crisis even though some countries went through debt defaults and debt restructuring primarily due to pre-pandemic debt problems and the knock-on effects of the pandemic. As the end of the pandemic seems to become more remote than expected and as the synchronized global economic recession persists, concerns are rising about how to keep a systemic world debt crisis at bay. The fiscal and monetary ammunition of countries suffering from a high debt burden seems to be mercilessly insufficient. According to the International Monetary Fund, advanced economies deployed the equivalent of 20 per cent of GDP on pandemic response, and low-income countries only 2 per cent of GDP.[15] With negative GDP growth, fast-shrinking government revenue, the drastic contraction of international trade and foreign direct investment, the sudden stop of tourism and the free fall of remittances, it is natural that the debt indicators of developing countries have been deteriorating. According to the latest data, the total external debt stocks of low-income countries eligible for the Debt Service Suspension Initiative rose 9 per cent in 2019 to $744 billion, equivalent on average to one third of their combined gross national income. Lending from private creditors was the fastest-growing component of the external debt of Debt Service Suspension Initiative-eligible borrowers, up fivefold since 2010. Obligations to private creditors totalled $102 billion at the end of 2019. The debt stock of the Debt Service Suspension Initiative-eligible countries to official bilateral creditors, composed mostly of the Group of 20 countries, reached $178 billion in 2019 and accounted for 27 per cent of the long-term debt stock of low-income countries.[16]

16. Countries with an unprecedented high debt burden prior to the pandemic are facing even more unsustainable debt and may face insolvency sooner or later. These would not be only low-income countries; many emerging economies, small island countries and middle-income countries are also facing a significant risk of unsustainable debt. The pandemic has exacerbated existing debt vulnerabilities in many countries.[17] The reason is very simple: it is difficult to raise new money from any source during the pandemic. Meanwhile, their revenue is declining and the expenditure to sustain social and economic order in their countries has been increasing quickly.

17. Clearly, the suspension period for the Debt Service Suspension Initiative is far from sufficient. A group of civil society organizations and networks already warned in July 2020 that:

> All 73 countries must still repay up to $33.7 billion worth of debt this year, which is $2.8 billion per month. This figure is double the amount that Uganda, Malawi and

[13] See International Labour Organization, "ILO Monitor: COVID-19 and the world of work", 6th ed., 23 September 2020.

[14] See "The inequality virus", Oxfam Briefing Paper, 25 January 2021. Available at www.oxfam.org/en/research/inequality-virus.

[15] See www.imf.org/en/News/Articles/2021/01/14/tr011321-transcript-imf-md-media-roundtable-washington-post-nikkei-pti-business-day-le-figaro?cid=em-COM-789-4253.

[16] See World Bank, *International Debt Statistics 2021*.

[17] See Ceyla Pazarbasioglu, "Current sovereign debt challenges".

> Zambia combined spend on their annual health budget. … Failure to include private or multilateral creditors in the Debt Service Suspension Initiative also means that the bilateral debt relief granted (as well as new loans given to these countries in need) is simply being diverted into the pockets of some of the richest investors in the world.[18]

It is also noted in the report by Christian Aid, Oxfam, Global Justice Now and the Jubilee Debt Campaign that "most of the money that developing countries have to repay to their creditors is owed to private actors and multilateral banks. Specifically, of the $42.7 billion that the 73 Debt Service Suspension Initiative countries owe in debt payments in 2020, less than half (41 per cent) is due to bilateral creditors, 27 per cent is owed to private creditors and 32 per cent to multilateral banks."[19]

18. If there is a wall of sovereign defaults, and taking into consideration a debt landscape much more complex than before with different forms of debt instruments and diverse and multiple creditors, what kind of role would credit rating agencies play? Would they once again hand out rapid-fire downgrades, plunging countries into even worse economic and social chaos? Would they continue to deter international efforts to assist countries in debt trouble?

19. The United Nations and international financial institutions have called for urgent reforms of the international debt architecture.[20] The reform of credit rating agencies has not been clearly identified in an article by the International Monetary Fund calling for the reform of the debt architecture;[21] however, this reform is long overdue.

III. Role of credit rating agencies

20. Credit rating agencies play a crucial role in the international financial system. They are supposed to act as a bridge between lenders and borrowers by reducing the information asymmetry through the provision of objective, independent and expert information on issuers or borrowers of bonds and other debt instruments and fixed-income securities. As the purpose of lending is to receive a return on the lender's investment, the major concern is centred around the credit worthiness of the borrower, that is, the ability of a Government or an enterprise to observe its obligations to the debt. Reliance on the information of credit rating agencies is especially heavy among institutional investors. Credit rating agencies provide analyses to evaluate the borrowers' financial situation, as well as their political and economic conditions, based on which the agencies also would give their opinion or judgment in letter form (for example, credit ratings such as A, B, C and so forth), which varies among credit rating agencies. Credit ratings would not only influence investors' portfolio allocation decisions, but also the pricing of the debt instruments, such as the interest rates required for the debt to be repaid. Therefore, credit rating agencies are market makers and movers and have significant impacts on the allocation of financial resources and the cost of the capital. In its *Trade and Development Report 2015*, the United Nations Conference on Trade and Development highlighted that ratings had a series of impacts, including on asset allocation, as they contributed to the determination of the interest rate – or price – the borrower must pay for obtaining financing, and constituted a key component of regulatory risk measurement.[22]

21. If indeed credit rating agencies can provide expert, independent, objective and forward-looking information, they would play the role of preventing debt crises by guiding

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[18] See Christian Aid, Oxfam, Global Justice Now and Jubilee Debt Campaign, "Passing the buck on debt relief: how the failure of the private sector to cancel debts is fueling a crisis across the developing world", July 2020. Available at www.globaljustice.org.uk/resources/passing-buck-debt-relief.

