CREDIT RATING

Definition – Agencies – Importance – Determiners

مركز التواصل والمعرفة المالية
Comm. & Financial Knowledge Center

Introduction

Credit ratings are an important indicator and a fundamental factor that directly influences, positively or negatively، the financial; economic; and investment decisions of countries and major institutions.

The importance of credit rating lies in it being an evaluation of creditworthiness carried out by specialized rating agencies with the aim of estimating the solvency of a particular country or institution، thereby determining its ability to meet its coming financial obligations and ascertaining its eligibility for new loans at a particular time.

High credit rating for an institution or country reflects its ability to meet its obligations and repay its loans, as well as its ability to successfully withstand any potential financial crisis. On the other hand, low credit rating indicates a high probability of inability to meet these obligations, which makes lenders place stricter conditions on these institutions or countries for obtaining the requested loan, such as raising the interest rate on the loans or shortening the repayment period.

This report, which is prepared in cooperation with the Gulf Research Center, brings to the foreground the concept of credit rating; its importance; its types; its most prominent, globally recognized agencies; and their approved measurements, standards, and determiners in assigning these ratings.

1. INTRODUCTION TO CREDIT RATING

1.1. ANALYSIS

Credit rating is the assessment of the creditworthiness of a borrower toward any debt or any financial obligation. It helps in estimating the interest rate at which the debt/loan is to be re-paid. Credit ratings to corporate and sovereign entities are provided by recognized credit rating agencies (CRAs). Based on investment opportunities, credit ratings are classified as investment grade and speculative grade, and the ratings by each CRA may **Globally recognized credit rating agencies include:**

Moody's (MCO)

A US credit rating agency that conducts economic research and financial analysis and evaluates private and government institutions in terms of financial and credit strength. It controls approx-imately 40% of the global credit rating market. Moody's is the U.S. provider of financial analysis software and services. It also provides software and research for economic analysis and risk management.

Standard & Poor's (S&P)

A US financial services company based in the United States. The company provides thousands of services globally to markets, most notably providing short-term and long-term credit ratings on bonds, countries and investments, as well as providing high-quality credit risk research on the debt of public and private companies, including governments.

Fitch Ratings (Fitch)

Fitch is a wholly-owned Hearst business with dual headquarters in New York and London, operating in more than 50 countries around the world and is a leader in financial information services. It is the world's third most important credit rating agency in terms of sales and market share, after Moody's Investors Service and Standard & Poor's.

DBRS Morningstar(DBRS)

the world's fourth largest credit ratings agency and a market leader in Canada, the U.S. and Europe in multiple asset classes. DBRS Morningstar classifies more than 3,000 issuers, as well as 60,000 securities worldwide, with nearly 700 employees in 8 offices worldwide.

China Chengxin International Credit Rating Co.

A Chinese rating agency founded in Beijing on October 8, 1992. After which it formed subsidiaries and established branches throughout China, becoming the first nationwide credit rating company in 2002. It is one of the few major credit rating agencies currently operating in China.

Japan Credit Rating Agency (JCR)

A Japanese financial services company approved by Financial Services Agency of Japan (FSA) as eligible for Japanese local banks to utilize under the Basel. (JCR) provides credit ratings on the corporate debt of Japanese companies, local governments and foreign bond issuers. It also publishes a variety of financial and economic information and serves as a guide for counterparty credit risk.

1.2. OVERVIEW AND KEY TRENDS IN CREDIT RATING

A credit rating is assigned to any entity that is willing to borrow money or is subjected to a financial obligation, including corporate entities, sovereign governments, and state or provincial authorities. These ratings are not static and can change with variations in the input data or determinants. They also represent the credit risk carried by a debt instrument, i.e., a loan or a bond issuance, and signifies the debtor probability of default.

Based on the type of entity, credit ratings are categorized as follows:

Corporate Credit Rating-

A corporate credit rating is an assessment of the creditworthiness of companies or corporate entities. In the global market scenario, S&P, Moody's, and Fitch are the three main corporate credit rating providers. Corporate credit ratings are not a guarantee that a company will repay its obligations; they are just a reflection of the variations in its creditworthiness, based on its long-term credit records. As per the data cited by S&P, the default rate for speculative-grade bonds was 5.5 percent in 2020, whereas no default in investment bonds was recorded during the same year.

