



APRM

African Peer Review
Mechanism

AFRICA SOVEREIGN CREDIT RATING REVIEW

2022 END OF YEAR OUTLOOK





ECA

**Africa Peer Review Mechanism
Continental Secretariat**
Directorate of Governance &
Specialized Reporting
in Collaboration with the
**United Nations Economic
Commission for Africa**

ABOUT THIS REPORT

This 6th edition of the African Union – African Peer Review Mechanism (AU-APRM) end of year Sovereign Credit Rating Review Report presents an analysis of the long-term foreign currency sovereign credit rating actions in Africa by the three dominant international credit rating agencies (CRAs) – Moody’s, Fitch and S&P Global (S&P) – during the second half of 2022 (2022H2) and makes recommendations to both CRAs and African governments on how credit ratings can be improved.

Authors:

Dr Misheck Mutize: Lead Expert Researcher -
Credit Rating Agencies, AU – APRM

Email: misheck.mutize@aprm-au.org

Dr McBride Nkhalamba: Ag. Director of Governance &
Specialised Reporting, AU – APRM

Ms Ejigayhu Tefera: Economic Researcher, AU-APRM

Email: ejigayhu.tefera@aprm-au.org

Ms. Sonia Essobmadje: Chief of Innovative Finance &
Capital Markets, United Nations Economic Commission
for Africa (UNECA)

Email: sonia.essobmadje@un.org

Mr. Sheng Zhao: Economic Affairs Officer, United Nations
Economic Commission for Africa (UNECA)

Email: sheng.zhao@un.org

1

INTRODUCTION

The continent faces a number of challenges to achieving the 2030 Agenda for Sustainable Development and the African Union (AU) Agenda 2063 ‘*The Africa We Want*’. Amongst these challenges is the high borrowing costs, which is keeping most African states out of the financial markets, and this has been exacerbated by the risk of unsustainable debt levels as cited in the ratings actions. Hence, African governments continue to raise their dissatisfaction on the general decline in credit ratings, which has become a significant threat to debt sustainability.

Addressing the 77th United Nations General Assembly in New York on 20 September 2022, the current Chairperson of the African Union (AU) – President Macky Sall of Senegal – expressed concern¹ that ‘*the perception of risk in Africa continues to be higher than the actual risk*,’ causing high insurance premiums and making African economies appear unattractive to investors. He further highlighted the shortcomings in the assessment processes of credit

rating agencies (CRAs), the importance of ‘*transparent methodologies so as not to undermine confidence in ratings*’ and called for a constructive dialogue with the CRAs on improving their working and assessment methods. Addressing at the same gathering, President Nana Akufo-Addo of Ghana also criticized² CRAs for being ‘*quick to downgrade African economies which has worsened the financial situation, denying smaller countries access to cheaper borrowing, pushing them deeper into debt*.’

Risks associated with climate change are also increasingly being significant as witnessed by the extreme weather conditions and credit rating agencies (CRAs) are integrating them into their analyses. The 27th Conference of the Parties to the United Nations Framework Convention on Climate Change (COP27) also called³ for appropriate measures to address the establishment of a sustainable sovereign debt hub towards reducing the cost of capital and debt stock.

1 <https://au.int/en/pressreleases/20220920/77th-session-United-Nations-General-Assembly-address-he-macky-sall#:~:text=I%20have%20come%20to%20say,on%20a%20mutually%20beneficial%20basis>.

2 <https://presidency.gov.gh/index.php/briefing-room/speeches/2285-address-by-president-akufo-addo-at-the-77th-session-of-the-united-nations-general-assembly>

3 https://www.uneca.org/sites/default/files/documents/9th-sept-clean-final-communique_egypt-icf-and-meeting-of-african-ministers.pdf

2

GENERAL RATING OUTLOOK

Like in the first half of 2022 (2022H1), the second half of 2022 (2022H2) again witnessed a 57% more negative than positive rating actions as African governments continue to face the elevated debt levels, pushing their fiscus to allocate a larger share of their revenues to servicing external debt. United Nations Conference on Trade and Development (UNCTAD) estimates⁴ debt service (% of revenue) in Sub-Saharan Africa to average 17% in 2022, a 3% increase from the pre-Covid-19 period, which is amongst a series of post-Covid-19 pandemic recovery challenges. Over the 2022H2 period, there were a total of 13 rating downgrades, 86% more downgrades than those in 2022H1 – when 5 countries were downgraded. The majority of rating downgrades in 2022H2 were assigned to Ghana, which suffered a total of 10 negative rating actions in 2022, 8 of which were assigned in the 2022H2 period. The Government of Ghana grappled with increasingly costly debt and limited policy levers to address the high inflation, depreciating local currency and rising debt. Ghana is currently rated Selective Default (SD)⁵ by S&P. There was, however, a

slight increase in rating upgrades, from 3 in 2022H1 to 5 in 2022H2. The number of upgrades however remain far below the downgrades, reflecting a general deterioration of the creditworthiness of African countries in 2022H2.

On rating outlooks⁶, 6 countries had a positive change in their outlook during the 2022h2 – Angola, Lesotho, Gabon, Tanzania, Mali and Morocco. This is equal to the number of positive changes in outlook in the 2022H1. However, out of the 6 countries that had a positive change in their outlook during the 2022H1, only Mozambique and Seychelles were upgraded in the 2022H2. Egypt and Uganda had their outlooks downgraded by Fitch and Moody's, respectively, from stable to negative in the 2022H2, compared to only one country – Egypt – in 2022H1.