[19] Ibid.

[20] See Kristalina Georgieva, Ceyla Pazarbasioglu and Rhoda Weeks-Brown, "Reform of the international debt architecture is urgently needed", International Monetary Fund, 1 October 2020. Available at https://blogs.imf.org/2020/10/01/reform-of-the-international-debt-architecture-is-urgently-needed/.

[21] Ibid.

[22] United Nations publication, 2015, p. 105.

investment decisions, avoiding overborrowing and assisting with debt crisis resolution by smoothing capital flows for countries facing temporary liquidity problems. Their risk analysis and evaluation at country and enterprise levels, if done properly, should forewarn the coming of a debt crisis and contribute to debt crisis prevention.

22. Debt can be an important tool for economic development if used wisely. Countries may need to borrow from external sources owing to different reasons, including insufficient domestic savings, a narrow taxation base and the resultant fiscal deficits, the need to increase investment in infrastructure, and special difficult circumstances such as natural disasters, climate-induced crises or a pandemic. Non-excessive borrowing can promote economic growth and development for the majority of the population, if it is carried out in a transparent and planned way and when it leads to the expansion of productivity in the real economy. To rely on heavy taxation to mobilize financial resources would have adverse effects on poverty alleviation, on private savings and on public welfare as a whole. Financing is the blood of an economy. For countries whose currency is not a reserve currency, such as the United States dollar, printing money can only be a short-term option for mitigating financing needs. Therefore, borrowing externally can be necessary and can increase the aggregate demand for, and the provision of, goods and services, thus enhancing the enjoyment of economic and social rights of the population if handled well. Meanwhile, borrowing, especially overborrowing, would have unwelcome short-term and long-term consequences, such as inflation, the crowding out of private investment, the risk of capital outflows, a heavy debt service burden and an unsustainable fiscal deficit. An increased debt service burden owing to various reasons, including external shocks, would adversely affect social expenditures and human rights, as proved by the current COVID-19 pandemic and past debt crises. Therefore, an overly optimistic credit rating is by no means better than an overly pessimistic rating.

23. However, external shocks and domestic problems can worsen debt indicators and cause debt-servicing difficulties. Borrowing could obtain the badly needed new money to bridge the financing gap and avoid turning the problem into a full-blown debt crisis.

24. While debt can promote economic development if used wisely, in order to allow investors to lend their money to the borrowers who need their unused capital, credit rating agencies are needed to fill in the information gap. The main issue at hand is that credit rating agencies are not structured to be in a position to take a balanced and objective view of the borrower’s financial situation and its capacity to service or repay the debt.

IV. Inherent structural defects of credit rating agencies

25. As the sub-prime mortgage crisis of 2007–2009 erupted, and in its aftermath, many scholars and institutions expressed the view that credit rating agencies had contributed to the sub-prime mortgage crisis in the United States of America, the subsequent global financial crisis of 2007 and the escalation of the eurozone debt crises. These crises brought negative impacts on the economic and social situations in relevant countries, discredited the rating agencies for what was identified as their role in the crises and shed light on the inherent defects of credit rating agencies.

26. The operations of credit rating agencies have long been suffering from multiple problems and failures, including the characteristics of an oligopoly; conflicts of interest; procyclicality in rating; inaccuracy or errors in their statements, rating warnings and downgrades; a lack of transparency; and accountability.

A. Oligopoly by the “big three” private companies with quasi-governmental status

27. Credit rating is a big international business. However, the credit rating market is highly monopolized by three agencies, namely Standard & Poor’s, Moody’s Investors Service and Fitch Ratings, which also have a cross holding of shares among them, forming

an oligopolistic position in the market of private and public debt.[23] Although there are some smaller credit rating agencies in the world, according to a report of the Securities and Exchange Commission from January 2020, the "big three" control more than 94 per cent of outstanding credit ratings, with Standard & Poor's and Fitch Ratings occupying about 82 per cent.[24]

28. The three agencies are de facto private and profit-seeking companies. However, since 1975, following the introduction of new rules by the Securities and Exchange Commission, they have been recognized as "official" rating agencies and each named a nationally recognized statistical rating organization. This status has elevated their profile and importance while giving more credibility to their judgments. In addition, this status has further strengthened and maintained the oligopoly by making market entry barriers more formidable, thus reducing the possibility for the entrance of medium and small competing companies.[25]

29. The lack of competition and the privileged position these agencies enjoy appear to give the "big three" too much comfort and too little incentive to strive to hand out objective judgments of sovereign and private borrowers.

