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INTERNATIONAL RATING AS A CREDITWORTHINESS MEASURE OF A STATE

ABSTRACT

Credit rating agencies play an important role in the world due to the fact that rating has become a reliable indicator of the evaluation of a debt investment. A reliable agency that is globally recognised ought to be independent, objective, professional, ethical and substantive. Rating itself constitutes an opinion that concerns the possibility of servicing of payment obligations made by a given entity. It is also frequently defined as an independent and objective evaluation of credit risk of a given entity wishing to contract a debt. Rating is a dynamic category concerning the future, therefore each forecast is surrounded by uncertainty. Ratings of individual agencies may differ considerably. The aim of the article is to discuss the role of international rating as a credibility measure of a state, the role of credit rating agencies, of the rules of rating and of the level of rating for the countries of the European Union, especially given the fact that rating for a country is reflected in its credibility and attractiveness.

Keywords: credit rating agencies, "Big Three", international rating, rating, the European Rating Platform

1. INTRODUCTION

Currently the literature on the subject defines rating as an independent and objective evaluation of credit risk of a given entity which wishes to contract a debt on the market. Therefore, rating constitutes an opinion concerning the possibility of servicing of payment obligations made by a given entity. Rating is expressed synthetically by means of a number of symbols and a credit grading system. An individual evaluation is a result of an accurate analysis of a specified entity and also of its surroundings. Rating is a dynamic category, it concerns the future, therefore each forecast is always surrounded by uncertainty. For this reason, when analysing

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ratings issued for entities by different credit rating agencies (Dziawgo, 1998, pp. 131–144), it can be noted that in many cases they differ and that simultaneously some ratings of individual agencies are far from reality, which has been particularly visible after the last financial crisis.

Rating is assigned for various institutions, including national institutions; actually, it concerns the maximum ceiling for foreign currency denominated government bonds, which are subject to political control in particular. Evaluating the creditworthiness by credit rating agencies is of great assistance in the issuing activity of a state. In the case of an independent issuer, its credit rating typically results from a fundamental analysis based on complex sets of macroeconomic information.

Credit rating of a state is also an indicator of the capacity and readiness of its central bank to give economic entities the access to foreign currencies for debt servicing and also for servicing the whole state debt. Such rating is not a direct evaluation of the creditworthiness of a government, but it refers to the total national debt, that is borrowers from both the public and private sector (Ciak, 2011, p. 31).

2. "BIG THREE" AS THE MOST IMPORTANT CREDIT RATING AGENCIES IN THE WORLD

Credit rating agencies play an important role in the investment world due to the fact that rating has become a very good indicator of the debt investment evaluation (Brylak, 2011, p. 311).

Nowadays 72 credit rating agencies operating worldwide and they are of a local, regional or international character; nevertheless, only three of them are of global nature (DefaultRisk, 2016, Chądzyński 2016)[1] and they include all asset classes (corporate bonds, State Treasury bonds, instruments like SFI and covered bonds). A large number of credit rating agencies and a significant level of their diversification may create the impression of diversity and competitiveness of this segment of global finance. However, in practice so called "Big Three", that is Moody's Investor Service, Standard & Poor's (S&P) and Fitch Ratings are responsible for the majority of ratings and they earn most of the income from this activity globally. The issue is presented in table 1.

Table 1. Market share of registered credit rating agencies in the territory of the European Union in 2015

Registered Credit Rating Agencies		Percentage of market share
1	AM Best Europe-Rating Services Ltd. (AMBERS)	0.79
2	ARC Ratings S.A.	0.02
3	ASSEKURATA Assekuranz Ratings-Agentur GmbH	0.21
4	Axesor S.A.	0.61
5	BCRA-Credit Rating Agency AD	0.02
6	Capital Intelligence (Cyprus) Ltd.	0.12
7	CERVED Group S.p.A	1.20
8	Creditreform Rating AG	0.50

[1] According to other sources, the number of rating agencies may amount to as many as 150.

