

The role of rating agencies in international financial market

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Abstract. *In the context of financial markets globalization, the role of rating agencies and credit ratings expanded sharply. Standard & Poor's awarded in the late 70's ratings only for 12 countries and currently it assigned ratings for 129 countries. Global rating agencies Standard & Poor's, Moody's and Fitch publish long term sovereign ratings and short term sovereign ratings. The role of sovereign ratings is the decrease of informational asymmetry between borrowers (countries) – acting as issuers and lenders – acting as investors. In this paper I will analyse sovereign rating definition and I will explain the importance of rating agencies.*

Keywords: sovereign rating, rating agency, financial market, informational asymmetry, globalization.

JEL Classification: G15.

1. Introduction

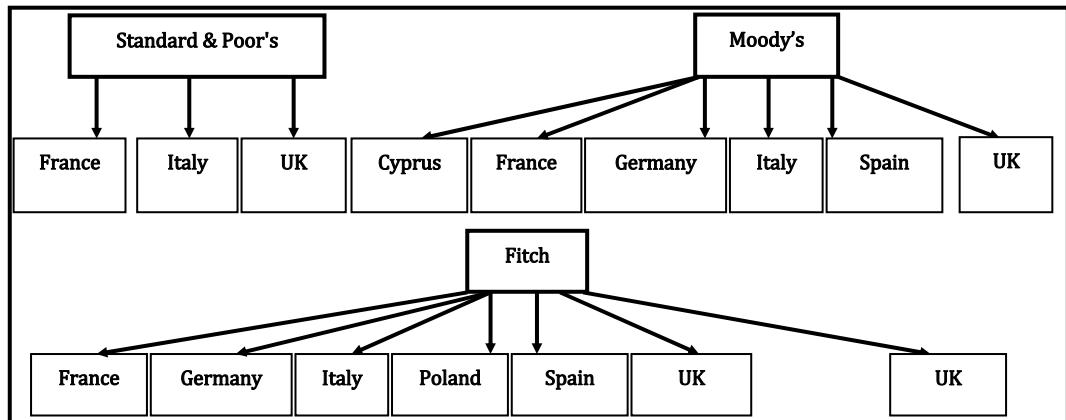
Although certain decisions of rating agencies have been challenged by some public policy makers, especially during the sovereign debt crisis, I consider that especially in the last four decades, the importance of the credit rating activity increased. One reason for this statement is that many countries received ratings for the first time after 2007, and countries that also had ratings in prior periods still receive ratings. This study focuses on sovereign ratings provided by global rating agency Standard & Poor's and it is divided into four chapters, as it follows: the second chapter analyzes international ratings market, the third chapter studies developments on sovereign rating activity, and the fourth chapter formulates conclusions of this study.

2. Credit ratings market

According to (Adelson, 2012: p. 1), the main role of credit ratings is, to help close the information gap between lenders and borrowers by providing independent opinions of creditworthiness. (Lăzărescu, 2003: p. 30) considers that rating agencies contribute to the standardization of value judgment with respect to borrowers in the current context of globalization.

(Bayar, 2014: p. 56) state that although the new regulations has increased the number of credit rating agencies (the number accepted by the US is 10 and by the EU is 37), the share of Standard & Poor's, Moody's and Fitch in the credit rating market has still been about 94%. (Miricescu, 2011: p. 28) explained that during 2007-2008, seven new rating agencies were recognized in the US: (i) A.M. Best Company, Inc.; (ii) DBRS Ltd.; (iii) Egan-Jones Rating Company; (iv) Japan Credit Rating Agency, Ltd.; (v) LACE Financial Corp.; (vi) Rating and Investment Information, Inc. and (vii) Realpoint LLC., and global rating agencies reconfirmed this status.

Currently, according to European Securities and Markets Authority there are registered or certified in the EU 39 rating agencies, whose countries of residence are: (i) Germany for eight agencies, (ii) the UK for seven agencies; (iii) Italy for six agencies; (iv) France for four agencies, (v) Spain for three agencies, (vi) Cyprus for two agencies, (vii) Poland for two agencies, (viii) Bulgaria for one agency, (ix) Greece for one agency, (x) Portugal for one agency, (xi) Slovakia for one agency, (xii) Japan for one agency, (xiii) Mexico for one agency and (xiv) the US for one agency.

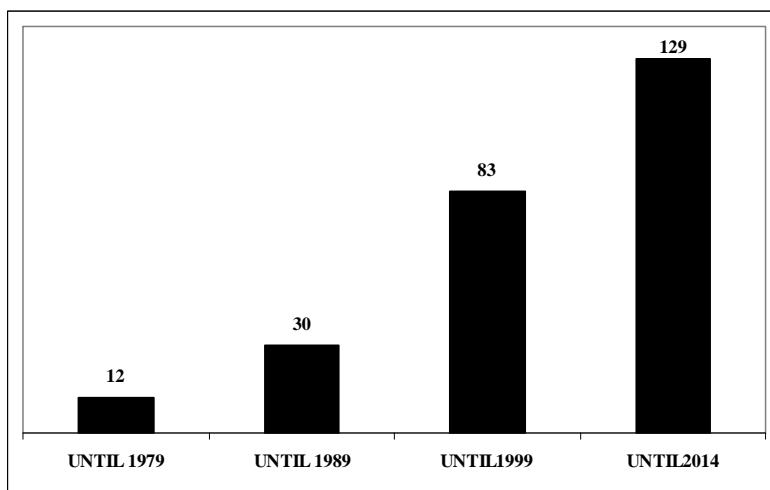
Figure 1. Global credit rating agencies in the EU

Source: Our results based on information provided by the European Securities and Markets Authority.