Sovereign Credit Rating-

A sovereign credit rating is an assessment of the creditworthiness of a country or sovereign entity. It reflects the level of risk associated with investing in the debt of a particular country, including political risks. Debt service ratio, domestic money supply growth, import ratio, and export revenue variance are among the main factors that influence sovereign credit ratings. In the global market scenario, S&P, Moody's, and Fitch are the three most influential sovereign CRAs, along with other well-known agencies such as China Chengxin International Credit Rating Company, Dagong Global Credit Rating, DBRS, and Japan Credit Rating Agency (JCR).

Further, based on the level of credit risk, credit ratings are categorized as follows:

Investment-Grade

The investment-grade rating mainly denotes lower levels of credit risk. CRAs such as S&P and Fitch assign this rating to grade BBB- and above, whereas Moody's Investors Service attributes investment grade rating to grade Baa3 and above.

Speculative-Grade

The speculative-grade rating mainly denotes higher levels of credit risk. CRAs such as S&P and Fitch assign this rating to grade BB+ and below, whereas Moody's attributes it to grade Ba1 and below.

In the financial architecture, CRAs analyze and evaluate the creditworthiness of any corporate entity and securities of sovereign debt issuers. The majorly recognized CRAs in Saudi Arabia are S&P Global Ratings Europe Limited, Moody's Investors Services Middle East Limited, Fitch Australia PTY Ltd, and SIMAH Rating Agency. To operate in Saudi Arabia, CRAs must comply with the following requirements:

1. They should be incorporated in the Kingdom with a minimum capital of SAR 2,000,000 or a working capital sufficient for three months, whichever sum is larger.

2. Foreign CRAs registered or licensed in a jurisdiction whose regulatory standards and requirements are at least equivalent to those of the CMA (as determined by the CMA, under its discretion) through a branch to be established and licensed to operate in the country.

The following table depicts the distinction between the credit rating scale adopted by the three major CRAs and the interpretation of each scale/level.

TABLE 1. CREDIT RATING SCALE ADOPTED BY MOODY'S, S&P, AND FITCH

	Moody's		S&P Global		FitchRatings		
	Long-term	Short-term	Long-term	Short-term	Long-term	Short-term	
INVESTMENT	Aaa	P-1	AAA	A-1+	AAA	F1+	Prime
	Aa1		AA+		AA+		High Grade
	Aa2		AA		AA		
	Aa3		AA-		AA-		
	A1		A+	A-1	A+	F1	Upper Medium Grade
	A2		A		A		
	A3	P-2	A-	A-2	A-	F2	
	Baa1		BBB+		BBB+		Lower Medium Grade
	Baa2	P-3	BBB	A-3	BBB	F3	
	Baa3		BBB-		BBB-		
SPECULATIVE	Ba1	Not prime	BB+	B	BB+	B	Non – Investment Grade (speculative)
	Ba2		BB		BB		
	Ba3		BB-		BB-		
	B1		B+		B+		Highly Speculative
	B2		B		B		
	B3		B-	C	B-		
	Caa1		CCC+		CCC	C	Substantial risk
	Caa2		CCC				Extremely speculative
	Caa2		CCC-				In default with little prospect for recovery
	Ca		CC				
			C				
	C		D	/	DDD		In Default

Note: Moody's uses numeric 1, 2, and 3, and S&P and Fitch uses (+) and (-) signs for generic rating classification to show relative standing in major rating categories.

