Credit rating agencies in Arab financial markets: A Proposition to The Establishment Of An Arab Agencies

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Received: 14/06/2022 *Accepted*: 24/06/2022 *Published*: 31/08/2022

Abstract :
Credit rating agencies operates in assessing the ability of States, companies and financial institutions to fulfil their obligations, as with other financial markets, Arab markets are the subject of a sovereign rating. This study highlights the realities of Arab financial markets and the impact of the credit rating on them. With the proposed establishment of an Arab classification agency which has become imperative as Arab governments increasingly move towards engagement within the global economy.
The study revealed that Arab financial markets are directly affected by the sovereign rating. The study also noted the absence of a local or regional Arab agency with criteria proportional to the local environment of the Arab States.
***Key Words*:** Credit Rating Agencies, Arab Financial Markets, Regional Rating Agencies.

JEL Classification: D53, G24.
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Introduction :

Rating agencies are essential in financial markets. They contribute to resolving the problem of asymmetry in information between lenders and investors about the credit worthiness of institutions or countries. The role of rating agencies has grown as financial globalization, the development and openness of financial markets, and increased interest in more credit, requiring accurate information on borrowers' ability and willingness to pay their debts.

The Arab States, in a range of challenges and problems they face, mainly the decline in their hard currency reserves (oil- producing countries such as Algeria, Iraq and tourist countries such as Lebanon and Morocco), other than the security problem in some Arab countries (such as Tunisia, Egypt and Iraq), have been forced to search for new sources of financing, financial markets were an appropriate alternative. However, the ranking of the Global Rating Agencies for the Arab States. Was within the degree of speculation for most countries, which negatively affected their investments, their local financial markets, and the cost of obtaining loans.

Given the criticism of global credit rating agencies after the 2008 mortgage crisis, Where she was accused of not being able to give due assessments or overestimate them, and then the sovereign debt crisis comes to confirm the failure of these agencies, because of their difficulty in knowing all about the Arab local market and the high cost of obtaining a credit rating if applied. As a result of these factors, the Arab countries need a regional rating agency. which will contribute to reducing the cost of obtaining a rating and is distinguished from its global counterpart, given its knowledge of the specificity of the Arab market, which makes its classification more accurate.

Problematic study: Through the previous submission, the problems of the study are reflected in the following fundamental question:

What is the role of credit rating agencies in the Arab financial markets? Is it necessary to establish a regional credit rating agency for Arab Countries?

Study hypotheses: To address the study's problems, we relied on a set of hypotheses:

- The credit rating is one of the most important factors used by investors to determine the trends of their investments, and for countries to issue bonds in global markets;
- Arab financial markets are affected by the sovereign rating and this is reflected in their performance indicators;
- The establishment of an Arab regional rating agency is necessary at present to attract foreign direct investment and activate the financial market in Arab countries.

Purpose of the study: The study aims to try to reach the following:

- Identifying and clarifying the difference between global and regional classification agencies;
- Identifying and clarifying the difference between global and regional classification agencies;
- Submission of a proposal for the establishment of an Arab regional credit equity agency and its expected results if established.

Study methodology: The deductive approach was used to describe the importance of establishing an Arab classification agency and the conditions and advantages of its establishment by analyzing the credit ratings of Arab countries from international rating agencies.

In order to achieve this study and answer its problem, this study was divided into the following axes:

Define the credit rating agencies -

- The reality of the sovereign rating in the Arab financial markets
- Conditions and advantages of establishing an Arab regional credit rating agency.

I. The credit rating agencies

1. The establishment of credit rating agencies

Rating agencies first appeared in the United States of America, with the first drip agency in 1841 arising under the name of "The Mercantile Agency", after the economic panic of 1837, which was viewed as a result of the vulnerable transmission of information and data between different customers, became consequently accountable for collecting and distributing data and information to different customers in order to help make the best economic, commercial and financial decisions. The rating process was first started in 1909 by Moody's Corporation, the first institution to introduce a rating system for rail way companies, by its founder John Moody, starting with A, meaning good financial condition, through F, meaning bad financial condition. From the mid-1910s, Fitch and Standard and Poor's emerged as rating agencies, and in 1918 came the Sovereign Risk Rating (SDR) associated with determining the Government Solvency, produced by Moody's. (Ilanah, Juliette, & Emelina, 2012, p. 5)

Credit rating agencies come in different sizes, issue different types of ratings, and have a geographic reach that varies. A number of these agencies are affiliated with larger agencies.