B. Conflict of interest and conflicting roles

30. Conflict of interest is considered as a serious problem in the financial world and offenders, when condemned in a court of law, are subject to punishment. However, there seems to be more tolerance for conflicts of interest among credit rating agencies. Briefly, it can be said that their business model, usually referred to as the "issuer pay" model for their credit ratings, is at the heart of the conflict of interest. To give credit rating judgments to the very clients who pay them for their assessments casts a large shadow of doubt over the ability of credit rating agencies to give objective, impartial assessments. In other words, the question is: What is the probability of credit rating agencies not being influenced by financial, political and customer relationship pressure? It is even harder to understand or trust the levels of objectivity when credit rating agencies are partners in the design of the investment products or financial engineering instruments, such as mortgage-backed securities, they rated before the sub-prime mortgage crisis, reaping huge profits from the instruments they themselves had rated as AAA level. Therefore, credit rating agencies have, in many cases, been paid for positive ratings. As illustrated in the book *The Big Short: Inside the Doomsday Machine*[26] and other documents, credit rating agencies continued to give bonds AAA ratings even when the prices of these securities started to fall, as they themselves were reaping high profits from these debt instruments at that time.

31. The conflicts of interest of credit rating agencies have been considered one of the major underlying factors of the mortgage bubble that led to the dramatic impact on the right to housing[27] and caused the global financial crisis, which set back many economies by a decade. In 2015, Standard & Poor's paid about $1.4 billion to settle allegations that it had boosted ratings on mortgage-backed securities in the run-up to the crisis in the United States,

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[23] According to Moody's Analytics, "the results show that the three largest CRAs – S&P Global Ratings, Moody's Investors Service, and Fitch Ratings – account for 92.1% of the market for credit rating agencies in EU, representing a 2.7% increase on 2018. The remaining 7.9% of the market is shared between the other 23 CRAs that are registered in EU." See "ESMA publishes market share figures for credit rating agencies in EU," 29 November 2019. Available at www.moodysanalytics.com/regulatory-news/nov-29-19-esma-publishes-market-share-figures-for-credit-rating-agencies-in-eu. See also Securities and Exchange Commission, *Annual Report on Nationally Recognized Statistical Rating Organizations* (December 2015), p. 15. Available at www.sec.gov/files/2017-02/2015-annual-report-on-nrsros.pdf.

[24] See Securities and Exchange Commission, "Annual Report on National Recognized Statistical Rating Organizations", *Financial Times*, 3 April 2020.

[25] See Frank Partnoy, "What's (still) wrong with credit ratings?", *Washington Law Review*, San Diego Legal Studies Paper, No. 17-285 (2017).

[26] See Michael Lewis, *The Big Short: Inside the Doomsday Machine* (W.W. Norton and Company, 2015).

[27] For more on the impact on the right to housing, see A/67/286 and A/HRC/34/51.

including in different states in the country, admitting that it had held off on downgrades for fear of losing market share. Moody's Investors Service paid $864 million in 2017 to settle similar charges.[28]

32. The Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System (sometimes referred to as the "Stiglitz Commission") concluded that the credit rating system was one of the specific areas most urgently in need of reform.[29] It identified as a key problem the fact that credit rating agencies were ineffective and plagued with conflicts of interest. The report of the Securities and Exchange Commission for 2016 referred to concerns about the conflicts of interest and the structural problems giving rise to the possibilities of external influence on rating analyses and opinions, as well as the evidence of errors and the low quality of ratings.[30]

33. Conflict of interest is the major underlining reason for many failures and errors by credit rating agencies. More transparency and disclosure could facilitate better performance. However, this defect of credit rating agencies cannot be addressed through enhanced transparency alone, and fundamental reforms of their business model are needed.

C. Procyclical rating and lack of social indicators

34. The ratings of credit rating agencies have a tendency to be lax or overly optimistic at the top of the economic cycle and too severe at the bottom of the business cycle. Procyclical ratings could encourage overborrowing during good times and deepen the debt crisis during a crisis by triggering market panic and the resultant capital outflows and currency depreciation.

35. During an upswing in the economic cycle, overly optimistic credit ratings, which underestimate default risks in order to attract investors, can lead to overborrowing, which sows the seeds for a debt crisis. Conversely, during a period of economic downturn, when countries and enterprises require money (liquidity) to service debt and bridge fiscal gaps, such as in the context of the critical need for social investment in the midst of the COVID-19 pandemic, credit watch announcements or downgrades from credit rating agencies can lead to capital outflows and a loss of access to the international capital market owing to reputation damage caused by downgrades. A reduction of inflows and an increase of outflows of capital from public and private investors combined with an inability to borrow new money from the international capital market could turn a liquidity problem (lack of money) into an insolvency crisis (inability to service debt) because of the credit crunch, which has been happening to some countries during the COVID-19 pandemic. Credit rating agencies have never once acted as a fire alarm to warn about the coming of a financial or debt crisis, which they could have done through their analyses and judgments of credit worthiness of countries and enterprises. Some people have called them the fire alarm that never rings. Instead of preventing debt crises, credit rating agencies have contributed to the formulation of financial or debt crises, such as the global financial crisis of 2007, and increased the severity of the crisis, such as the eurozone debt crises and the current COVID-19 pandemic.