⁴ <https://sdgpulse.unctad.org/debt-sustainability/>

⁵ The Government of Ghana suspended payments on most of its external debt.

⁶ Which gives information to lenders, investors or other ratings users about the expected direction of rating movement in the short to medium term (typically six months to two years).

Table 1: Summary of sovereign credit rating actions (Jul – Dec 2022)

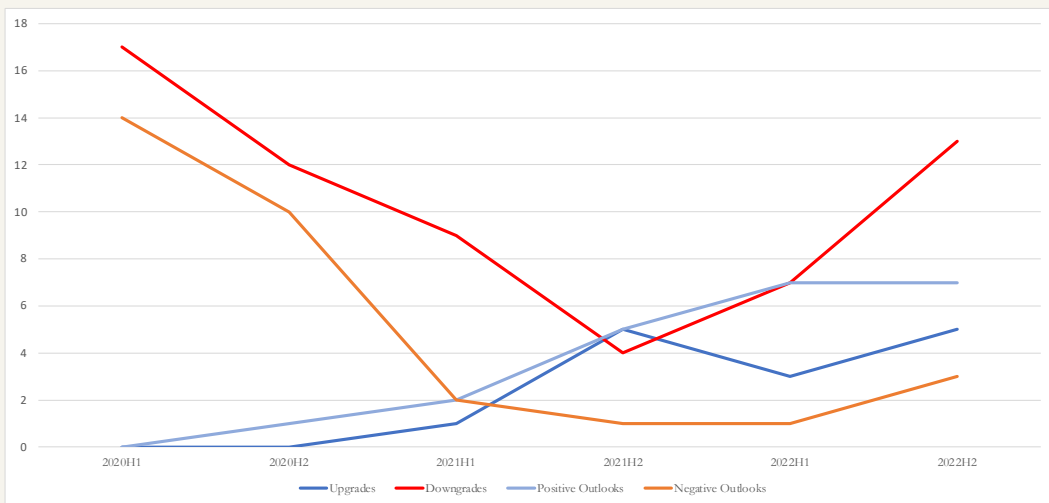
Country	Moody's		S&P		Fitch	
	Previous	Current	Previous	Current	Previous	Current
Credit Rating Upgrades						
DR Congo	Caa1 (Pos)	B3 (Stable)				
Congo Republic					CCC	CCC+
Tunisia					CCC	CCC+
Mozambique					CCC	CCC+
Seychelles					B+ (Pos)	BB- (Stable)
Total		1		-		4
Credit Rating downgrades						
Ghana	Caa1(Stable) → Caa2 (UR)	Ca (Stable)	B- (Stable)→ CCC+ (Neg)→ CC (Neg)	SD	B- (Neg)→ CCC+ CC	C
Ethiopia					CCC	CCC-
Kenya					B+ (Neg)	B (Stable)
Nigeria	B2 (Stable)	B3 (UR)			B (Stable)	B- (Stable)
Mauritius	Baa2 (Neg)	Baa3 (Stable)				
Total		4		3		6
Positive changes in Credit Rating Outlooks						
Angola	B3 (Stable)	B3 (Pos)			B- (Stable)	B- (Pos)
Lesotho					B (Neg)	B (Stable)
Gabon					B- (Stable)	B- (Pos)
Tanzania	B2 (Stable)	B2 (Pos)				
Mali	Caa2 (Neg)	Caa2 (Stable)				
Morocco	Ba1(Neg)	Ba1 (Stable)				
Total		4		-		3
Negative changes in Credit Rating Outlooks						
Egypt					B+ (Stable)	B+ (Neg)
Uganda	B2 (Stable)	B2 (Neg)	B (Stable)	B (Neg)		
Total		1		1		1

Source: APRM Primary Data Monitoring, 2022

The general trend of credit ratings in 2022 has been downwards, as African governments experienced more credit rating downgrades and negative changes in outlooks more than upgrades and positive outlooks. The number of downgrades has

been increasing since the 2022H1, arguably reflecting the impact of the Russia-Ukraine conflict on African economies, that have been facing challenges to recover from the devastating Covid-19 pandemic shocks.

Figure 1: Trend of credit rating actions in Africa 2020H1-2022H2



Source: APRM Primary Data Monitoring, 2022

3

CONTINENTAL KEY RATING DRIVERS

The following are the key drivers cited by the three international CRAs for the credit rating upgrades and positive changes in outlook witnessed in the 2022H2:

- a) The Republic of Congo was upgraded by Fitch on the expectation that the increase in government revenue from higher oil prices will significantly ease the government's financing needs in the 2022/23 year, and Seychelles because of generally stronger fiscal metrics.
- b) Fitch upgraded Mozambique and Tunisia and Moody's upgraded Democratic Republic of Congo (DRC) because of the easing financing constraints following the three-year US\$456 million Extended Credit Facility (ECF), the US\$1.9 billion Extended Fund Facility (EFF) and the US\$203 million ECF of the International Monetary Fund (IMF), respectively.
- c) Moody's positive outlook change in Angola reflected the robust economic growth prospects supported by significant revenue growth from elevated oil prices and in Tanzania, it was the decline in political risks under the government's new approach to promoting economic development and engagement with the international community.
- d) The settlement of all unpaid debt obligations by the Military Government of Mali led to the change in outlook from negative to stable by Moody's, which also upgraded Morocco's outlook following some recovery in its real GDP to pre-pandemic levels.
- e) Fitch revised Gabon and Lesotho's outlook positively due to the improvement in the country's fiscal trajectory driven by higher oil revenue anchored by an IMF programme and better-than-expected performance in public finances that have combined to ease financing pressures, respectively.