2. Regional and local global credit rating agencies

Rating agencies are divided into local, regional and global rating agencies according to the size of the market wherein they operate, every of that is defined as follows:

2.1 Global credit rating agencies:

a. Standard and poor's rating agency:

Standard & Poor's (S&P) is a leading credit rating agency with offices in 28 countries around the world. It has been in operation for over 150 years. It has more than one million ratings for government, institutions, the financial sector, and securities, in order to help increase transparency and provide information to market activists so they can make their investment decisions. (About S P Global Ratings, 2018):

b. Moody's Investors Service:

Moody's is the oldest global credit rating agency, dating back to 1909. It provides credit ratings along with research data and analytical tools for credit risk assessment. Its offices are located in 41 countries around the world and employs more than 11,700 people across many countries. In 2016, its revenue was close to \$3.6 billion. (henry & Raymond, 2016, p. 10)

c. Fitch Agency

Fitch is one of the most important credit ratings providers in maximum international economic markets. The agency is based in New York and covers nearly 150 countries, with greater than 50 workplaces worldwide. (Rating, 2017)

2.2. Local and regional credit rating agencies

The work of local credit rating agencies is limited only to the local market, for example, the German Unternehmens Rating agegentur AG, which operates on the

German market and evaluates only German companies, while the work of regional credit rating agencies extends to the markets of several countries. , primarily the Swedish Upplysningscentralen AB, which operates in Sweden and Norway. The following table shows the most important local and regional rating agencies.

Table 1: Local and regional rating agencies

Rating agency	Nbr of workers	itsratings	ownership
Bonniers Kreditfakta NordenAB	20	780000 company	Bonnier Group
Canadian Bond Rating Services	35	500 company	Private ownership
Credit Safe AB	21	690000 company in Sweden	Norwegian Company
Dominion Bond Rating Service	30	500 company	Private ownership
Dun & Bradstreet	11000	53million company	Private ownership
Egan-Jones credit rating Co		2000 company	
Euro Rating AG	7		Private ownership
Instantia Creditsystem AB International	5	780000 company in Sweden	Owned by the Koster family (The Koster Family)
Italrating DCR Spa		53 company in Italy	Owned by the Italian Investment Bank and Duff & Phelps
Japan Credit Rating Agency	74	600Japenes companies	Owned by major investors
Japan rating and Investment	140	1100 company in Japan	Nikkei newspaper
Mikuni & Co		1400 issues, and 1600 company	Private ownership
RS rating services AG	8		Private ownership
Svea Credit-Information AB	3	All companies located in Sweden	Private ownership
Svefo Sverige AB	30	All companies located in Sweden	Owned by AB Telia.
Unternehmensratingagentur AG	12	German companies	Private ownership
Capital Intelligence	11	400 banks	Private ownership, and active regionally.

source: (Basel, 2000, pp. 21-22)

Through Table No. 1, which shows the local and regional rating agencies, we note the absence of a local or regional Arab credit rating agency.

II. The fact of the sovereign rating in the Arab financial markets

1- Characteristics and traits of Arab financial markets

- **Limited size and scope of financial markets:**Arab financial markets are distinguished by their tiny size and limited reach, as well as their limited influence in the mobilization and distribution of resources. Due to the broad ownership of public securities agencies and private enterprises of the closed type owned by families, there are a limited number of securities available for trading.
- **Institutional focus of securities acquisition:** The institutional focus process means that traditional institutions such as banks, insurance companies, and social funds own a significant portion of the issuance of securities.

The next table shows the concentration of Ten Arab Companies' activities:

Table 02: Concentration of 10 Arab companies' activities (2018)

Country	Jordan	Egypt	Morocco	Saudi Arabia	Oman	Kuwait
Concentration Ratio	72%	28.7%	70.4%	77.3%	45%	54.5%

Source: (aek, 2018)

- **Limited distribution:** As a result of the concentration of financial markets in Arab countries on stocks and bonds, all Arab stock exchanges are expanding, much like small stock exchanges, with limited opportunities for investors to diversify their stock portfolios, and they are still far from diversifying investment tools, particularly for monetary instruments and derivatives. This common feature restricts investment strategies for both individual and institutional investors, and in most Arab stock exchanges, the banking and contracting sectors controlled trading volume, and it appears that investor behavior in the stock exchange has become governed by the herd policy, despite the presence of some promising sectors with high profitability, such as the real estate sector.However, because stock trading is based on two or three shares on the stock exchange, rumors play a significant influence.
- **Lack of liquidity**: the stock market performs its function in the efficient allocation of resources through a system of incentives and penalties, in which trading on the shares of successful companies increases and their market value increases, and vice versa for unsuccessful companies, where trading on their shares decreases and their market value decreases, and vice versa for unsuccessful companies. When the market is efficient, the main function of the market is to achieve liquidity for the securities, and the liquidity of the markets is usually at the top of the local and international investor's priorities.The decrease in the number of transactions completed per day and the number of trading days per year can be used to track the Arab stock exchanges' liquidity problems. In Lebanon, 0.08 in Saudi Arabia, and 0.12 in Muscat, the liquidity of Arab securities is lower than in some emerging markets, such as Brazil and India, where the ratio is estimated at 0.18, and Mexico,

where the ratio is estimated at 0.12, and the Kuwait market is excluded from this lack of liquidity by 0.41 (aek, connectivity as a mechanism for development and globalization of arab financial markets, 2018).