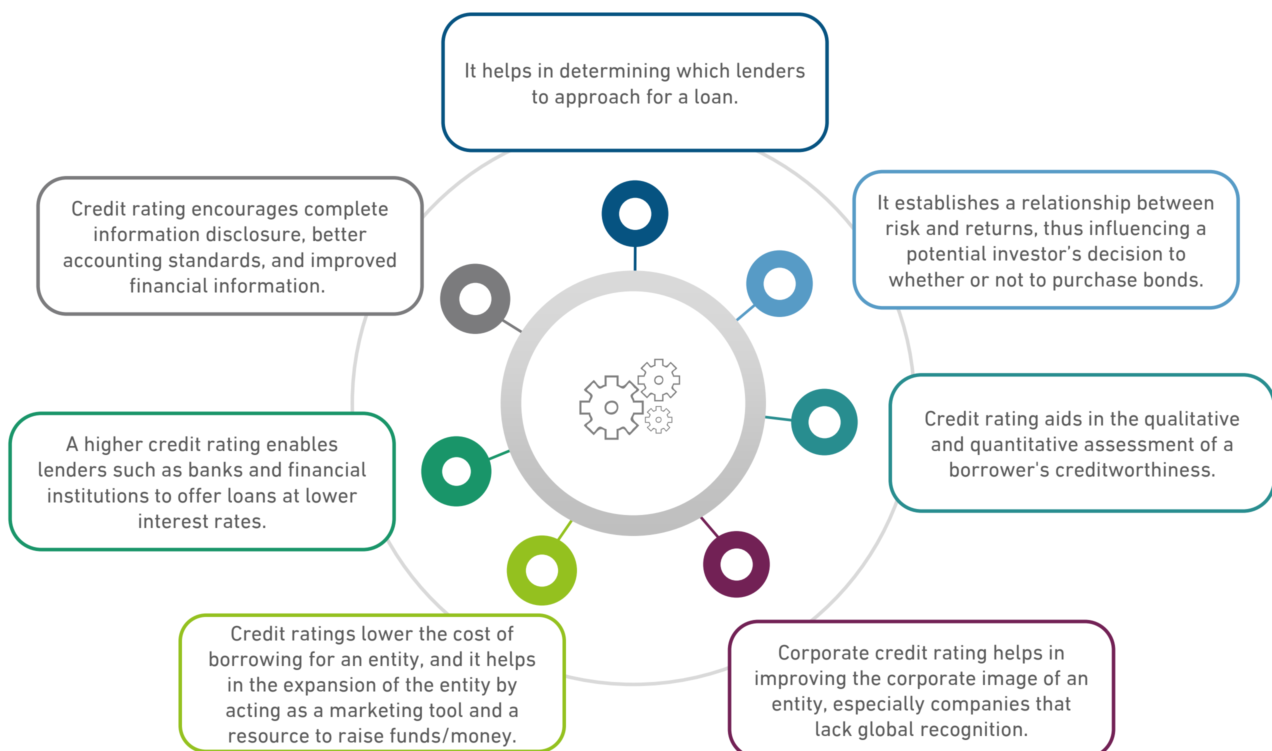
Source: What is Credit Rating: meaning and why it's so important

1.3. IMPORTANCE OF CREDIT RATING IN INTERNATIONAL TRADE

International trade is an opportunistic trade that expands a county's reach to goods and services that are not available in its domestic market or are available at a higher price. It is highly influenced by the financial condition of a country or customer. In case of severe financial crises, countries or customers turn to trade credits rather than bank credit in international trades. Trade credit acts as a short-term loan, offering customers a certain period between the supply of goods and the payment of goods. It is used as the main source of financing by nearly every major country in the world. Top multinational companies or countries have access to financial credit; however, they prefer trade credit as it offers them an edge against marketable collateral held at financial institutions.

The wide adoption of trade credit in international trade has highlighted the role of credit ratings in the financial markets. The globalization of financial markets; expansion in the number of firms issuing debts; and growing use of financial innovations, especially asset- and mortgage-backed securities, are the major factors influencing the importance of credit rating in international trade finance. The dependency on credit ratings has increased as they are directly linked with several regulations that cover the field of financial institutions and investment intermediaries. Credit rating is gaining importance in international trade due to the following aspects,:

FIGURE 1. IMPORTANCE OF CREDIT RATING IN INTERNATIONAL TRADE



2. IMPACT OF CREDIT RATINGS

2.1. ANALYSIS

Credit rating is an important financial tool that helps attract FDI, assess the creditworthiness of borrowers, and enable investors and corporate entities to make informed decisions regarding investments and business expansion. These ratings also promote financial transparency in the public sector, which helps in assessing a government's financial position along with the actual costs and benefits of government activities. CRAs have the power to downgrade or upgrade the value of a sovereign or corporate entity through the rating assigned by them. A lower, or a speculative-grade, rating relegates an entity and, thus, lowers its value in the international or domestic market. Similarly, a higher, or an investment-grade rating, increases the value of an entity in the market.

The ratings issued by CRAs are based on or influenced by various determinants that fluctuate during an economic cycle. Thus, the credit ratings may also change during the economic cycle, resulting in their procyclical nature. The ratings issued to a sovereign entity lag market sentiment, and they are sticky and overreactive with a lag to business cycles and economic conditions. Further, credit ratings are more likely to dampen a credit cycle rather than amplifying it. Changes in credit ratings result in long-lasting alterations in fundamental credit risks instead of temporary cyclical developments.

The accuracy of credit ratings issued by the CRAs, and the methodology adopted by them have been questioned and examined several times. Especially during global financial crises, agencies get accused of many faults including false ratings, flawed methodology, encroaching on government policy, political bias, selective aggression, and rating shopping. However, these agencies are not held accountable for their performance as sovereign and corporate ratings are considered as opinion rather than a judgment. With the lack of transparency in the methodology of CRAs, it has been assumed that orthodox policies focusing on curbing inflation and government budget deficits are favored when issuing a rating to any entity. Several policymakers are focusing on the shortcomings related to the practices adopted by CRAs, such as the lack of competition, entry barriers in the industry, the conflict of interest, and the lack of transparency and accountability.