According to the 'big three' CRAs, the rating downgrades in 2022H2 were driven by the following risk factors:

- a) Ethiopia was downgraded by Fitch on the expectation that the country may not access external financing necessary to meet substantial external financing gaps as it faces a material decline in external liquidity.
- b) The weakening quality and effectiveness of the Bank of Mauritius's balance sheet and reduced monetary policy predictability were cited by Moody's in the downgrade of Mauritius credit rating, whilst Fitch attributes the persistent twin fiscal and external deficits, high debt and deteriorating external liquidity due to depleted foreign exchange reserves in its downgrade of Kenya.
- c) Ghana's rating was lowered initially because of its worsening external liquidity position, which pushed it into talks with the IMF on a record US\$3 billion funding package and to debt restructuring. Further downgrade to selective default (SD) was after the country announced that it would suspend coupon payment on its commercial foreign currency debt.
- d) The rating downgrades of Egypt and Nigeria by Moody's and Fitch were driven by the significant deterioration in government finances as well as external position, exerting increasing pressure on the sovereign credit profile, leaving the countries vulnerable to adverse global conditions.
- e) Moody's and S&P lowered Uganda's outlook to reflect the increasing external debt-service payments, depletion of the foreign exchange buffer and the increased external vulnerability risks.

4

AFRICAN SOVEREIGN DEBT MARKET

There was no activity on the Eurobond market in the 2022H2 as no African country tapped into the market. The appetite for Eurobonds has declined from US\$27 billion in 2020/21, issued by a total of 9 countries, to US\$6 billion in 2022. Only 3 countries – Angola, Nigeria and South Africa – issued Eurobonds in 2022H1. The sharp decline in Eurobond issuance is not by choice⁷, but rather, several African governments have been closed out of international financial markets. Interest rates have become too high that, even if governments consider the option of selling Eurobonds, it has become an unsustainable financing option.

Although Eurobonds have always been costly since their introduction in Africa, they remain attractive to governments because investors buy bonds without preconditions. Unlike multilateral

concessionary loans that are granted with policy adjustment conditionalities, governments have total discretion in how to use the proceeds from issuing bonds. Interest repayments have constantly been on the rise since the introduction of Eurobond borrowing on the continent, becoming the highest and the fastest growing expenditure portion in the fiscal budgets of Africa's Eurobond holders. On the other hand, the shrinking Eurobond market is also posing a significant risk to sovereign debt refinancing as governments are using their current low reserves to repay their debts, which could worsen Africa's sovereign ratings outlook in the fiscal year 2023/24.

Nigeria, Ghana, Zambia, Egypt and Kenya are now spending 86%⁸, 45%,

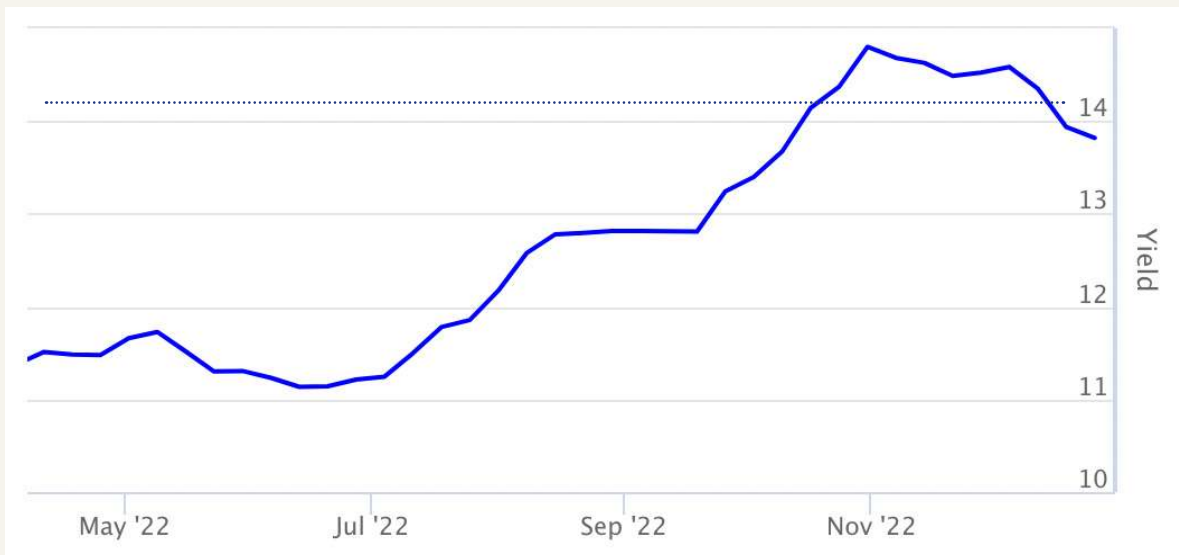
7 https://journals.co.za/doi/10.10520/ejc-defa_v7_n2_a2

8 <https://www.blueprint.ng/nigerias-eurobonds-servicing-rises-by-86-dmo/>

39%⁹, 33% and 24% of their revenue on servicing Eurobonds, respectively. This situation leaves very little to no resources for funding other fiscal obligations. A number of African countries suspended their plans to issue Eurobonds in 2022H2 due to unfavourable market conditions, as bond yields were too high compared to previous issuances of the same tenors. Global lenders and investors were generally shunning countries with speculative ratings due to perception of high risk, driving governments to consider alternative sources of funding.