36. For the Asian financial crisis of 1997,[31] the global financial crisis of 2007 and the eurozone debt crises of 2009,[32] there was evidence of overly optimistic ratings and at times completely wrong public statements and warnings, which fuelled the pre-crisis lending boom and the capital inflows and resulting asset bubbles in some cases. Then, when the crisis set

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[28] See Patrick Temple-West, "Rating agencies brace for backlash after rash of downgrades: critics claim S&P, Moody's and Fitch might be poised for rerun of 2008 financial crisis", *Financial Times,* 2 April 2020. Available at www.ft.com/content/253210d5-4a2d-439f-a4a6-204a7f66d445.

[29] Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System.

[30] See Securities and Exchange Commission, *2016 Summary Report of Commission Staff's Examinations of Each Nationally Recognized Statistical Rating Organization.* Available at www.sec.gov/ocr/reportspubs/special-studies/nrsro-summary-report-2016.pdf.

[31] See G. Ferri, L.G. Liu and J.E. Stiglitz, "The procyclical role of rating agencies: evidence from the East Asian crisis", *Economic Notes,* 2 December 2003.

[32] See Council on Foreign Relations, "The credit rating controversy", 19 February 2015.

in, there were waves of fast credit downgrades, which contributed to massive capital outflows and a loss of access to capital markets by enterprises and sovereigns. These actions exacerbate financial market volatility, make Governments' efforts to contain debt crises ineffective and increase human suffering. This is particularly evident in the case of Greece during the eurozone debt crises. Regarding the global financial crisis of 2007, economists and regulators have the view that credit rating agencies' failure to perform their role and their mistakes in judgments were the main reasons for the crisis. The assessment of the United States Senate Permanent Subcommittee on Investigations was that "inaccurate AAA credit ratings introduced risk into the U.S. financial system and constituted a key cause of the financial crisis."[33] The overly positive, incorrect ratings of credit rating agencies made investors believe that mortgage-backed products were risk-free. People were not aware that the credit rating agencies themselves did the financial engineering together with investment banks. Even so, when the crisis hit, credit rating agencies followed the same downward spiral pattern of negative ratings, which worsened the spread of the crisis.

37. With memories of the quick-fire downgrades of Greece, Ireland, Portugal and other countries affected by the eurozone debt crises, the European Securities and Markets Authority has cautioned credit rating agencies against deepening the COVID-19 crisis through the quick-fire downgrades of countries, which would push pandemic hit economies into deeper recession.[34] During previous crises, such behaviour increased financial market volatility and constrained policy space for Governments, negatively affecting their access to international capital market at times when Governments facing debt problems needed it the most.

38. According to the Africa Sovereign Credit Rating Review,[35] a report produced by the African Peer Review Mechanism (an entity of the African Union) in collaboration with the African Development Bank and the Economic Commission for Africa, during the COVID-19 pandemic, 11 countries saw their sovereign credit rating downgraded during the first half of 2020, and 12 countries had their outlooks changed to negative by different credit rating agencies.

39. The timing of ratings actions should be carefully calibrated during crises and should take into consideration social and human rights factors. Human capital is one of the most important factors of productivity, which means a lack of concern for social rights could lead to the long-term loss of economic growth and the worsening of debt problems down the road. That is a major reason for awarding regulators direct oversight of credit rating agencies during crises. The most recent case was during the financial crisis of 2007 when sovereign downgrades were suspended in order to avoid worsening the eurozone debt crises.

40. Procyclical downgrades can trigger a self-fulfilling prophecy of debt crises. Credit rating agencies' downgrades and negative statements can, in most cases, shift the sentiments of the capital market towards a debtor, and sometimes the multiplier effect can be triggered overnight. The "self-fulfilling prophecy" effect would wipe out the efforts made by Governments to resolve a debt problem.[36]

D. Rating with an ideological bias

41. Credit rating agencies have shown their preference for ideological beliefs in their ratings. The United Nations Conference on Trade and Development pointed out the following:

33 See www.hsgac.senate.gov/imo/media/doc/PSI%20REPORT%20-%20Wall%20Street%20&%20the%20Financial%20Crisis-Anatomy%20of%20a%20Financial%20Collapse%20(FINAL%205-10-11).pdf.

34 S&P Global, "ESMA urges rating agencies to avoid quick-fire downgrades amid crisis: Reuters", 10 April 2020. Available at www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/esma-urges-rating-agencies-to-avoid-quick-fire-downgrades-amid-crisis-reuters-57982524.