Registered Credit Rating Agencies		**Percentage of market share**
9	CRIF S.p.A	0.33
10	Dagong Europe Credit Rating Srl	0.02
11	DBRS Ratings Limited	1.47
12	Euler Hermes Rating GmbH	0.20
13	European Rating Agency a.s.	0.00
14	EuroRating Sp. z o.o.	0.00
15	Feri EuroRating Services AG	0.64
16	Fitch Group*	16.80
17	GBB-Rating Gesellschaft fur Bonitatsbeurteilung mbH	0.32
18	ICAP Group SA	0.55
19	INC Rating Sp. z o.o.	0.00
20	ModeFinance S.A.	0.00
21	Moody's Group**	43.67
22	Rating-Agentur Expert R.A GmbH	0.00
23	Scope Credit Rating GmbH	0.14
24	Spread Research SAS	0.11
25	Standard & Poor's Group***	40.42
26	The Economist Intelligence Unit Ltd.	0.87
In total:		100.00

* Fitch Group: Fitch France S.A.S; Fitch Deutschland GmbH; Fitch Italia S.p.A.; Fitch Polska S.A.; Fitch Ratings España S.A.U.; Fitch Ratings Limited and Fitch Ratings CIS Limited.

** Grupa Moody's: Moody's Investors Service Cyprus Ltd; Moody's France S.A.S.; Moody's Deutschland GmbH; Moody's Italia S.r.l.; Moody's Investors Service España S.A.; Moody's Investors Service Ltd; oraz Moody's Investors Services EMEA Ltd

*** Standard & Poor's Group: Standard & Poor's Credit Market Services France S.A.S.; Standard & Poor's Credit Market Services Italy S.r.l.; oraz Standard & Poor's Credit Market Services Europe Limited.

Source: own study based on: Report of the European Commission for the European Parliament and the Council concerning alternative solutions for external credit ratings, the situation on the credit rating market, competition and management in the area of credit ratings, the situation on the market of ratings of financial instruments resulting from securitization and the possibility of creating a European credit rating agency, the European Commission, Brussels, 19th October, 2016, COM (2016) 664 final, p. 12.

As the above table shows, the market share expressed in income of the three above mentioned credit rating agencies amounted to about 92% in 2015. Although new companies are entering the European market of credit rating (according to ESMA, currently there are 26 companies and 4 certified credit rating agencies), most of the smaller agencies evaluate only a limited group of assets, not carrying many international activities (ESMA 2016; Report of the Commision, 2016, p. 10).

It should be underlined that among others a long history and developed over many years competitive position, international scope of activity as well as their experience contribute to the stable position of so called "Big Three". For this reason, investors using the services of credit rating agencies actually ignore ratings of the lesser known ones.

3. THE RULES OF RATING BY CREDIT RATING AGENCIES

In practice, when evaluating the ability of a country to pay its debt, analysts concentrate on two aspects of the lack of the possibility to perform the obligation of paying a debt.

Firstly, a country cannot perform the obligation due to the lack of foreign financial inflows (deficit of inflows from transactions from foreign countries – the lack of foreign currency). Secondly, lenders of a given country may not be able to perform their obligations in the situation of a short-term lack of liquidity caused by the limitation of the flow of funding for instance exported goods or services.

Simultaneously, when developing a credit rating of a given country (Dziawgo, 1998, pp. 113–114; Cantor, Packer, 1996, p. 38)[2], credit rating agencies make use of reports on individual countries, publications of information agencies, various kinds of international statistics, experts' reports and other foreign sources that include economic, social and political data essential for an evaluation, as rating involves different groups of indicators concerning internal and foreign practice, also national and foreign economy. The basic task of credit rating agencies is to deliver independent and coherent opinions on credit risk existing in among others debt securities issued by governments of individual countries. Such opinions are presented in the form of tables of evaluations used by credit rating agencies.

In practice, a reliable credit rating agency recognised globally is independent, objective, professional, ethical and substantive (Young, 1993). Therefore, the prestige and reputation of credit rating agencies are determined by the following qualities:

- objectivity and factuality, that is: equal treatment of all evaluated entities and not yielding to pressure exerted by the entities that would treat rating as a way to a public confirmation of their value;
- reliability and credibility that mean stability and invariability of the assessment criteria for all entities within a given industry and in time;
- professionalism based on analysts' expertise and on the accuracy and reliability of used data;
- ethics and discretion of working methods – they distinguish credit rating agencies from other institutions engaged in evaluating the financial situation of economic entities. Agencies have full access to the management's resolutions, to internal reporting systems of evaluated entities, to the information concerning their strategic plans and other such documents;
- independence indicates that an agency has a legal and economic status which guarantees its resistance to all influences that could be exerted by evaluated entities, public authorities and other institutions (Ammer, Packer, 2000; Boot, Tood, Schmeits, 2006, p. 61).