According to figure 1, global credit rating agencies have 16 of 39 rating agencies registered or certified de by the European Securities and Markets Authority

3. Developments regarding sovereign rating activity

I consider that (Afonso et al., 2011: p. 8) stated an appropriate definition for the rating – an assessment of the issuer’s ability to pay back in the future both capital and interests. The authors considered that the three main rating agencies use similar rating scales, with the best quality issuers receiving a triple-A notation.

Figure 2. Total number of countries receiving rating from Standard & Poor's

Source: Our results based on information provided by Standard & Poor's.

According to figure 2, Standard & Poor's issued ratings: (i) since 1975 until 1979 to 12 countries, (ii) since 1980 until 1989 to 30 countries, (iii) since 1990 until 1999 to 83 countries, and (iv) currently to 129 countries.

I notice the rapid increase in the number of states being rated. If the late 70's sovereign ratings were related only to developed countries: Australia, Austria, Canada, France, Finland, Japan, the UK, Norway, New Zealand, the US, Sweden and Venezuela, currently most of the countries receive sovereign rating.

(Lăzărescu, 2000: p. 23) found that the rating: (i) divide low risk (investment) securities from speculative securities and (ii) marks a correlation between short term rating scale and long term rating scale.

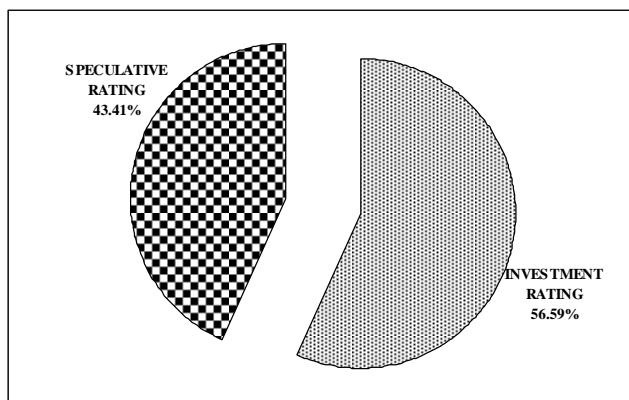
Table 1. Dividing securities according to STANDARD & POOR'S

	Long term rating scale	Short term rating scale
Investment securities	Rating >= BBB-	Rating >= A-3
Speculative securities	Rating <= BB+	Rating <= B

Source: Our results based on information provided by Standard & Poor's.

In this respect, Standard & Poor's considers investment securities, if: (i) the rating is equal or superior than BBB- for long term scale and (ii) rating is equal or superior than A-3 for short term scale; or speculative securities, if: (i) rating is equal or inferior than BB+ for long term scale and (ii) rating is equal or inferior than B for short term scale.

Figure 3. Sovereign rating denominated in foreign currency



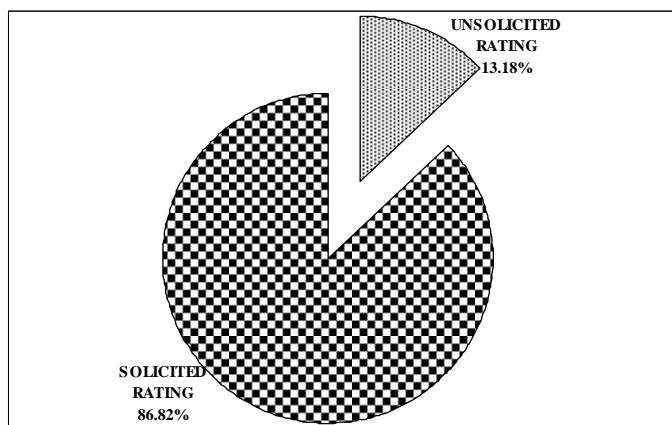
Source: Our results based on information provided by Standard & Poor's.

As the number of rated countries increased, sovereign ratings decreased and diversified. Thus, in the 70's all countries received maximum rating (AAA), and in 2014 the countries received: (i) investment rating – 56.59% and (ii) speculative rating – 43.41%. I consider that the change of ratings is mainly due to the fact that, in the current period the rating agencies assess both developed countries and also developing countries.

Generally, the costs for assessment and awarding sovereign ratings are sustained by the countries issuing securities in the financial market, through the fees paid to rating agencies. For unsolicited ratings these costs are sustained by credit rating agencies.

(Standard & Poor's, 2012: p. 37) stated that unsolicited ratings are assigned at the initiative of Standard & Poor's and not at the request of the issuer or its agents.

Figure 4. Sovereign rating (solicited/unsolicited)



Source: Our results based on information provided by Standard & Poor's.

In 2014, from the total number of countries receiving rating from Standard & Poor's: (i) 86.82% were solicited by the issuer, and (ii) 13.18% were unsolicited by the issuer. Generally, unsolicited sovereign ratings belong to developed countries, for which there is a strong demand of securities in the financial market.

4. Conclusions

In the current period the number of rating agencies is large, but the global rating agencies Standard & Poor's, Moody's and Fitch have the vast majority of the specialized world market. As the number of officially recognized rating agencies increase, it creates the potential for amplifying competition in the field.

Rating agencies assess both developed countries and developing countries; and consequently sovereign ratings decreased. A large part of developed countries do not require rating, but these countries use for free sovereign ratings.

Acknowledgements

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