III. Conditions and benefits for establishing an Arab regional credit rating agency

1. Terms and requirements for establishing a credit rating agency

The establishment of a regional credit rating agency for the Arab countries necessitates the fulfillment of a set of international conditions, as well as other requirements specific to Arab countries, in order to receive a license.

1.1 Eligibility conditions and international criteria for licensing credit rating companies

The licensing of rating companies is subject to a number of conditions, the most essential of which are as follows: (amani, 2016, p. 4)

- **Standard 01 "Methodology"**: The rating agency uses an established rating methodology that complies with worldwide best practices and ISCO and NRSRO standards. (It is a nationally renowned statistical assessment organization).
- **Standard 02 "Human Resources"** states that the rating agency has a specialized professional team of experienced credit analysts capable of assessing risks and conducting technical assessments and analyses.
- **Standard 03 "Ownership Independence":** That the agency has financial resources from outside sources to ensure that the ownership structure does not conflict with providing objective and neutral ratings.
- **Standard 04, "Employee autonomy":** To ensure confidence in its classifications, the Agency's organizational and ownership structures must be free of any economic or political pressure, as well as the dominance of any enterprises or entities subject to classification.
- **Standard 05, "Efficiency of classification procedures and processes":** The Agency has transparent, disclosed classification procedures and methodologies based on published data, data from the classifier, and special data.
- **Standard 06, "Impartiality and Objectivity":** Integrity, impartiality, and objectivity are among the most valuable attributes of classification agencies. Internal controls and a code of professional and ethical conduct for employees must be in place to ensure that no confidential customer information or data is used or treated in a way that compromises classification neutrality.

1.2 Requirements for establishing a regional rating agency for Arab countries:

The establishment of a regional rating agency requires Arab countries to meet the following criteria: (imad, 2011, p. 17)

Examine the company's work practices and classification phases for credibility and transparency.

- Advertising transparency and disclosure of all classification algorithms for all market segments. It must appropriately design categorization methodologies that adhere to international norms. It must instead be announced and disclosed to the market on its website.

- Providing tires that are specialized in their classification and have a lot of experience.

The rating agency's ownership should be independent, and the work process should be independent of the market, so that its credibility and transparency are not harmed.

- The regulatory authorities must approve or license the rating agency.
Given the numerous requirements and conditions, it is critical that the regional or local rating agency receive the necessary government support. This confirms the existence of numerous initiatives in Arab countries to establish a local or regional rating agency, but they failed due to a lack of necessary government support.

2. Motives and advantages of establishing an Arab regional rating agency

The establishment of a rating agency for Arab countries is necessary for a variety of reasons. The numerous benefits that this agency might attain will necessitate some effort to develop.

2.1 Motives for establishing a regional rating agency for Arab countries

The standards of international rating agencies are not commensurate with the Arab region's economic environment, necessitating the establishment of a rating institution for Arab countries that is compatible with local legislation and environment. For example, the Abu Dhabi Energy Company refused to accept the standards used in Category and terminated a contract with one of the international rating agencies. (amani, credit rating and its relationship to the basel convertion 2)

- Building an economy compliant with Islamic law, which cannot be evaluated by rating institutions that do not differentiate between Islamic and traditional, and do not take into account the specific criteria required to be available in the Islamic product. (rahim, 2014, p. 2), which requires the necessity of establishing a regional rating agency that classifies both Islamic and traditional products.

- The headquarters of the three major agencies is in the United States of America, which raises many questions, because despite the successive declines in the indicators of the American economy since the beginning of the third millennium, the credit rating assigned to the American economy by these agencies is in no way less than (AAA+). Rather, it went beyond that, as these agencies were accused of obstructing the United States of America's competitors by downgrading the rating, an accusation leveled at the three agencies by China, Russia, and Turkey as working for the benefit of the United States (Ahmed, 2017).

- Criticism of credit rating agencies after the global financial crisis of 2008. During the period 2003 and 2008, these agencies granted high ratings and a stable future outlook to many mortgage-backed bond issues issued by banks, which prompted the world to give its confidence to these issues.