After the last financial crisis (2008), unflattering words were used when the aforementioned agencies were written about. Opinions indicating that such agencies had become regular intermediaries contracted by the biggest investment banks could even be heard. Additionally, it was in their interest to encourage clients to issue bigger and bigger amount of "ghost instruments", which apart from their creators were understood by only a handful of hedge

[2] Credit rating constitutes a complex evaluation of the financial credibility of an entity. It is presented as a form of investor protection but it cannot be treated as a guarantee that the chance of a loss is non-existent.

funds. Until October 2008, 90% of CDOs, rated for instance by Moody's in the years 2006-2007, were degraded to the lowest levels, and 85% instruments lost the AAA rating. In the case of Standard and Poor's Agency, similar proportions could be observed: 84% of total and 76% with triple A. The fact that until recently Spain, with its unemployment amounting to 20% and the collapsed real estate market, was well rated by Moody's (Aa2), Fitch's (AA+) and Standard and Poor's (AA) (see table 3) proves to what extent the ratings were far from reality. If like in the case of American "toxic assets" ratings are based on historical data (property can only be more expensive), it has to be recognised that in the last two centuries Spain has gone bankrupt thirteen times (Credit Rating Agencies, 2010).

The following areas are taken into account by credit rating agencies when evaluating the economy of a given country:

– administration system;
– political system and first of all the form of governance and the stability of the system;
– social situation including income distribution, demographic data, standards of living, working conditions, the rate of unemployment, the role of trade unions, religious and ethnical differences;
– country's internal relations, that is transfers of public financial funds and decision making responsibility in this area;
– functioning fiscal system;
– external debt of a given country reduced by foreign reserve assets;
– balance of payments flexibility;
– structure of the economy (Ciak, 2011, p. 32).

It is worth emphasising that rating is performed by credit rating agencies and their activity in the European Union is regulated in the regulation of the European Parliament and of the Council (EEC) no. 1060/2009 of 16th September, 2009 on credit rating agencies (the Official Journal of the European Union L 2009.302.1 as amended).

4. RATING SYSTEM – RATING GRADES USED BY RENOWNED CREDIT RATING AGENCIES

Currently, the aforementioned most important credit rating agencies use a specific rating system for individual countries and various public and private entities taking into consideration the analysis of the above areas. Short-term rating (a four-level scale) and long-term rating (a nine-level scale) can be distinguished. The system is based on a special letter code accompanied by the "+" and "–" making the rating higher or lower.

It should be emphasised that ratings usually concern issuers of securities, foreign currency-denominated ones in particular (dollars, euro or Japanese yen). Short-term ratings are issued for issuers of short-term securities (up to a year), and long-term ratings are issued for bond issues with maturity of over a year.

Central European Rating and Analysis Centre (CERA S.A.), which has been functioning in Poland since 1996, and which changed its name to Fitch Polska S.A. in November 2001, explains the meaning of grades for short-term ratings. Ratings of CP-1, CP-2, CP-3 and NK are mentioned here.

CP-1 and CP-2 indicate that issuers or guaranteeing institutions have the ability to pay their short-term liabilities. CP-3 constitutes a satisfactory ability to pay those liabilities, and the last rating informs about so called issuer's ineligibility.

Long-term ratings are issued for bond issues and the following grades are specified:

– AAA – the highest quality bonds, constituting the "elite" among debt securities,
– AA – bonds that are considered a high quality debt security in every respect,
– A – bonds with credibility above average with good credit characteristics,
– BBB – bonds with an average credibility of liabilities repayment with usually good credit characteristics,
– BB – bonds with significant speculative characteristics and high volatility in the scope of the security of funds,
– B – bonds without the characteristics of the "desired investments", which entails serious doubts concerning fulfilling obligations by their issuer,
– CCC – bonds with such a grade do not ensure secure investments,
– CC – bonds speculative in nature, do not ensure the fulfilment of obligations,
– C – the lowest group of bonds, with a small probability of fulfilling obligations (Ciak, 2011, p. 33).

