

Country Credit Rating Review



Sovereign Credit Rating History for the People's Republic of China

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Background

The People's Republic of China: Selective Default

The Chinese Communist Party (CCP) is the present government of the People's Republic of China (PRC). The CCP has repudiated an estimated \$750 billion - \$1 trillion of [China's unpaid full faith and credit international sovereign debt](#) (the Debt) held by creditors in numerous countries including the United States. A portion of the Debt is held by the U.S. government which acquired it through the use of U.S. taxpayer monies.

The successor government doctrine of settled international law affirms the continuity of obligations among successive internationally recognized governments. The PRC inherited the repayment obligation for the Debt on October 25, 1971, the date upon which the PRC became the internationally recognized government of all China by majority vote of the United Nations General Assembly.¹

In defiance of international law, the CCP maintains a selective default posture regarding the Debt and continues to make exclusionary and non-proportional payments to other equally-ranked creditors while refusing to honor repayment of the Debt held by foreign creditors.² The prevailing sovereign credit ratings published and distributed for China exclude the actions of the Chinese government in regard to the country's defaulted national debt.

¹ United Nations General Assembly Resolution 2758.

² The PRC negotiated a discriminatory settlement with Great Britain in 1987 which settled the claims of U.K. residents only, and which excluded all other creditors. See the U.K.-China Claims Settlement Treaty (1987) and the U.K. Foreign Compensation (People's Republic of China) Order 1987.

Credit Rating Agencies and the Issuer Pay Revenue Model

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Public Law 111-203) created a regulatory regime over certain entities granted designation as Nationally Recognized Statistical Rating Organizations (NRSROs), including prohibitions on abuse of the “issuer pay” revenue model.

The three primary NRSROs are Standard & Poor’s Ratings Services, Moody’s Investors Service and Fitch Ratings, which collectively constitute an industry oligopoly whose ratings have the force and effect of law.

Credit Rating Agencies and the Sovereign Ceiling Convention

Under the “sovereign ceiling” convention, a country’s sovereign credit rating acts to effectively constrain the ratings which may be issued for domestic entities domiciled within each country, thus domestic corporations may generally not receive credit ratings which are higher than the country’s prevailing sovereign rating. Since a credit rating is deterministic of the cost of capital to the issuer, a sovereign ceiling which constrains the ability of domestic issuers to access the international credit markets would adversely affect the NRSROs’ ability to earn revenue by restricting the number of entities willing to pay for a rating. The three primary NRSROs all utilize the “issuer pay” revenue model and are thus incentivized to publish and distribute an artificial sovereign credit rating for the People’s Republic of China in order to earn increased revenue from rating domestic Chinese corporations. Moody’s Investors Service has even sponsored a [conference](#) encouraging domestic Chinese corporations to exploit the artificial sovereign credit rating which Moody’s publishes and distributes for China. Acting upon a profit motive, the three primary NRSROs continue to collectively maintain artificial sovereign credit ratings for the People’s Republic of China, which artificial ratings exclude the actions of the CCP in regard to its continuing posture of selective default and the making of discriminatory payments to selected creditors while simultaneously excluding payments to holders of the Debt.

Threats to the People's Republic of China Sovereign Credit Rating

Both Houses of the United States Congress have introduced resolutions (e.g., [Senate Concurrent Resolution 78](#) and [House Resolution 1179](#)) censuring the CCP for its actions in regard to evasion of repayment of the Debt as well as the three primary NRSROs for publishing and distributing demonstrably false sovereign credit ratings for China. The chairman of the Joint Economic Committee of the U.S. Congress has requested the United States Securities and Exchange Commission to open an [investigation](#) into the practices of the credit rating agencies in regard to their publication of a false sovereign credit rating for China, and various regulatory agency complaints have been filed referencing the matter (e.g., [U.S. Department of Justice Antitrust Complaint](#)), and private civil litigation has been developed referencing the matter as well.

Potential Liability of Capital Markets Gatekeepers

Although the CCP denied at the time that China was seeking to obtain a sovereign credit rating with which to reenter the international financial markets after the CCP repudiated the Debt, [Morgan Stanley](#) reportedly acted as the initial credit rating adviser to the PRC. It has recently been revealed in an unrelated court case that Morgan Stanley has engaged in [practices](#) intended to induce the NRSROs to assign artificially high credit ratings to various debt products.

The law firm of Skadden Arps Slate Meagher & Flom acted as underwriters' counsel in 1994, assisting the CCP in penetrating U.S. capital markets with the offer and sale of the first PRC sovereign bond issue offered and sold in the U.S. and deliberately withholding disclosure of the refusal of the CCP to honor repayment of the Debt.

[Goldman Sachs](#) subsequently acted as the credit rating adviser to the PRC in order to facilitate the offer and sale of the PRC's sovereign bonds in the U.S. capital markets again in 2003, deliberately withholding disclosure of the refusal of the CCP to honor repayment of the Debt.

It is uncertain at present how the recently enacted Dodd-Frank legislation will affect the actions of the credit rating advisers to the PRC and the three primary NRSROs in regard to the continued publication and distribution of China's artificial sovereign credit rating.

History of Rating Actions by the Three Primary NRSROs

Sovereign Rating Actions by Standard & Poor's Ratings Services

Assigned China's second rating and seven subsequent upgrades:

- Assigned "Satisfactory" rating classification (July 1988)
- Upgraded from "Satisfactory" to "BBB" (February 1992)
- Upgraded from "BBB" to "BBB+" (May 1997)
- Reclassified from "BBB+" to "BBB" (July 1999)
- Upgraded from "BBB" (affirmed in 2001) to "BBB+" (February 2004)
- Upgraded from "BBB+" to "A-" (July 2005)
- Upgraded from "A-" to "A" (July 2006)
- Upgraded from "A" to "A+" (July 2008)
- Upgraded from "A+" to "AA-" (December 2010)

Standard & Poor's has maintained an "investment grade" rating for China since 1992, which S&P defines as an issuer not having any defaulted and unpaid full faith and credit sovereign debt outstanding. S&P affirmed China's "investment grade" credit rating the very next day (October 22, 2003) following the Congressional hearing on the defaulted claims represented by the American Bondholders Foundation, in order to strengthen the sale of China's sovereign bonds and notes offered and sold in the U.S. the same month (October 2003).

Compare the published definition of China's prevailing artificial investment grade rating with the definition of the truthful rating of "selective default":

http://globalsecuritieswatch.org/Sovereign_Ratings_Definitions_and_Criteria

Sovereign Rating Actions by Moody's Investors Service

Assigned China's first rating and four subsequent upgrades:

- Assigned "A3" rating classification (May 1988)
- Reclassified from "A3" to "Baa1" (November 1989)
- Upgraded from "Baa1" to "A3" (September 1993)
- Upgraded from "A3" to "A2" (October 2003)
- Upgraded from "A2" to "A1" (July 2007)
- Upgraded from "A1" to "Aa3" (November 2010)

Moody's has maintained an "investment grade" rating for China since 1988.

Sovereign Rating Actions by Fitch Ratings

Assigned China's third rating and two subsequent upgrades:

- Assigned "A-" (December 1997)
- Upgraded from "A-" to "A" (September 2006)
- Upgraded from "A" to "A+" (November 2008)

Fitch has maintained an "investment grade" rating for China since 1997.