For instance, Nigeria was unable to meet its external borrowing targets as investors '*despised its Eurobonds*'¹⁰. Yields on its 10-year government bond has been on an upward trend, rising from 4.048% in November 2020 to above 14% in October 2022 and closing the 2022H2 trading at 13.819%. This means that Nigeria's risk perceptions amongst Eurobond investors has substantially increased over the past 3 years.

Figure 2: Yield for Nigeria's 10-year government bond



Source: World Government Bonds

⁹ <https://data.worldbank.org/indicator/GC.XPN.INTP.RV.ZS>

¹⁰ <https://www.reuters.com/world/africa/nigeria-has-no-plans-issue-eurobonds-2023-finance-minister-2022-12-14/>

¹¹ <https://meetings.imf.org/en/2022/Annual/Schedule>

Despite the challenges in accessing international financial markets, as in the 2022H1, the Federal Government of Nigeria continue to explore borrowing opportunities on domestic markets. The dual listing of its Eurobonds worth \$1.25 billion at 8.375% on the Nigerian Exchange Limited and the FMDQ Securities Exchange Limited was another significant milestone for the government in the 2022H2. This reflects Nigeria's commitment to boosting its domestic capital market activities and creating opportunities for local players.

The other key highlight on the sovereign bond market in Africa was the proposal by the Government of Ghana to haircut its government bonds – a debt restructuring phenomenon of reducing the outstanding interest payments or a portion of a bond payable that will not be repaid. Ghana, which has been facing challenges in containing its rising debt and inflation, also suspended interest payments on its US\$13 billion Eurobonds, commercial loans and most bilateral obligations in 2022H2, pending an agreement with creditors external debt. This move

caught bondholders by surprise as Ghana engaged in restructuring talks aimed at unlocking a US\$3 billion IMF program. The ripple effect of these default warnings from Ghana generally sparked high yields on all African bonds as investors exercise extreme caution on all African countries that are seeking to continue borrowing through Eurobond issuances.

Box 1: Ghana haircut domestic bonds and Eurobonds

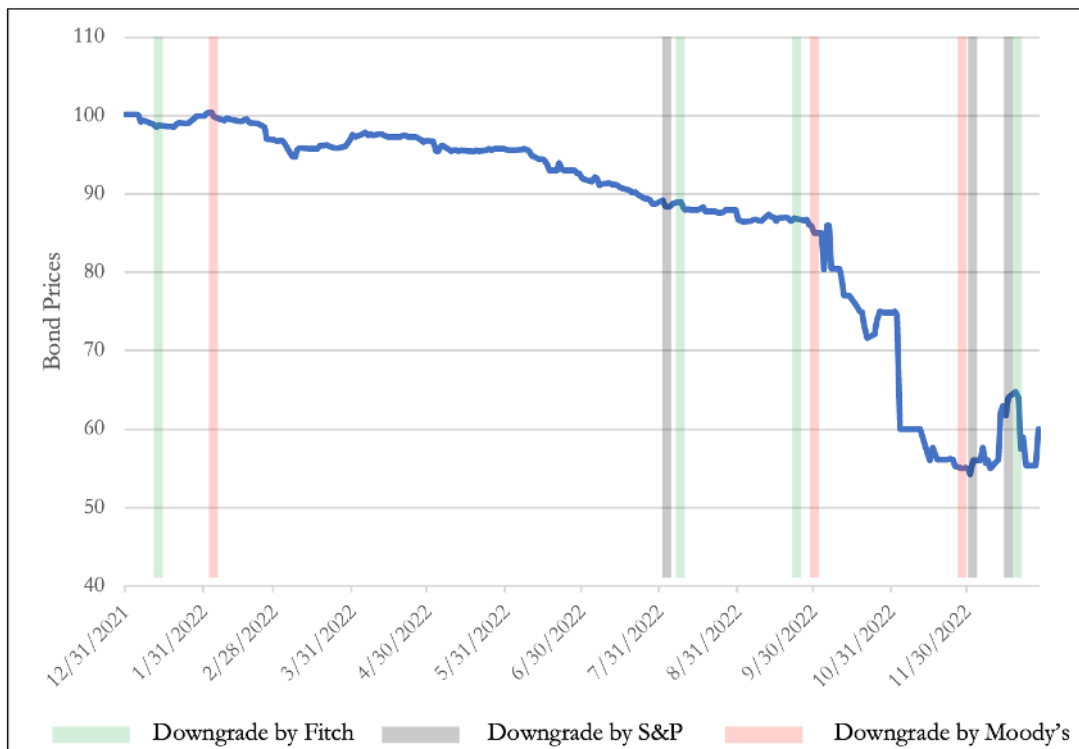
Ghana proposed bondholders to 'accept losses' of as much as 30% on the principal and forgo some interest payments as part of its debt sustainability plan to qualify for a US\$3 billion loan from the IMF. The government launched the domestic debt operations in December 2022 after making an announcement of suspending coupon payments on foreign bonds for three years and a formal invitation for investors to exchange local-currency debt, which CRAs deem to be the initiation of a default-like process. Domestic bondholders were invited to exchange their existing bonds for new bonds which pay significantly lower coupons; a zero coupon for 2023, 5% for 2024 and 10% for 2025 onwards, and effectively extending maturities for eligible outstanding local-currency domestic debt. This move was an interim measure to stabilize finances, although it leaves a dent on Ghana credibility with investors.

Source: Ministry of Finance, Ghana, December 2022.

The impact of these developments has been severe on the cost of the Ghana's bonds. For instance, the yield on the country's 15 -year sovereign bond,

which was issued at 7.786% in October 2015, spiked closer to 20% following the announcement of a moratorium of debt repayments.

