Rating Agencies
Economic Forum of Thrace

Frankfurt am Main, 28 August 2011. The international system of credit ratings and the organizations providing them are about to change. Along with those changes, new financing options will appear, as well as some of the existing financing options might disappear. The driving forces behind this development are well-known: The international credit rating system which is dominated by US rating agencies assumes the responsibility of unveiling global credit risks. But the leading US agencies did not realize the revolutionary change of the international credit pattern. Safeguarding mainly the interests of US investors and US issuers, they were assigning higher credit ratings to the most developed debtor economies.

Consequently the possession of global credit resources is in a great imbalance. This imbalance in turn is causing an imbalance in world's economic development, which is a major source of global sovereign credit risks as well as the fuse for triggering financial crisis.

On June 8, 2011, the Germany based Feri EuroRating Services downgraded the rating of United States of America from AAA to AA. On August 2, 2011, the China based Dagong Global Credit Rating decided to downgrade the local and foreign currency credit rating of the US put on the negative watch list on July 14, 2011, from A+ to A with a negative outlook. The United States of America were already downgraded by less known rating agencies all over the world. Reluctantly, S&P's followed their opinions and lowered their long-term sovereign credit rating on the USA from AAA to AA+ and affirmed the A-1+ short-term rating. S&P's could lower the long-term rating to AA within the next two years if they see less reduction in spending than agreed to, higher interest rates, or new fiscal pressures during the period result in a higher general government debt trajectory than they currently assume in their base case.

Issuers with an AAA rating have virtually a license to print money when there is no doubt about their capacity to meet all of their obligations. Once such debtor status is downgraded, creditors become aware of likely further downgrades. Therefore, the capacity of governments to bail out banks or help banks with speculative grade ratings is reduced by their own downgrades. As a consequence, banking supervision is tightening up; corporate bank lending will suffer as a result in such a scenario.

On the occasion of reconstructing the international credit rating system, the credit rating agencies and regulators across the globe are duty-bound in this regard; especially the domestic credit rating agencies in each country could be the pioneering force in directing the development of the rating industry that concerns the security all over the world, undertake the responsibility of maintaining the steady development of the world economy and financial system. It is not only inevitable but also imperative to build an international credit rating agency that is able to undertake the international rating responsibility with an innovative thinking, new idea, original structure and novel mechanism.

Those changes on the macro level will affect financings on the micro level. If capital flows around the globe are channeled in a different way, quantitative and qualitative changes are inevitable. Most likely, shipping companies and all other debtors have to adapt to new rules of the game.

The most dangerous misconception of the consequences of the financial crisis is the notion that the role of credit rating agencies in the global financial system would be reduced. Since US rating agencies played an important role in the development of the crisis it could be assumed that they would be "punished" by investors with disregard as well as by regulators by reducing official use of ratings. However it might be an irony of history that the financial crisis became the /strongest promoter to the development of credit rating agencies around the globe instead since everybody began to realize how important credit rating agencies really are. Even non-financial media report rating topics now every day. The power of rating agencies to influence capital markets was well illustrated again by billions of losses due to the downgrading of the rating of the USA alone.

The European Commission not only started to regulate credit rating agencies in Europe as a consequence, but also initiated a project to look at alternative structures that would reduce dependence on the US rating agencies. The success of those initiatives depends on the more professional use of credit ratings by market participants. Therefore market participants, issuers as well as investors, presumably will be forced by law to make better use of credit ratings, either by questioning the outcomes of rating processes or by installing better functioning own rating systems. In any case, companies have to prepare for rating processes, get a better understanding to rating systems and rating criteria which are applied.

There are two types of errors in any rating system, the alpha error and the beta error. The alpha error is due to the mistake of rating debtors too high, like AA instead of A or BBB. The beta error is the mistake of rating debtors too low, e.g. B instead of BBB or A. Since overvaluation is the major concern for bank lenders, there is usually a high percentage of wrong classifications to the disadvantage of debtors which credit risk characteristics are difficult to recognize by statistical models.

Victims of the beta error will turn to rating agencies, since only by asking expert teams to do a more comprehensive and more individual analysis such companies have a chance to get their better credit standing documented in form of a credit rating of a recognized rating agency and to receive a better mark.

Why the US bias of the rating oligopoly matters to Greece will be discussed at the Economic Forum of Thrace.

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