2.2. COSTS AND BENEFITS OF OBTAINING CREDIT RATINGS

The ratings issued by CRAs help the concerned entity to expand its reach in the private capital market and international trade. A good rating, i.e. an investment-grade rating, results in lower debt issuance and interest cost. CRAs certify the value of various corporate and sovereign entities in the international and domestic markets. An investment-grade rating offered by the agencies can increase the value of an entity, and a speculative-grade rating can diminish its value in

the global or international market, thereby reducing its capital costs. Similarly, the relegation of a country from a high rating to a low rating can reduce its value in the international market, discourage investors from purchasing the country's bonds or making investments in it. For example, in 2010, the European sovereign debt crisis worsened with lowered sovereign rating assigned by S&P to Greece, Portugal, and Ireland.

CRAs aid in diminishing or solving the informative asymmetries between purchasers and issuers. Credit ratings help issuers to identify the repayment capability of a purchaser/borrower. Moreover, corporate, and sovereign ratings indirectly benefit low-income and developing markets by encouraging FDI, promoting more vibrant local capital markets, and supporting public sector financial transparency. Sovereign entities rely on foreign investors to purchase their debt or issue bonds, while the investors depend on the credit ratings issued to the respective entity to analyze their creditworthiness. Thus, corporate entities assess the financial stability of a country or another corporate entity before investing in them or expanding operations in a new country. Treasury bills from the US are of low risk as their credit rating is the same as that of the US, a country with a strong economy and low political risk.

2.3. BOOMS AND BUSTS: FINANCIAL CRISES IN EMERGING MARKETS AND PROCYCLICALITY OF RATINGS

Credit rating systems and agencies have been at the center of major financial crises during the collapse of the financial markets in New York City in the mid-1970s, the Asian financial crisis of 1997–1998, the Enron scandal of 2001, and the global financial crisis of 2008. Credit ratings are influenced by determinants such as GDP per capita, real GDP growth per capita, and Consumer Price Index (CPI), and the ratios of government fiscal balance to GDP and government debt to GDP. Such financial variables tend to fluctuate during an economic cycle, resulting in the procyclicality of credit ratings. Many empirical studies depict those sovereign ratings are sticky and lag market sentiment, and lags in economic conditions and business cycles lead to overreacting ratings. They have also highlighted the correlation between credit ratings and sovereign bond yield spreads. A systematic lag was observed in the credit ratings due to changes in the market conditions, which directly impacted the international capital market. According to a study conducted by Moody's on procyclicality, credit ratings were more likely to dampen a credit cycle rather than amplifying it, and most rating changes reflected in long-lasting alterations in fundamental credit risk rather than temporary cyclical developments. Such busts in the credit rating systems have raised concerns regarding the credit rating practices adopted by the rating agencies.

2.4. ACCURACY AND PERFORMANCE OF RATINGS

Credit ratings determine the level of interest rate a borrower must pay, in addition to predicting creditworthiness. Thus, the ratings must be nearly accurate to avoid distortions in the prices of debt instruments and interest rates payable on them. Inaccurate ratings create asset bubbles that eventually burst and disrupt the functioning of the financial markets.

The three major CRAs in the world have been scrutinized for their ratings and methodology since the major financial crises occurred in the past. The CRAs have been accused of many faults, including false ratings, flawed methodology, encroaching on government policy, political bias, selective aggression, and rating shopping. However, they cannot be held accountable for their inaccurate or wrong ratings as the credit ratings of debt instruments are considered opinions rather than judgments. Thus, these agencies have been shielded from liability by the First Amendment to the United States Constitution, ensuring "the freedom of speech," despite their capability to disrupt financial markets, especially for developing countries.

2.5. IMPACT OF RATINGS ON POLICIES PURSUED BY BORROWING COUNTRIES

The lack of precise knowledge of how macroeconomic policies are taken into consideration by CRAs to issues ratings has led to the assumption that they consider orthodox policies focusing on the reduction of inflation and government budget deficits for this purpose. Therefore, to avoid the downgrading of ratings, borrowing countries adopt policies addressing the short-term concerns

of investors, even if they conflict with the long-term development needs. Credit ratings issued by the CRAs also serve as a benchmark for financial market regulations. For instance, a few laws require certain public institutions to hold investment-grade bonds having a rating of BBB or higher.