Figure 3: Impact of credit ratings on price of Ghana's 10-year government bond



Source: Data from S&P Capital IQ Pro

Key factors that have contributed to African countries' losing access in the 2022H2, especially to international financial markets, are as follows:

i. The recent default warnings¹² ignited concern from investors

and other creditors about the sustainability of rising debt levels in many African countries, who still want to borrow more.

ii. Mismatch between the short-term duration of Eurobond

¹² <https://www.devex.com/news/african-countries-face-growing-risk-of-debt-defaults-afdb-warns-100212>

debt that African governments are taking to finance long-term projects – in some cases, loss-making – and refinance maturing Eurobonds.

- iii. Fungibility of Eurobonds proceeds – flexibility to be utilised for purposes other than the ones they are raised for, which is a concern to investors as it expose the funds to the downside vulnerabilities of misappropriation¹³ and non-productive expenditures.
- iv. Generally aggressive rating downgrades by international CRAs, with all African governments, except two – Botswana and Mauritius – now rated sub-investment grade or ‘junk’ status.
- v. Weakening exchange rate of domestic currencies against foreign currencies (US dollar and the Euro).

Although Eurobonds still appeal to African governments as an alternative financing source because they provide

an easy way of raising a decent scale of financing that governments are free to invest as they see fit, they have become unsustainable and African governments must consider discontinuing¹⁴ excessive Eurobond borrowing. The International Monetary Fund (IMF) has identified¹⁵ 17 out of the 21 African countries with outstanding Eurobonds as near or under debt distress. Countries that have been unable to borrow from international loans market due to high-interest rates, are thus being pushed into restructuring their debts, which is being supported by the World Bank¹⁶ and the IMF. This follows the fears that developing country debt could escalate to a crisis if governments are unable to access commercial loans to service loans as they fall due.

13 <https://www.standardmedia.co.ke/business/article/2001322533/eurobond-money-earned-but-no-project>

14 <https://theconversation.com/african-governments-have-developed-a-taste-for-eurobonds-why-its-dangerous-165469>

15 <https://economic-research.bnpparibas.com/Views/Display-Publication.aspx?type=document&IdPdf=41794>

16 <https://openknowledge.worldbank.org/bitstream/handle/10986/38092/EnglishReport.pdf?sequence=9&isAllowed=y>

5 CHALLENGES IN RATING SERVICES

The decline of creditworthiness in the 2022H2 suggests that there are a number of ways in which international CRAs are contributing to these worsening outcomes. There is an ethical obligation and economic logic in ensuring that due attention is paid to these challenges, as this could see an improvement in the credit ratings of African countries. Some of these challenges include the following.

Selective classification of default events: Despite being challenged from various quarters regarding the guarantee that the Group of 20 (G20)'s Common Framework (CF) for debt treatment beyond the Debt Service Suspension Initiative (DSSI) will not lead to investor losses nor a sovereign default event on debt owed to private creditors, CRAs¹⁷ continue to undertake rating actions based on the speculation of risk of a default event that may result from the government's participation in the G20

¹⁷ <https://www.fitchratings.com/research/sovereigns/fitch-downgrades-ethiopia-to-ccc-removes-from-uco-20-12-2022>

CF debt relief initiative. CRAs continue to disregard the mechanism's guiding principle of comparable treatment for both official and private creditors. African countries participating in the CF debt relief or restructuring are still being downgraded, which impede efforts by governments to strengthen post Covid-19 fiscal metrics. On the contrary, in Europe, CRAs assigned credit rating upgrades¹⁸ and stable outlook on the basis of creditors agreeing to back requests for freezing of payments on international bonds. These conspicuous inconsistencies and subjectivity also call into question the independence and credibility of international CRAs. It is also important to highlight that similar political economy considerations have never been accorded to African countries.

¹⁸ <https://www.fitchratings.com/research/sovereigns/fitch-upgrades-ukraine-to-cc-17-08-2022>

Persistent challenges in managing

conflict of interest: S&P agreed to pay US\$2.5 million in penalty¹⁹ to the United States of America (USA)'s Securities and Exchange Commission after violating conflict of interest rules designed to prevent sales and marketing considerations from influencing credit ratings. The charges include S&P commercial employees, who were responsible for managing the relationship with issuers, on several occasions, attempted to pressure their analysts to rate transactions consistent with preliminary feedback the analytical employees had given the customer, which turned out to include a calculation error. This admission of guilt proves that CRAs' internal control systems are still having material weaknesses, especially in the case of complex structured operations. It is prudent to conclude that, in Africa, where checks and balances are largely unavailable, these misconducts are unaccounted for and unpunished. With the exception of South Africa, no other African country has managed to penalise international CRAs.

¹⁹ <https://www.sec.gov/news/press-release/2022-205>

Delay and limited comments on credit positive events:

It has consistently been observed that rating analysts take comparatively longer periods to comment on significant positive macroeconomic developments than they do for negative ones. In many cases, they do not comment at all. Given the public imprimatur that CRAs have, the delay or failure to comment on positive events prejudice governments the upside market benefits that accrues from financial market gains and investor confidence.