A list of ratings issued by the most important credit rating agencies, that is by Fitch Agency, Moody's and Standard and Poor's is presented below.

Table 2. A list of ratings according to Fitch Agency, Moody's and Standard and Poor's

Fitch Agency		**Moody's Agency**		**Standard & Poor's Agency**	
Investment	**Speculative**	**Investment**	**Speculative**	**Investment**	**Speculative**
Aaa	Ba1	AAA	BB+	AAA	BB+
Aa1	Ba2	AA+	BB	AA+	BB
Aa2	Ba3	AA	BB-	AA	BB-
A1	B1	AA-	B+	AA-	B+
A2	B2	A+	B	A+	B
A3	B3	A	B-	A	B-
Baa1	Caa1	A-	CCC+	A-	CCC
Baa1	Caa2	BBB+	CCC	BBB+	DDD
Baa3	Caa3	BBB	CCC-	BBB	DD
	Ca	BBB-	CC	BBB-	D
	C		C		
	WR		D		

Source: own study based on (Siemiątkowski, 2015, p. 384).

It should be stressed that through ratings determined for individual countries there are higher or lower credibility of a given country. Additionally, the higher credibility of a given country and the more stable its economy, the longer the periods for which it can enter into commitments and the lower interest rates. It results from the fact that the risk of non-payment of debt or the debt losing its value is also lower.

As many studies indicate, credit rating agencies can conduct effective evaluation of public debt only when they dispose of relevant instrument and methods and when they act in accordance with rules established by competent public authorities.

Table 3. Ratings of the EU member states' creditworthiness according to the main credit rating agencies

Specification	Fitch Agency	Moody's Agency	Standard & Poor's Agency
Group I			
Austria	AAA	Aaa	AAA
Belgium	AA+	Aa1	AA+
Denmark	AAA	Aaa	AAA
Finland	AAA	Aaa	AAA
Holland	AAA	Aaa	AAA
Luxemburg	AAA	Aaa	AAA
Malta	A+	A1	A
Germany	AAA	Aaa	AAA
Group II			
France	AAA	Aaa	AAA
Sweden	AAA	Aaa	AAA
Great Britain	AAA	Aaa	AAA
Italy	AA-	Aa2	A+
Group III			
Czech Republic	A+	A1	A
Estonia	A+	A1	A
Lithuania	BBB	Baa1	BBB
Latvia	BBB-	Baa3	BB+
Poland	A-	A2	A-
Slovakia	A+	A1	A+
Slovenia	AA	Aa2	AA
Romania	BBB-	Baa3	BB+
Group IV			
Bulgaria	BBB-	Baa2	BBB
Cyprus	A-	Baa1	A-
Croatia	BBB-	Baa3	BBB-
Greece	CCC	Ca	CC
Spain	AA+	Aa2	AA
Ireland	BBB+	Ba1	BBB+
Portugal	BBB-	Ba2	BBB-
Hungary	BBB-	Baa3	BBB-

Source: Own study based on: (Forsal.pl, 2016). Grouped after: (Siemiatkowski, 2015, pp. 385–386).

Analysing the information in table 3, it can be concluded that individual countries of the European Union can be divided into four groups depending on what ratings have been issued by the most important credit rating agencies. The first group includes the countries with the highest rating assigned by for example Fitch Agency on the AAA, AA+ and A+ levels. The second group consists of four countries, that is France, Sweden, Great Britain and Italy with stable credibility (Italy, as one of so called PIIGS countries has the lowest rating on the

AA- level given by Fitch, Aa2 given by Moody's and A+ from S&P). The third group includes countries with a not very stable situation. Poland can be found among them with its rating A-, A2 and A- respectively (the latest rating for Poland is presented in table 4). The last group consists of Bulgaria, Cyprus, Croatia, Greece, Spain, Ireland, Portugal and Hungary – the countries with unstable economic and financial situations.

