Abstract

Credit Rating Agencies' Armageddon
-a tale of unregulated beasts

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The use of credit ratings arose in the early 1900s in the U.S. when investors sought assurance about the security of railroad bonds. Credit ratings have evolved and expanded to become the norm where public monies are being sought. In 1975, the SEC recognized Moody's, Standard & Poor's, and Fitch, the three major rating agencies in existence at that time, as the first nationally recognized statistical rating organizations(NRSRO).

Before 1970, investors subscribed to publications from each of the rating agencies but issuers paid no fees for performance of research and analyses that was made by the credit rating agency. Circa 1970 credit rating agencies began to recognize their value to issuers in terms of facilitating market and capital access by increasing the value of their securities in the market place, and thereby decreasing the costs of obtaining capital. Expansion and complexity in capital markets led the credit rating industry to charge issuers of securities fees for rating services. Issuers keen on full subscription began to actively seek ratings and were prepared to pay for them. In recent times issuers have been known to shop around the CRAs and search for the best rating for their securities in order to attract more investors. This arrangement has been cited as one of the primary causes of mortgage backed securities crisis, domestically and internationally.

This paper attempts to explore the conflicts of interest among securities issuers, investors, and regulatory bodies. As it is evident, the credit rating agencies can no longer always be impartial when issuing ratings for those security issuers when they charge fees for their rating services. In other words, it seems that the rating agencies are primarily serving the interest of parties other than investors.