CRAs' analysts have earned a reputation for making quick, premature and speculative comments on negative macroeconomic developments, which usually dampens the mood on financial markets. For example, all the 'big three' published their comments speculating policy and political uncertainty after Kenya's election results were contested. However, when the Supreme Court concluded the case and upheld the initial presidential results, the CRAs did not publicly announce a change on their

initial views on the country's policy and political uncertainty. Another example is the S&P analyst²⁰ who speculated on Egypt's food crisis by November 2022 but did not make an immediate public acknowledgement, as credit positive, when the Emergency Food Security and Resilience Support Project was adopted, nor when the US\$3 billion IMF Extended Fund Facility Arrangement (EFF) was approved for Egypt. The bias toward negative opinions continues to be a norm.

Exemption of some CRAs from legislation: There are some inconsistencies in the legislation of CRAs across the continent, which creates an unfair advantage for some agencies and challenges for regulatory authorities to effectively enforce legislation. The following are a few examples. First, the Securities Exchange Commission of Zambia, the Capital Markets Authority of Kenya and the Securities Exchange Commission of Ghana, are amongst regulators that only enforce registration, licensing and supervision on local CRAs, exempting international CRAs. Second, the Financial Sector Conduct Authority of

South Africa exempted²¹ Fitch Ratings Limited from section 3(2) and certain regulated persons from section 4(1) of the Credit Rating Services Act (2012). This has been ongoing since 2015²² when the Fitch Group's subsidiary, Fitch Southern Africa, expressly renounced²³ its license to operate in South Africa. This treatment of CRAs is different from that accorded by the United States and the European Union.

Selectively adopting the 'wait & see approach' before rating actions:

Africa has witnessed an avalanche of premature downgrades, usually more than what would be justified by the countries' economic fundamentals. For instance, within two months of Covid-19 outbreak on the continent, 10 African countries were downgraded based on 'expectations' that their fiscal situations would deteriorate, and their health systems would be severely strained by the pandemic. On the contrary, the 'big three' CRAs adopted a 'wait and see' approach

21 <https://www.fsca.co.za/Notices/FSCA%20CRA%20Notice%201%20of%202022.pdf#search=fitch>

22 <https://www.fsca.co.za/Notices/Fitch%20Sovereign%20Rating%20Exemption%20Notice%204%20Nov%202015.pdf>

23 <https://www.fsca.co.za/Regulated%20Entities/Regulated%20Entities%20Documents/Notice%201%20of%202015.pdf>

20 <https://www.youtube.com/watch?v=KuqIUhtM49M>

to the European crises' periods, even when they commit to incredibly large amounts of public expenditure. During the 2022H2, CRAs only threatened to downgrade and changed the outlook of the United Kingdom (UK) despite the serious energy deficit in Europe, political leadership failures²⁴, labour unrests, policy blunders²⁵, declined Pound Sterling, 100% debt-to-GDP ratio and other significant impact of the Russia-Ukraine conflict. A similar situation in a middle- or low-income country would not have led to the same outcome. These inconsistencies create unwarranted perceptions of reduced exposure to risk for the Western countries and increased exposure to risk for African countries.

Material weaknesses in the Environmental, Social and Governance (ESG) rating criteria: In addition to the perceived subjectivity in the ESG criteria, which has exposed governments to analysts' pessimism due to the inconsistencies on what constitutes good ESG performance and differences in interpretations of available

24 <https://www.cnbc.com/2022/10/20/uk-prime-minister-liz-truss-resigns-after-failed-budget-and-market-turmoil.html>

25 <https://www.imf.org/en/Blogs/Articles/2022/10/23/europe-must-address-a-toxic-mix-of-high-inflation-and-flagging-growth>

information, lack of transparency and insufficient disclosure is prejudicing issuers. Empirical review²⁶ found that information provided by CRAs on ESG does not allow users 'to draw a definite conclusion on what would have been the credit rating in absence of climate change risk' and the magnitude of the impacts of these risks are not disclosed.

Issuing unsolicited ratings: The challenges posed by unsolicited credit ratings – issued without a request or agreement with the rated sovereign or entity for which the CRA does not receive compensation – have not been afforded due attention. The issuance of unsolicited ratings has material negative downside impact. First, unsolicited ratings are usually neither participatory nor consultative with government representatives during the review process, which means that CRAs do not gain an adequate understanding of the sovereign risk exposures and the government's strategy in addressing the downside risk factors.

26 <https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op303%7Eeaa6fe6583.en.pdf?26d23c18fd6af8516a0d-3b1c86384422>

Second, the lack of an agreement with government opens a door for CRAs to use unfavourable ratings as a credible ‘threat’, forcing countries into contracts. Third, because there is no any written protocol or guideline on how unsolicited ratings should be conducted, evidence from prior cases indicate that they are likely to result in low ratings. Lastly, because of the lack of compensation, agencies that issue unsolicited rating may invest the least resources – analysts, stakeholder consultations and time – which compromises the quality of the rating outcome. However, given the influence that CRAs have on the international financial markets, African governments face pressure from these unsolicited rating, which may unduly influence their decisions to contract CRAs.

Misrepresentation of solicitation status of ratings: Despite the challenges posed by unsolicited ratings, CRAs continue to issue them and misrepresent in their reports the solicitation status. For instance, Fitch and S&P did not have contractual agreement in 2021 and 2022 to rate the Government of Kenya after their contracts expired. However, the

CRAs²⁷²⁸ continued to issue ratings with either ‘solicited’ status or not disclosing the solicitation status. Moody’s also issues the rating of Mauritius²⁹ as ‘solicited’ although it has no contract with the government. These instances arguably constitute malpractice and may be considered unethical owing to the gross lack of integrity and accountability.