The growing importance of CRAs in the modern financial architecture has prompted policymakers such as the International Organization of Securities Commission (IOSCO), the United States Securities and Exchange Commission (SEC), the European Commission Committee of European Securities Regulations (CESR), and the United States Congress and Senate to focus on the shortcomings arising from the concerns related to CRAs, and these concerns have been mentioned in the figure below:

Entry Barriers & Lack of Competition

- It is a highly cnsolidated market due to the presence of a limited number of CRAs.
- There are ~120 active CRAs across the world, and only a few are internationally recognized.
- According to the United States Department of Justice, the NRSRO designation has been acting as an entry barrier for new players, in a catch-22 manner. A new rating agency cannot obtain national recognition without NRSRO status and it cannot obtain NRSRO status without national recognition.
- As stated in the CSER›s 2005 report, the impact of regulatory requirements on competition is not clear, and therefore, there is no decisive proof about the influence of regulatory requirements on the entry barriers to the rating industry.

Potential Conflict of Interests

- In 2003, the IOSCO highlighted that potential conflict of interests may arise when a rating agency offers consulting or other advisory services to issuers it rates, since they could be unduly pressured to purchase advisory services in return for an improved rating.
- Conflict of interest also arises due to «notching» by CRAs, i.e. lowering ratings for issues which they had not rated, and that of «›solicited» versus «unsolicited» ratings, where aggressive tactics might be used to induce payments for a rating an issuer did not request.
- Moody›s and S&P have adopted IOSCO›s recommendation in their own Codes of Professional Conduct. The recommendation states that a credit rating assigned by a CRA should not be affected by the existence of a potential business relationship between the CRA (or its affiliates) and the issuer (or its affiliates) or any other party, or by the non-existence of any such a relationship.

Transparency

- Many concerns have arised over the lack of transparency in CRAs' ratings methodologies, procedures, practices, and processes.
- According to an emphasis by the IOSCO Code, CRAs should explain how each provision of the Code Fundamentals is addressed in their own Code of Conduct. They should discolse if and how their own Code of Conduct deviates from the Code Fundamentals and how such deviations, nonetheless, meet the objectives laid out in the Code Fundamentals and the IOSCO-CRA principles. Further, they should make their methodologies public to ensure greater transparency.
- According to the CESR of EC, as an alternative to self-regulation, there is a need to introduce several specific rules on fair representation, which would establish a minimum level of disclosure on the elements and assumptions that provide market operators and investors the understanding on how a specific rating is determined by a CRA.
- The nature and extent of information made available to the public still varies from agency to agency.

Accountability

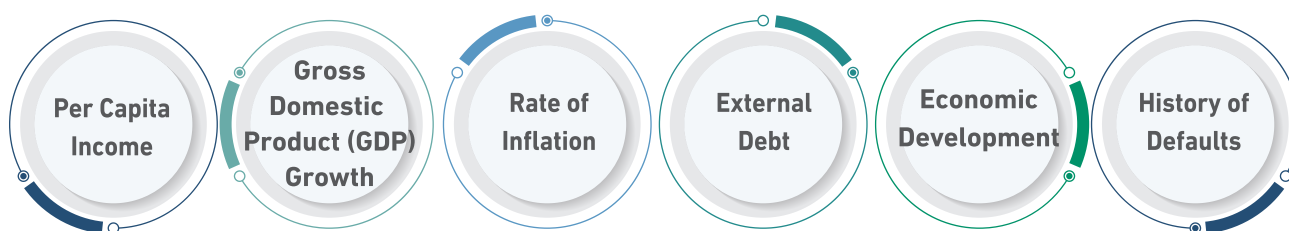
- There is no mechanism to protect investors and borrowers from mistakes made by CRAs or any abuse of power on their part.
- There is an accountability gap in the credit rating industry, and it is a matter of concern for CRAs as well as market participants. For the former, the accountability gap may affect their credibility in the marketplace; and for the latter, it is of particular concern, given the role they play in capital markets.
- In the US, the Credit Rating Agency Reform Act of 2006 has clearly designated the SEC to monitor CRAs› compliance with new securities laws and regulations.

3. DETERMINANTS OF SOVEREIGN CREDIT RATINGS

3.1. ANALYSIS

A sovereign credit rating is an assessment of the creditworthiness of a country. It indicates the level of risk associated with lending to a particular country and this rating is applied to all bonds issued by the country government. International agencies evaluate the creditworthiness of national governments by assessing their ability to pay back debt, considering the economic, market, and political risks associated with the country. Thus, these ratings are the forward assessment of a nation's ability to meet its financial obligations in time and in full. The ratings range from top-notch investment grades to junk bonds that are already in default and are usually denoted through letters.