35 Available at https://au.int/en/documents/20200610/africa-sovereign-credit-rating-review.

36 Submission by the Civil Society Financing for Development Group, November 2020.

> Credit rating agencies' assessments appear to be based on a bias against most kinds of government intervention. In addition, they often associate labour market "rigidities" with output underperformance, and a high degree of central bank independence as having a positive impact on debt sustainability. At the same time, their ratings are significantly correlated with indicators that measure the extent to which the economic environment is "business-friendly", regardless of what impact this might have on debt dynamics.[37]

Some academics have also affirmed that credit rating agencies' methodology in sovereign ratings shows a preference for countries implementing austerity measures.[38]

E. Lack of accountability

42. One of the reasons why credit rating agencies are not held accountable for their inaccurate or incorrect ratings on the ground is that the credit ratings of debt instruments are considered as opinions and not judgments. Downgrades and credit watch announcements are considered as opinions expressed by credit rating agencies regarding the credit worthiness of enterprises and sovereigns. Therefore, they have been shielded from liability by the first amendment of the Constitution of the United States, ensuring "the freedom of speech", even though this kind of speech or opinion has the power to create volatility in the financial market, including massive capital inflows and outflows for developing countries in particular. With this accountability gap, investors and borrowers cannot be protected from mistakes made by credit rating agencies or any abuse of power by these agencies. The Dodd-Frank Wall Street Reform and Consumer Protection Act required the Securities and Exchange Commission to hold credit rating agencies to the same standard of "expert liability" that auditors and lawyers face. But credit rating agencies protested and threatened to freeze ratings. Subsequently, the Commission decided to postpone the enforcement of the rule temporarily.[39]

V. Existing proposals for reforming credit rating agencies

43. Recent crises have highlighted the tremendous importance of ensuring that credit rating agencies play their role properly. Therefore, it is not surprising that many proposals, especially from the United States and the European Union, were made immediately after the sub-prime mortgage crisis and subsequent global financial meltdown of 2007 and the eurozone debt crises of 2011 to address the inherent structural defects of the agencies and the lack of regulation and accountability. However, most of these proposals have run into various challenges and resistance. Thus far, little progress has been made in reforming credit rating agencies and most of the reform proposals have been either stalled or shelved completely, mainly due to strong resistance from the agencies. The reliance on the "big three" credit rating agencies will likely continue for the near future.

44. In September 2013, during the sixty-seventh session of the General Assembly, a thematic debate was held, pursuant to resolution 67/198, on the role of credit rating agencies in the international financial system. The debate, which was entitled "External debt sustainability and development", was the first on this topic held by the Assembly. During the discussions, it was recognized that credit rating agencies had grown "increasingly embedded, or 'hard-wired', into investment mandates, banking rules and securities regulations across the globe. … whose function is designed to heighten predictability and reduce risk".[40] At the

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[37] "Credit rating agencies: junk status?", Policy Brief, No. 39 (November 2015).

[38] See, for example, Leks Luten, "Credit rating agencies: Do the notorious big two influence domestic austerity policies?", master's thesis, Leiden University, 2016. Available at https://openaccess.leidenuniv.nl/bitstream/handle/1887/54340/2016_Luten_PA_IEG.pdf?sequence=1.

[39] See Kathleen Day, "Analysis: credit agencies remain unaccountable", USA TODAY, 19 May 2014. Available at www.usatoday.com/story/money/business/2014/05/19/credit-rating-agencies-in-limbo/9290143/.

[40] Vuk Jeremić, President of the sixty-seventh session of the General Assembly, statement at the thematic debate on the role of credit rating agencies in the international financial system, 10 September 2013. Available at www.un.org/en/ga/president/67/.

time, there was already agreement on a number of measures to reform these agencies, with several proposals on the table. These included some presented by the Financial Stability Board, including those focused on reducing regulatory reliance on the ratings produced by credit rating agencies. However, there was also recognition that many more measures were needed in remaining areas of concern. Eight years later, the situation for rating credit risks remains equally worrisome and stagnant. The reform of credit rating agencies would require a more structural reform of the international financial architecture, including addressing credit rating agencies' inherent problems, such as the "issuer pay" business model, conflicts of interest and the opacity of the agencies' decision-making.

45. In view of the important role of credit rating agencies in the international financial system, there have been many proposals for their reform, especially from the United States and the eurozone since the sub-prime mortgage crisis and the ensuing debt crisis. In fact, such reform is even more important for developing and low-income countries. For developed countries, unless they have multiple problems with macroeconomic fundamentals and little control of their monetary policy, such as during the eurozone debt crises, sovereign credit downgrades tend not to change investors' sentiments drastically. However, for developing countries, a rating downgrade can often lead to capital outflows, the brutal and massive sell-offs of debt instruments, currency depreciation and the loss of access to the credit market, thus resulting in a country's failure to pay its scheduled debt service.[41] Even the debt service suspension of bilateral official debt, as requested by a country, which would not be considered as a default, would "be viewed as a credit negative, which in some cases could constitute a sovereign default".[42] When credit rating agencies follow this kind of mechanical criteria for their judgments, it would certainly be difficult to implement positive reforms for a debt crisis resolution.