Weak government coordinating mechanisms: Interactions with AU member states show that only a few member states have well-established country liaison teams, that stands ready to engage with CRAs. In most countries, they have adhoc teams or a person, who is usually unavailable to respond to enquiries from CRAs in a timely manner. It has also been noted that, at different times, several countries do not fully participate in periodic credit rating reviews, whilst others do not respond to information requests from both CRAs and investors on material macroeconomic events.

27 <https://www.fitchratings.com/research/sovereigns/fitch-downgrades-kenya-to-b-outlook-stable-14-12-2022>

28 <https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/type/HTML/id/2885328>

29 https://www.moody.com/research/Moodys-downgrades-Mauritiuss-rating-to-Baa3-changes-outlook-to-stable--PR_467667

6

DOMESTIC CREDIT RATINGS MARKET

The newly licensed Sovereign Africa Ratings (SAR), a South African registered CRA, launched its inaugural credit rating for South Africa in the 2022H2, providing an alternative opinion to the 'big three' CRAs for investors. SAR describes its methodology of rating as unique in that it emphasises additional metrics above the traditional risk factors used by other CRAs. Its methodology incorporates the distinctive structural framework of a country and its natural resource endowment. SAR thus assigned its first rating to South Africa, of investment grade BBB (with a stable outlook).

Scope ratings, an emerging European CRA also published its first sovereign credit rating in Africa as part of expanding its sovereign rating portfolio

to Africa. It assigned South Africa a BB+ rating (with a stable outlook). Scope's methodology incorporates the potential demographic dividend, rich ecological and biodiversity resources and the long-run environmental and economic sustainability in African countries. These emerging CRAs are considering expanding their credit rating portfolios to rate other African sovereigns, sub-sovereigns and corporates.

The entrance of new CRAs in Africa is a welcome development as it does not only provide alternative credit rating opinions for investors but, more importantly, accelerate the growth of the domestic credit ratings space, which is critical in supporting debt sustainability. It is envisaged that emerging CRAs will begin to address

the credibility and capacity challenges and play a leading role in facilitating borrowing in domestic currencies. Rating of domestic instruments is aligned with Africa's long-term strategy for promoting access to affordable capital and promoting the development of domestic financial markets. Domestic borrowings, which has limited exposures to exchange rate risk, is also in line with the African Union and United Nations Economic Commission for Africa's 'innovative financing' initiative that is supporting governments to mobilise domestic resources through domestic financial markets. Given the track record of domestic CRAs in assigning ratings for domestic issuances, a number of emerging CRAs have a distinctive advantage of having an African-oriented rating scale, a unique understanding of the domestic context of Africa and issuing more informative and detailed ratings.

Box 2: Agosto & Co. is the first African CRA licensed as Green Bond Verifier

Agusto & Co., an African CRA, headquartered in Nigeria, with offices in Kenya and Rwanda, was approved by the Climate Bonds Standard Board in February 2022 to become the foremost company of African origin to be an Approved Verifier of green bonds, projects and assets in Africa. It is one of only three companies – the other two are IBIS ESG Consulting and Rubicola Consulting – exclusively focusing on Africa as their core region of operations. As an Approved Verifier, Agosto & Co. will support African governments and corporates to unlock access to green financing both locally and internationally, which has become a centre of development that promote sustainable and best environment-friendly practices. The emergence of the green bond market in Africa provides opportunities for funding the rapid and far-reaching transitions into the vital environmental friendly investment.

Source: Agosto & Co.

A vibrant credit rating framework and universally credible practice in Africa would ultimately reflect risk profiles and make Africa competitive in the international debt markets. Collaborating with emerging CRAs will harness opportunities for African sovereigns and businesses to access the Green Bond markets to raise capital.

Regarding regulatory improvements, the Capital Markets Authority of Kenya has reviewed the country's regulation on CRAs, coming up with the new Capital Markets (Credit Rating Agencies) Guidelines & Regulations (2022) pursuant to Section 12(1) (h) of the Capital Markets Act, Cap 485A of the Laws of Kenya. The new regulations aim to enhance best practices on the conduct of sovereign or company ratings in Kenya. The draft regulation, subject to stakeholder comments, is

set to replace current guidelines on the approval and registration of CRAs, issued in November 2001. The draft regulations detail the new procedure for licensing and recognition of CRAs, the rating process and increased level of oversight of CRAs by the Regulator. The new draft guidelines issued for public comments in the 2022H2, will now include all foreign CRAs, which were previously exempted³⁰, to apply for a certificate of recognition before issuing credit ratings in Kenya. These guidelines may also bring to an end unsolicited ratings by global CRAs, which are now required to seek regulatory approvals before rating the sovereign or companies' debt portfolios.

.....
30 <https://www.aprm-au.org/publications/technical-support-mission-on-international-credit-ratings-republic-of-kenya/>

7

RECOMMENDATIONS

A number of African countries abandoned their plans to issue Eurobonds in 2022H2 due to unfavourable market conditions as bond yields became too high. The unsustainable debt burden being posed by the existing debt is sufficient proof that the future of Africa's finance is not in Eurobonds. The following recommendations are made to governments;

i. Diversify from Eurobonds:

The recent default warnings are a clear sign that, if uncurbed, Africa is inevitably heading towards a Eurobond debt trap. If governments cannot exercise financial discipline, increase their capacity to collect revenue, commit to reducing government deficits and debt accumulation, they should be encouraged to instead seek financial support through concessionary loans from the

World Bank, Islamic Development Bank, African Development Bank and others traditional multilateral institutions. Past evidence shows that, despite weaknesses in their policy conditionalities, funding from the multilateral institutions may be a cheaper option in helping developing economies to stabilise and provides some checks and balances³¹.