Sovereign credit ratings are important for countries that want to access funds in the international bond market. Usually, a credit rating agency (CRA) evaluates the economic and political environments in the country at the request of the government and assigns a rating ranging from AAA grade to grade DDD. The agencies use both qualitative and quantitative techniques to determine the sovereign credit rating. The following are some of the factors to consider by credit rating agencies while assigning the sovereign credits ratings.



3.2. PER CAPITA INCOME

Per capita income refers to the average income or amount of money earned per person in a specified geographical area, in a specified year. It is calculated by dividing the total income earned by the people in a particular area by its total population during the specific period. Per capita income is recognized as an important factor in assigning a credit rating to a sovereign entity, as the tax base of a country helps in identifying its financial stability. A borrowing country with a strong potential tax base reflects a greater ability of the government to repay debts. The country's tax base can also serve as a proxy for the level of political stability in a country.

3.3. Gross Domestic Product

The GDP is among the major determinants influencing the credit ratings of any country. GDP growth is inversely proportional to the credit risk of a country. A relatively high GDP growth rate suggests that a country's existing debt burden would ease out and reduce over time. Saudi Arabia ranks second in terms of the world's most valuable natural resource, worth US$ 33.50 trillion, and the Organization of the Petroleum Exporting Countries (OPEC) termed it the "Energy Superpower," as of 2018. Accounting for the second-largest oil reserves and production capacity globally, it is a leading oil exporter in the world.

3.4. Rate of Inflation

Inflation is a crucial factor that depicts the financial and political stability of a country. A government resorts to inflationary money finance when it fails to or is unwilling to pay for current budgetary expenses through taxes or debt issuance. A high inflation rate, which points out structural problems in the government's finances, leads to public dissatisfaction and, in turn, leads to political instability in the country.

The Laspeyres formula is used to calculate all three inflation rates—consumer price index, wholesale price index, and inflation consumer prices (annual percent). According to the World Bank, "The consumer price index reflects changes in the cost of a basket of goods and services to an average consumer, which may be fixed or can be changed at specified intervals, such as yearly. Furthermore, the wholesale price index refers to a mix of agricultural and industrial goods at various production and distribution stages, including import duties. As measured based on the consumer price index, inflation reflects the annual percentage change in the cost to the average consumer for acquiring a basket of goods and services that may be fixed or changed at specified intervals, such as yearly.

3.5. EXTERNAL DEBT

External debt refers to the portion of a country's debt borrowed from foreign governments, commercial banks, international financial institutions, and so on. Failure in repaying external debt results in debt crises, and the sovereign entity is in a sovereign default. The external debt burden increases with the rise in foreign currency debt of a country, relative to its foreign currency earnings (exports). External debts have a direct impact on the credit rating of a country as a higher debt burden corresponds to a greater risk of default.

3.6. ECONOMIC DEVELOPMENT

The Kingdom's financial and economic structural development over the past five years, in line with the Saudi Vision 2030 objectives, has had a positive impact on monetary and macroeconomic policy performance, fiscal policy effectiveness, and the advancement of its comprehensive agenda for economic diversification, all of which have contributed to the growth of non-oil revenues.

In 2022 and in the medium term, the Kingdom is also keen to support the ongoing recovery in the economy, particularly post Covid-19 era, while maintaining initiatives previously taken and achieving Saudi Vision 2030 objectives by reducing reliance on oil revenues, diversifying the economy, developing non-oil revenues, and ensuring their sustainability.

3.7. HISTORY OF DEFAULTS

The CRAs rate the countries with defaults on their past debt obligations at high sovereign credit risks. Thus, countries with a record of defaults receive low ratings, which makes them less attractive to investors looking for low-risk investments.

4. CORPORATE CREDIT RATING

4.1. ANALYSIS

Corporate credit ratings indicate the risks associated with companies and their financial instruments, i.e., debt securities such as corporate bonds. These ratings are assigned by individual rating agencies, and they represent the probability of the default on debts. European Central Bank (ECB) recognizes four rating agencies: Standard & Poor's, Moody's, Fitch, and DBRS Morningstar for determining collateral requirements for banks planning to borrow from the central bank and other financial institutions. It is an opinion on a relative standing of an entity concerning the adoption of corporate governance practices.