- The agencies' mishandling of the Eurozone crisis, as attested by their inability to assess future risks and their slowness or delay in monitoring the negative trends that some debt issuers are exposed to after the issuance process, and thus the late reaction in reducing ratings, as it was very late in reducing the rating of each From Greece, Ireland, Cyprus, Portugal, and Spain, despite the availability of all the necessary conditions and considerations to do so. (rahim, 2014)

- The Arab oil producing countries need a regional rating agency now more than ever, especially in light of the trends in the bond market, which requires the availability of an agency that evaluates its products and financial institutions, and the need is now great, unlike the previous one, which was relying on the large cash reserve from oil revenues, but with the decline in oil prices, Arab countries must consider proposing the establishment of a regional rating agency to fill their financial deficits on the debt market.

The aforementioned motivations highlight the necessity and inevitability of establishing a regional rating agency based on standards commensurate with the local environment of Arab countries, working on classifying Islamic and traditional products, and contributing to the revitalization of the Arab bond market so that it becomes a major source of financing in the region.

2.3 Advantages of a regional rating agency for Arab countries

If a regional rating agency for Arab countries is established, it will gain a number of benefits, including:

- Regardless of how familiar international agencies are with market data and their distinction with important scientific frameworks, this agency is distinguished by its proximity to the market, which gives it accuracy in awarding ratings, and the most visible evidence of this is that most countries around the world consider their local rating agencies to be the region's main player.
- Regional agencies are less expensive, which saves companies a lot of additional costs.
- This agency will be aware of the market's unique characteristics, particularly because the Arab market is characterized by family-owned businesses that are linked to the government, a property that may be lacking or unclear in global corporations. (imad, 2011)

- The regional rating agency will be able to classify Shariah-compliant financing instruments alongside conventional products.

- The classification facilitates Arab companies' access to regional and global capital markets, which Arab companies require.
- Improving the efficiency of Arab financial markets by restoring confidence in the market and allowing new investors to enter.
- Strengthening the bond markets, which are still small in several Arab countries, including Algeria, which is attempting to use it as a new source of financing in light of the drop in oil prices.

- The regional agency is used as an alternative source of credit opinion for global investors.

-Increasing foreign direct investment (FDI) , because sovereign credit ratings help investors make investment decisions. Investors increase or decrease their investments when sovereign credit ratings stabilize.

- Providing information to investors based on reports that, to the greatest extent possible, reflect reality.

The benefits and advantages of establishing a regional classification agency for the many and diverse Arab States encourage Arab States to expedite the development of basic steps for its establishment. The Agency will provide assistance to Arab countries in all economic, political, and social areas.

Conclusion:

Following the expansion of credit rating agencies' activities and their expansion to most developed and developing countries, their role and relevance in influencing the global investment trajectory has grown significantly. In the absence of an Arab rating agency, there is a need to work toward the establishment of an Arab rating agency that works to classify both traditional and Islamic financial products while respecting Islamic sharia provisions.

The establishment of an Arab regional credit rating agency necessitates the availability of a number of conditions in order to be successful, the most important of which is obtaining the support of Arab governments for this agency while attempting to frame qualified human resources.

From the foregoing in our study, the following findings have been reached:

- Credit ratings in Arab countries are still developing. Some Arab countries, such as Algeria, have been left out of major classification agencies' publications;

- According to Moody's, ratings in Arab countries in 2017 ranged from speculative grade (Bahrain, Tunisia, Jordan, Morocco, Iraq, Lebanon) to investment grade (UAE, Kuwait, Saudi Arabia, Oman, Qatar);

speculative grade in 2016-2017;

- The Arab States Rating Agency will use criteria that are appropriate for the characteristics of Arab financial markets, which are distinguished by their small size, lack of fair access to information, and are heavily influenced by rumors. Most of the companies listed on Arab exchanges are family businesses, as opposed to developed financial markets, which are distinguished by their large market size, diversity of companies listed on their exchanges, and ease of information.

- In light of the study's findings, we have decided to make the following recommendations:
- Raise awareness of the importance of credit ratings and their growing role in the financial market, as well as explain their significance to governments, institutions, and investors;
- The Regional rating Agency must develop criteria for Islamic products as well as standards for traditional products. This is one of the shortcomings of international organizations. It makes no distinction between Islamic and traditional practices.
- The need to conduct an in-depth study of credit rating criteria and to draw on international experience with regional rating agencies;
- The Agency's human resources should be configured and enhanced so that it can perform its mandated tasks;
- The Arab States, in establishing their regional agency, should strive for a medium-term goal of global proliferation and competition of global agencies, rather than being limited to the Arab region.

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