It should be noted that high international rating is a great prestige for a country (or for another entity) confirming its good condition and it indicates an excellent ability to pay debts in due time. In such a situation a country is seen as a reliable, stable and solvent entity. It finds its reflection in the cost of commitment of expenditure in the future. In the case of the countries with high international rating the cost of borrowing capital (for example secured by issued Treasury bonds) is relatively lower than for the countries with a low rating. Therefore, downgrading of rating of a given country involves increased cost of debt servicing, since the country appears less attractive for investors (Redo 2016a, Redo 2016b). This can result in higher taxes, higher loan instalments and reduction in investments or currency depreciation. Nevertheless, also downgrading of rating for other countries the economy of a given country is connected with can contribute to such a situation.

Table 4. Current evaluation of the creditworthiness of Poland (as of December, 2016)

Agency	Foreign currency		National currency		Outlook
	Long-term	Short-term	Long-term	Short-term	
Fitch	A-	F1	A-	F-1	Stable
Moody's	A2	P-1	A2	P-1	Negative
Standard & Poor's	BBB+	A-2	A-	A-2	Stable

Source: (money.pl, 2016).

It should be noted once again that credit ratings issued by individual credit rating agencies constitute the reflection of the economic situation of a given country. Due to the fact that when a given rating is assigned numerous issues are taken into consideration (which was mentioned before), they reflect among others a given country's relationships with the neighbouring countries including the relations in the financial area. Therefore, as indicated in the literature on the subject, they represent the situation of economies in terms of their financial dependence (Siemiątkowski, 2015, p. 386).

5. CONCLUSIONS AND RECOMMENDATIONS

Recently measures to increase the competitiveness of on the market of credit rating agencies have been introduced, which has also improved the credibility of the ratings of individual agencies. One of the measures is the European Rating Platform(ERP), which was set up on 1st December, 2016 by the European Securities and Markets Authority (ESMA). It is a website maintained by ESMA which includes a database with current and historical public ratings and rating reports and announcements given by all credit rating agencies registered in the European Union under the supervision of ESMA. The aim is to enhance the visibility of credit ratings issued by smaller agencies and the comparability of the same instrument ratings issued by different agencies. Association of external credit ratings is also supposed to ensure fair treatment of evaluations on establishing implementing technical standards concerning association of credit ratings issued by external institutions of evaluating creditworthiness (Regulation of the European Parliament and of the Council (EU) no. 575/2013). Simultaneously, prudential supervisors will be able to ensure that systemically relevant rating agencies are effectively controlled.

Moreover, in the light of the last crisis (issuing inappropriate assessments by credit rating agencies), it is indicated that qualitative information on legality, good governance and political situation is essential for the European evaluation of creditworthiness.

Without doubt agencies played their role in the crisis in 2008. Financial instruments issued by banking "special purpose companies", risky and based on the real estate market, were assigned surprisingly high ratings from credit rating agencies. Owing to that it was profitable for banks to issue additional mortgages, which later, in the form of securities (highly rated by credit rating agencies) were transferred to companies set up for that purpose. It was all conducted under the control and supervision of authorities. So called Basel Frameworks in fact imposed such conduct on banks, if they wanted to get additional profits from cheap money expansion.

Attention should be drawn to a convergence of ratings issued by agencies, which does not have to result from identical conclusions drawn when analysing the probability of the insolvency of the issuer. The reason for such a state of affairs needs to be sought in current weak competitiveness between those agencies and in applying the rule according to which a change of rating introduced by one agency motivates another.

Time will tell whether in practice ratings will be assigned according to the situation in individual countries of the European Union, or whether it involve an element of discretion. Currently the evaluated entity pays for the rating, thus theoretically it is in the credit rating agency's interest to demonstrate the payer's best ratings. Nevertheless, it is undeniable that international rating constitutes a creditworthiness measure of a state.

In the case of Poland, downgrading of rating, will lead to an increase in the cost of servicing public debt, since country will became less attractive for investors. Already, due to BBB + S & P rating, public debt service costs are high. This can result, in futures, further increase in debt service costs, in higher taxes, higher loan instalments and reduction in investments or currency depreciation. This will have an impact on economic growth and pursued macroeconomic policy.

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