46. The following proposals, which include administrative and normative measures, have been put forward during the last decade or so with the aim of reforming or enhancing the oversight of the functioning of credit rating agencies:

(a) In 2010, the Congress of the United States passed the Dodd-Frank Wall Street Reform and Consumer Protection Act, which created the new Office of Credit Ratings within the Securities and Exchange Commission to oversee credit rating agencies. The European Union has passed several directives on the monitoring activities of credit rating agencies and the European Securities and Markets Authority has been assigned the mandate to do so;

(b) There have been various proposals from different countries and institutions, including the Financial Stability Board and the Basel Committee on Banking Supervision, to reduce the reliance on external credit assessments. The Group of 20, at its summit held in Seoul in 2010, approved the Board's principles on reducing reliance on external credit ratings;

(c) The International Organization of Securities Commissions revised the Code of Conduct Fundamentals for Credit Rating Agencies in 2008 to address issues of independence, conflicts of interest, transparency and competition;

(d) Calls to create new or public credit rating agencies have resonated from different corners. In its *Trade and Development Report 2020*, the United Nations Conference on Trade and Development advocated for an international public credit rating agency to provide objective expert-based ratings of the creditworthiness of sovereigns and companies, including developing countries, and to promote global public goods;[43]

(e) In 2020, discussion groups formed as part of the United Nations financing for development process offered their proposals in the context of "the era of COVID-19 and

41 White and Case, "The G20 Debt Service Suspension Initiative: reaction from key market participants", 8 June 2020. Available at www.whitecase.com/publications/alert/g20-debt-service-suspension-initiative-reaction-key-market-participants.

42 Ibid.

43 See *Trade and Development Report 2020: from Global Pandemic to Prosperity for All – Avoiding Another Lost Decade* (United Nations publication, 2020).

beyond". Their "menu of options" for the consideration of ministers of finance includes the following recommendations:[44]

(i) Publicly owned credit rating agencies should be created so that agencies are not both market evaluators and market players, as at present;

(ii) Credit rating agency regulators, with the agreement of the agencies themselves, should adopt common guidelines to incorporate longer-term, Sustainable Development Goal-aligned, social and environmental indicators into agency ratings in a progressive manner. Credit rating agencies should ensure that their ratings evaluate the net zero transition plans of, and capture the breadth of climate and inequality risks facing, the entities they rate. Agency regulators acting together should set a timeline for the development and adoption of common guidelines.

VI. Relevant international human rights standards and norms

47. Existing human rights standards and norms are relevant to the role of credit rating agencies and the impact of their activities on States' obligations under international human rights law, especially in relation to economic, social and cultural rights. States' obligations include international cooperation and assistance and the use of maximum available resources to protect and promote all human rights of their populations, and to combat inequality, notably during times of crisis; as well as the human rights obligations of private business actors. In this context, in this section of the present report, the Independent Expert refers also to the guiding principles on foreign debt and human rights,[45] which were endorsed by the Human Rights Council in its resolution 20/10, and the Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework,[46] which were endorsed by the Human Rights Council in its resolution 17/4. Both documents are aimed at addressing the human rights responsibilities of private businesses and creditors. Credit rating agencies, with clear and direct roles in debt crisis prevention, should avoid infringing on human rights and should address adverse human rights impacts in their activities.

A. Use of maximum available resources and international cooperation for economic, social and cultural rights

48. In response to the COVID-19 pandemic and rocketing public and private debt levels, international cooperation and assistance, as core provisions of international human rights law, are crucial to combat decisively the resultant socioeconomic damages, in particular for developing and low-income countries. As briefly discussed above, the most serious impacts have been experienced by millions of people around the globe in relation to economic and social rights such as rights to health, food, work, education and social security. Under article 2 of the International Covenant on Economic, Social and Cultural Rights, the standard on international cooperation is intertwined with the use of the maximum available resources; one cannot be discussed or understood without the other. Specifically, each State party is required to take steps, individually and through international assistance and cooperation, especially economic and technical, to the maximum of its available resources, with a view to achieving progressively the full realization of the rights recognized in the Covenant.

49. It is worth unpacking the various human rights standards interwoven in this provision of the International Covenant on Economic, Social and Cultural Rights. As the Committee on Economic, Social and Cultural Rights noted: "The undertaking by a State party to use 'the maximum' of its available resources towards fully realizing the provisions of the Covenant entitles it to receive resources offered by the international community. In this regard, the phrase 'to the maximum of its available resources' refers to both the resources existing within a State as well as those available from the international community through international

[44] See United Nations, "Financing for development in the era of COVID-19 and beyond".
[45] A/HRC/20/23, annex.
[46] A/HRC/17/31, annex.

cooperation and assistance."[47] International cooperation and assistance in a debt-related crisis can take a number of forms, notably debt restructuring, cancellation or standstills.