The corporate credit ratings are used mainly for:

- Providing information to stakeholders
- Setting references and benchmarks for further improvements
- Providing an independent and credible assessment of the quality and extent of the corporate governance

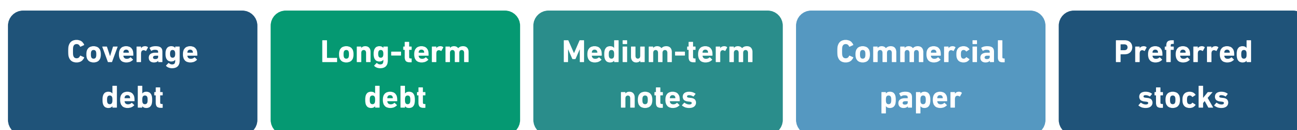
A company with a highly rated financial instrument has an opportunity to reduce the cost of borrowing from the investors by quoting lower interest rates on fixed deposits, debentures, or bonds as the investors with low-risk preference would come forward to invest in safe securities, irrespective of marginally lower rates of return. Such companies can approach the investors by using the press media extensively for resource mobilization. The higher-rated financial instruments can attract investors from different strata of society as they understand the degree of certainty about the timely payment of interest and principal on debt instruments with a better rating.

Companies assigned with financial instrument ratings can improve their image and avail the ratings as a marketing tool to create a better image for dealing with their investors and customers feel confident in the utility products manufactured by the companies carrying higher ratings for their credit instruments. A company with higher-rated instrument can attract the investors with the least efforts. Thus, they can economize and minimize the cost of public issues by controlling expenses on media coverage, conferences, and other publicity gimmicks.

Instrument ratings encourage the companies to grow as the promotors feel confident in their own efforts; they feel motivated to undertake expansion of their operations or new projects. With a better image created through higher credit ratings, the companies can mobilize funds from the public and instructions or banks through the self-assessment of their status, which is subject to self-discipline and self-improvement. Highly rated instruments benefit brokers and other finan-

cial intermediaries by saving the time, energy, costs, and manpower required for convincing their clients to invest in such instruments.

A corporates group rates public securities and private placements, including investment grade or high-yield securities. Specific financial instruments are as follows:



4.2. DETERMINANTS OF CORPORATE CREDIT RATING

Rating agencies analyze multiple financial factors such as liquidity, profitability, and leverage; business risk factors such as market share, innovation level, diversification, and competition; and management-related factors such as management quality, competence, and risk appetite to determine the corporate rating of the companies.

Major credit rating agencies, namely, Standard & Poor's, Moody's, and Fitch Ratings, provide corporate ratings by employing their confidential methodologies. These companies represent more than 95 percent of the credit rating business. Moreover, the long-term scale of DBRS is like Fitch and S&P ratings with modifications in representation. The determinants for corporate credit ratings are categorized as financial and nonfinancial determinants.

4.3. FINANCIAL DETERMINANTS

Financial determinants include corporate cash flows, leverages and obligations, capital structure, financial policy, and liquidity position. All the historic financial rationales are considered, and their forecasts are determined according to the type of financial instrument. Moreover, rating agencies have their specific considerations for the different industries, and they utilize their proprietary methodologies for the calculation of ratings for corporates and financial instruments. The financial soundness will be determined by analyzing each of the financial risk assessment factors. The rating agencies review their ratings at regular intervals and update the same for further review.

Corporate cash flows include all the cash generated from their operations, investments, and financing activities. The cash flows originated from the company's main business activities are considered under operating activities, while those generated from investments in other business ventures and capital assets revenues fall under investment cash flows. Financial cash flows are the gains from issuing equity and, debt, as well as from the payments made by the organization.

The leverages and obligations provide a glimpse of the financing of organization business and operations utilizing debt and equity. Further, the leverage ratios denote the level of debt incurred by organizations against their balance sheets, profit and loss statements, and cash flow statements.

Capital structures and financial policies offer a glimpse into the proposition of equity and debt financing of organizations, which allow them to continue their operations and meet future obligations. The cost of each type of capital and benefits of raising the same, along with their ability to raise the capital will be evaluated.

Liquidity position denotes the ability of a company to meet the short-term/current debt by utilizing its current assets. Quick ratio; current ratio; and net working capital, along with yearly changes in it, are among the major ratios considered while determining the liquidity position.

Credit rating agencies combine the abovementioned financial determinants while providing corporate credit ratings.

4.4. NONFINANCIAL DETERMINANTS

Nonfinancial determinants play a niche role in determining the overall credit rating of a company and risks associated with the external environment. Major nonfinancial determinants used by corporate credit rating providers are country risk, industry risk, competitive position, product/service portfolio, management, governance, and group/government influence.

The credit rating agencies capture the major business aspects of organizations, outlined based on their industry specifications, as per the defined methodology. The benchmarking is adjusted according to the sector-specific overlay factors that apply to the organization's credit profile.