ii. Improve efficiency and mobilise domestic resources:

Instead of borrowing more, governments must focus on improving efficiency in State-Owned Enterprises (SOEs), expanding Public-Private Partnership (PPPs), mobilising greater domestic resources through effective tax administration and broadening the tax base. Increasing efficiency and tax revenues will

³¹ <https://www.theeastafrican.co.ke/tea/business/world-bank-backs-new-push-for-debt-restructuring-3973784>

reduce budget deficits and public debt in the medium-term. Issuing more debt without implementing structural reforms will only worsen fiscal challenges. In addition, African governments need to refocus their funding source to domestic capital markets, where they can borrow through local currency denominated debt instruments. This will instill investor confidence in on domestic debt markets and support their development as they automatically become more active and liquid. In addition, governments should revive National Development Banks for more efficiency in funding long-term projects for sustainable development and develop enabling frameworks and policies to crowd in more private finance.

iii. Solicit sovereign ratings from emerging CRAs: As part of the medium to long-term solution to the dominance of the 'big three' CRAs, governments are encouraged to solicit sovereign credit ratings from the emerging CRAs, especially

member states that do not have any existing sovereign ratings. In addition, governments may also leverage on the emerging CRAs such as Augusto & Co. which is licensed by the Climate Bonds Initiative (CBI) as a Green Bond Verifier in Africa, to tap into green financing, which has become the focus for development financing.

iv. Strengthen country coordinating mechanisms: It is important for every country with a credit rating to maintain a credit rating liaison team of experts to lead the engagements with CRAs. The team is also critical in coordinating other stakeholders who should engage with CRAs for coherence on government policy position. It is the liaison team that should solicit relevant information from the government ministries, departments, and agencies for purposes of ensuring that proceedings and outcomes of the credit rating review are based on accurate, credible and legitimate records.

v. Implement review recommendations: In credit rating review reports, CRAs outline factors that could lead to positive (upgrades) or negative (downgrade) rating actions. It is therefore critical for governments to pay attention and make a substantive public investment in addressing these risk factors. In developing their national strategy to engage CRAs in the periodic review, the credit liaison team should convince CRAs on the satisfactory implementation of recommendations in previous review. This will significantly increase the chances for future positive sovereign ratings.

vi. Expedite establishment of regulatory authorities and enhancement of legislations of CRAs: Governments should develop legislation governing the operation of CRAs³² and establish regulatory authorities to facilitate licensing and supervision of all CRAs operating within their respective jurisdictions to ensure

proper conduct of business and enforcement. Regulators should also revise and/or issue new guidelines on CRAs to enhance and strengthen their role, as well as ensuring independence and objectivity of the CRAs in providing credible credit rating opinions.

vii. National regulators to participate in continental initiatives: the APRM and UNECA are coordinating an African Network of National Regulators of CRAs whose main objective is to explore ways of enhancing and harmonising cross-border regulation of CRAs. National regulators are encouraged to participate in this Network which will serve as a key catalyst in addressing some of the challenges related to the inadequacy of legislation and mechanism guiding dealings with CRAs at country level. It is clear that comprehensive legislation is key in regulating, amongst other things, the independence, objectivity, integrity and quality of ratings issued by CRAs and the rating process as a whole.

³² <https://www.uneca.org/stories/eca-and-aprm-support-african-countries-on-sovereign-credit-ratings-and-rating-regulations>

To CRAs, the following recommendations are made;

i. Maintain consistency, objectivity and independence in credit opinions:

The concerns and general discontent of African governments are founded on credible scientific basis and should therefore be taken seriously. Hence, they require better engagement with the rating agencies.

ii. Manage conflict of interest:

Instances of violating conflict of interest continue to resurface more than a decade after the mortgage crisis, and when they do, these misconducts are adding to other warning signs to both issuers and investors not to rely solely on CRAs as a source of credible information.

iii. Timely analysts' comments on credit positive events:

CRAs should establish a credible time standard for comments and apply the standard consistently for both negative and positive events. As enablers, rather than impediment,

for safe investments and access to capital, analysts should exert the same effort commenting on significant macroeconomic developments, as they do on speculative negative events. Also, analysts should minimise media commentaries that are not related to published credit opinions, as they only drive 'market noise'.

iv. Compliance with legislation:

The avoidance of compliance with legislation is an ethical issue commonly associated with lack of integrity. It is therefore important for CRAs to earn the trust of Africa issuers by complying fully with legislation that exist.

v. Strengthen the ESG rating criteria:

As the global financing and investment focus more on the environment, it is critical for CRAs to address the inconsistencies and subjectivity in the ESG criteria. Transparency and sufficient disclosure will enhance the

acceptance of ESG ratings by financial markets and issuers.

vi. Develop a protocol for unsolicited ratings: Unsolicited credit ratings have proven to be prejudicial to issuers. It is therefore in the best interest of both governments and CRAs to develop a protocol for issuing unsolicited rating that addresses the issues pertaining.

vii. Present accurate solicitation status of credit ratings: CRAs have responsibility to transparently and accountably present to investors the correct solicitation status of their credit rating opinion, especial when there is a change in their contractual status with sovereign issuers. Non-disclosure of these changes constitute gross misrepresentation, and regulators should explore legislative avenues to address this challenge.

African Peer Review Mechanism (APRM)
www.aprm.au.int



African Peer Review Mechanism (APRM)
230 15th Road, Randjespark
Midrand, South Africa
Tel: +27 (0) 11 256 3401



www.aprm-au.org