50. Principle 9 of the guiding principles on human rights impact assessments of economic reforms addresses the centrality of the progressive realization of rights and the use of the maximum available resources.[48] Further explanation is provided in the commentary on principle 9, taking guidance from the statement in 2007 by the Committee on Economic, Social and Cultural Rights on maximum available resources,[49] and highlighting several factors with regard to economic reform policies in times of crisis, such as the current COVID-19 pandemic. Under principle 9, for instance, there is an explicit indication that "States must not only use existing resources to fulfil this obligation but also generate potential resources in a sustainable way when the former are not sufficient to ensure the realization of rights. This requires, for example, seeking international assistance and cooperation,"[50] which "can also take the form of financial and technical assistance to promote economic, social and cultural rights, particularly of the most vulnerable,"[51] including initiatives such as the Debt Service Suspension Initiative with the aim of providing low-income countries suffering from a debt burden with financial resources to be used for COVID-19 response. These States cannot guarantee adequate social investment, especially in areas such as food security, social protection programmes, health services and access to vaccines, with their own limited resources while having to honour their debt service, especially during various kinds of crises such as the COVID-19 pandemic.

B. Guiding principles on foreign debt and human rights

51. In the guiding principles on foreign debt and human rights, it is stated that transparency, participation and accountability are core values that should be observed in the lending and borrowing decisions by States, international financial institutions and other actors as appropriate, the negotiation and execution of loan agreements or other debt instruments, the utilization of loan funds, the making of debt repayments, the renegotiation and restructuring of external debts, and implementation of debt relief when appropriate.[52] Credit rating agencies should also observe the standards of transparency and accountability. It is also stated in the guiding principles that international financial organizations and private corporations have an obligation to respect international human rights.[53] Furthermore, in relation to debt renegotiation and restructuring, it is clearly indicated in the guiding principles that circumstances rendering the debt unpayable (such as the severe financial distress of the borrower and natural disasters) may warrant changes in the reciprocal obligations between a debtor State and its creditors.[54] Hence, in their rating assessments, credit rating agencies should take this into consideration when making decisions during times of crisis, including the current COVID-19 pandemic.

C. Business activities and human rights

52. The Committee on Economic, Social and Cultural Rights offered, in its general comment No. 24 (2017), an authoritative interpretation of States' obligations under the Covenant in relation to business activities, whether transnational or domestic, and regardless of their size, sector, location, ownership or structure. The Committee underscored that States

[47] E/C.12/2007/1, para. 5.
[48] A/HRC/40/57.
[49] E/C.12/2007/1, para. 8.
[50] A/HRC/40/57, para. 9.2.
[51] See Committee on Economic, Social and Cultural Rights, "COVID-19: UN experts call for international solidarity to alleviate financial burdens of developing countries and the most vulnerable", 7 April 2020. Available at www.ohchr.org/EN/NewsEvents/Pages/DisplayNews.aspx?NewsID=25821&LangID=E.
[52] A/HRC/20/23, annex, para. 28.
[53] Ibid., para. 9.
[54] Ibid., para. 52.

had responsibilities for the action or inaction of business entities.[55] With regard to the obligation to protect, the Committee noted that States parties were required to adopt legislative, administrative, educational and other appropriate measures, to ensure effective protection against Covenant rights violations linked to business activities.[56] As one of their positive obligations, States were required to adopt a legal framework requiring business entities to exercise human rights due diligence in order to identify, prevent and mitigate the risks of violations of Covenant rights, to avoid such rights being abused, and to account for the negative impacts caused or contributed to by their decisions and operations.[57] Notably, the Committee also stated that that obligation sometimes necessitated direct regulation and intervention of States parties, and offered many examples of where such intervention had been needed.[58] According to the Independent Expert, the regulation, monitoring and intervention of States and the international community in the functioning of credit rating agencies is also necessary.

53. Along similar lines, the Guiding Principles on Business and Human Rights, endorsed by the Human Rights Council in its resolution 17/4, included in its foundational principles the human rights obligations of business enterprises to avoid infringing on the human rights of others and to address adverse human rights impacts with which they are involved.[59]

54. These standards are not only relevant but also pertinent to the impact of credit rating agencies and private investors on human rights, especially economic, social and cultural rights in the context of COVID-19. According to the Guiding Principles on Business and Human Rights, States have a duty to protect against human rights abuses within their territory and/or jurisdiction by third parties, including business enterprises. In this regard, the United States, where the “big three” credit rating agencies are located, has a duty to ensure that businesses operating within its territory respect human rights by taking steps to prevent human rights abuses, as well as to regulate, monitor and require transparency and accountability.

55. According to the Guiding Principles on Business and Human Rights, the responsibility of business enterprises to respect human rights means that they formally commit to respect human rights, have in place human rights due diligence processes and, where appropriate, ensure that victims of human rights abuses have access to remedy. This responsibility exists independently of whether or not Governments fulfil their human rights obligations. Businesses should comply with national laws and administrative regulations, but they should also respect international human rights norms and standards, including by ensuring international cooperation and assistance in good faith in the context of a crisis, such as the current case of the global pandemic.