5. ANALYSIS AND POTENTIAL FUTURE OUTLOOK-

Credit rating evaluates the risk associated with the prospective debtor (country, and corporations) and predicts their ability for debt payments. The credit rating represents the evaluation made by credit agencies such as S&P, Moody's, and Fitch regarding qualitative and quantitative information for the debtor. The ratings offered by credit rating agencies vary as per the determinants used by them; however, the applied base principle remains the same. These credit rating agencies are paid by debt issuers, such as banks, financial institutions, and sovereign credit issuers. As a result, they are facing allegations regarding biased ratings, which would be considered by third-party investors while issuing loans. Considering the number of businesses the credit rating agencies involve, including consultancy services and intelligence services, the agencies are under pressure to provide higher ratings for their clients. Several reports have been published by government entities stating credit rating agencies have provided a higher rating for some financial instruments for what they are now known to have been failing to meet their obligations.

The leading agencies work in an oligopoly market where large corporations primarily use services form leading agencies, and competition in the market is highly restricted. In addition, potential conflicts of interests have been raised where several services are provided to a single client, effectively compromising the ability to provide independent ratings for each separate arm of businesses, which tends to compromise on providing neutral ratings for the financial instruments.

Considering the criticism that the rating agencies are facing, the US and the UK government have taken steps to establish reforms to benchmark the regulations for these agencies in the public interest. The respective bills have been passed under the capital requirement directives and financial regulatory reforms. The credit rating agencies would continue to focus on financial regulators. However, regulatory reforms in the US and Europe have failed to propose an alternative revenue model for the agencies for the remuneration of ratings.

Europe is working on an investor-pay model that is expected to normalize the ratings further, but regulators need to address the issues posed by the stranglehold of leading rating agencies. Until then, the rating agencies will continue to dominate the financial market, and global financial institutions will keep referring to the ratings provided by selective credit rating agencies.

Banks and financial institutions are considering alternate rating sources; the Bank of England has recently proposed to undertake its own risk assessment for many classes of its collaterals, as an alternative for the credit rating agencies. As a neutral credit assessor, it would provide investors with robust, reliable, and high-quality ratings. The European Union is also focusing on the establishment of a European credit rating agency to decrease the dependency on the leading credit rating agencies.

6.1. LIST OF ABBREVIATION/GLOSSARY

TABLE 4. LIST OF ABBREVIATION/GLOSSARY

Expansion	Acronym
CESR	The European Commission Committee of European Securities Regulations
CMA	Certified Management Accountant
Covid-19	Coronavirus Disease 2019
CPI	Consumer Price Index
CRA	Credit Rating Agency
DBRS	Dominion Bond Rating Service
ECB	European Central Bank
FDI	Foreign Direct Investment
FX	Foreign Exchange
GDP	Gross Domestic Product
IOSCO	The International Organization of Securities Commission
JCR	Japan Credit Rating Agency
S&P	Standard & Poor's
SAMA	The Saudi Arabian Monetary Authority
SEC	The United States Securities and Exchange Commission
VAT	Value Added Tax

Source: GRC Analysis

6.2. REFERENCES

General Entertainment Authority

- Saudi Arabia’s Tourism Authority
- Saudi Central Bank
- Saudi Arabia’s General Investment Authority
- The World Bank
- Capital Market Authority, Credit Rating Agency
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	Moody's Long-term	Moody's Short-term	S&P Global Long-term	S&P Global Short-term	Fitch Ratings Long-term	Fitch Ratings Short-term	
INVESTMENT	Aaa	P-1	AAA	A-1+	AAA	F1+	Prime
	Aa1		AA+		AA+		High Grade
	Aa2		AA		AA		
	Aa3		AA-		AA-		
	A1		A+	A-1	A+	F1	Upper Medium Grade
	A2		A		A		
	A3	P-2	A-	A-2	A-	F2	
	Baa1		BBB+		BBB+		Lower Medium Grade
	Baa2	P-3	BBB	A-3	BBB	F3	
	Baa3		BBB-		BBB-		
SPECULATIVE	Ba1	Not prime	BB+	B	BB+	B	Non – Investment Grade (speculative)
	Ba2		BB		BB		
	Ba3		BB-		BB-		
	B1		B+		B+		Highly Speculative
	B2		B		B		
	B3		B-	C	B-		
	Caa1		CCC+		CCC	C	Substantial risk
	Caa2		CCC				Extremely speculative
	Caa2		CCC-				In default with little prospect for recovery
	Ca		CC				
			C				
	C		D	/	DDD		In Default