D. Environmental, social and governance indicators as a timid start for a human rights-based assessment

56. In recent years, some steps have been taken towards greater consideration of environmental, social and governance criteria in various areas of the sovereign debt market.[60] The long-standing call for a more systematic integration of social indicators, for instance, is slowly beginning to be heard, and the impact of the agencies’ debt valuations on the social fabric, working conditions and overall well-being of the population is beginning to be taken into account, at least partially. While governance-related indicators, such as potential political instability or institutional weaknesses, were considered more frequently in the past, other areas, such as the centrality of a “human capital” assessment, including labour conditions or key determinants of social well-being, have often been neglected, whether in qualitative or

[55] General comment No. 24 (2017), para. 11.
[56] Ibid., para. 14.
[57] Ibid., para. 16.
[58] Ibid., para. 19.
[59] A/HRC/17/31, principle 11.
[60] See Principles for Responsible Investment, United Nations Environment Programme Finance Initiative and United Nations Global Compact, *A Practical Guide to ESG Integration in Sovereign Debt* (2019).

quantitative considerations and indicators. The COVID-19 pandemic has brought to the fore the importance of assessing living standards, the quality of and access to health systems, social protection systems, the digital divide, online education capacities or labour conditions, and the impact that inequality, especially suffered by women and girls, and exclusion have on the potential for socioeconomic recovery. Environmental concerns, on the other hand, are a response to the fact that some countries are already experiencing climate-related disruptions and crises, with warning signs of a shortage of resources or physical risks. These developments may indicate a more positive direction.

57. The systematic assessment and incorporation of environmental, social and governance criteria in sovereign debt ratings could offer an entry point leading towards the inclusion of a human-rights lens in the work of credit rating agencies, and of public and private investors. In turn, these developments would be in keeping with the developments of the last decade with regard to the human rights standards applied to actions or omissions of the private sector.

VII. Conclusions and recommendations

58. **Despite various proposals having been made over recent decades, the structural defects of credit rating agencies, the market distortions they create and the errors in their assessments have yet to be amended. The amelioration of credit ratings has been marginal. The "big three" credit rating agencies continue to dominate over 92 per cent of the market and there is still no meaningful competition within this oligopolistic credit rating system. Accountability and transparency have not improved much.**[61] **Current existing regulations have not fundamentally altered the market structure for credit rating agencies, including the massive conflict of interest. Many good proposals have either remained on paper or have been stalled or shelved. Yet the importance of credit rating has not diminished, as demonstrated by the difficulties encountered in the implementation of the Debt Service Suspension Initiative.**

59. **The gravity of the sovereign debt situation, exacerbated by the COVID-19 pandemic, has once again proved the need to regulate and reform credit rating agencies, which should be taken as part of the reform of the international financial architecture and debt crisis prevention and resolution. In this regard, the consideration of allowing developing countries to have access to financial resources to strengthen economic, social and cultural rights during special circumstances, including situations such as the COVID-19 pandemic and natural disasters, and to assist them in obtaining long-term economic development should be part of the credit rating assessment equation. The Independent Expert makes the following recommendations:**

(a) **Reform credit rating agencies with steps taken at the international, regional and national levels. The reform should take into account the fact that large credit rating agencies operate on an international scale, hence national regulations, though necessary, may not be sufficient. At the international level, the involvement of the Group of 20, the Financial Stability Board or the Basel Committee on Banking Supervision, and international financial institutions is important but not inclusive enough. The United Nations has actively stepped into the process and should continue to perform its leading role. At the regional level, institutions should also be put in place. For instance, the African Union and its policy organs have been working on its continental policy framework of mechanisms on rating agencies' support for countries;**

(b) **Reduce or break the current oligopoly of the "big three". The lack of competition perpetuates wrongful behaviour and removes the incentive to improve the quality of credit ratings. The removal of the oligopoly could be made possible through the encouragement of the entrance of new players into the market, including publicly owned credit rating agencies;**

(c) **Address the issue of conflict of interest. The underlying cause of many of the problems for credit rating agencies is conflict of interest, and it is therefore**

[61] See Frank Partnoy, "What's (still) wrong with credit ratings?"

necessary that the issue be addressed urgently. The "issuer pay" business model should be changed;

(d) **Introduce a system of monitoring and accountability of credit rating agencies. A system of accountability would make credit rating agencies try harder to do a better and more professional job in the rating process and reduce sloppy performances;**

(e) **Strengthen the incorporation and application of relevant international human rights standards and norms in the context of the activities of credit rating agencies, including in the monitoring, supervision and reform of their functioning;**

(f) **Credit rating agencies should increase the inclusion of human rights standards, especially with regard to economic, social and cultural rights, and the incorporation of equality and non-discrimination standards in their assessments of sovereigns. Environmental, social and governance criteria should be further promoted, in keeping with the Guiding Principles on Business and Human Rights;**

(g) **Suspend the issuance of ratings during a crisis when there are international efforts to introduce mechanisms to deal with the crisis. In times of crisis, rating agencies should defer publishing their rating reviews, as markets have their way of discounting risk when fundamentals are conspicuously changing. In addition, rating announcements could hamper the implementation of special crisis containment and resolution measures introduced by the international community. Not suspending credit ratings during this kind of situation would compromise international efforts;**

(h) **Enhance disclosure and transparency. The disclosure of the rating methodology, key criteria and standards should be made so that investors and borrowers could be in a better position to do their own due diligence and assess the accuracy of the ratings.**