The Industry of Credit Rating Agencies

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Abstract: This paper develops a theoretical framework to shed light on the credit rating industry. Who the industry's firms are; what do they do; how they do it; and what the implications of their activities are? Since their creation rating agencies provide information to investors and governments helping them to make right and accurate decisions. Despite their major role, rating agencies have been accused of contributing in the creation of the worldwide financial crisis of 07-2008, and led to investigate why rating agencies didn’t send early warning signals, to avoid the worst, before the bubble bursts. Other critics made of them will be explored in this article.
Key words: Credit rating, Rating agencies, Moody’s, Standard & Poor’s, Fitch.
JEL codes: G2, G24

الملخص

يقدم هذا المقال تأصيلا منهجيا لوكالات التصنيف الائتماني في اطار نظري من خلال تسليط الضوء على ماهية هذه الصناعة، دورها في السوق، ماهي أوجه نشاطها وما هي اثار نشاطها على السوق؟ حيث لعبت وكالات التصنيف الائتماني، منذ نشأتها، دورا بارزا في توفير المعلومات اللازمة لمتخذي القرارات الاقتصادية سواء كانوا مستثمرين خواص او حكومات؛ غير أنّها أصبحت محل إدانة بالمساهمة في ظهور الازمة العالمية الأخيرة 2007-2008، وبدأت تُطرح التساؤلات حول عجز هذه الوكالات عن التنبيه ببوادر الازمة قبل تفاقمها؛ وقد جرّ هذا العيب الى توجيه انتقادات أخرى لهذه الوكالات تُشكِك في المصداقية الكبيرة التي كانت تحظى بها.

الكلمات المفتاحية: التصنيف الائتماني، وكالات التصنيف الائتماني.
رموز تصنيف jel: G2, G24

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Introduction

"Credit Rating" is the standardized evaluation of the future capability of a debtor to satisfy its liabilities vis-à-vis its creditors. Credit rating is assigned by credit rating agencies. Credit rating agencies are in the business of predicting default probabilities for different kinds of both debt securities and debt issuers. The focus is not on absolute default probability, but on the relative riskiness of different debt securities.

For nearly 100 years, rating agencies have been providing opinions on the creditworthiness of issuers of debt to assist investors. The Securities and Exchange Commission (SEC) and banking regulators also rely on ratings from rating agencies. In 1975, the SEC recognized Moody's, Standard & Poor's, and Fitch, the three major rating agencies in the world.

Both quantitative and qualitative rating methods are employed. Rating agencies are depicted as information intermediaries. Furthermore, credit ratings typically mirror long-term developments and do not respond to short-term market fluctuations; new significant information is reflected in up- or downgrades.

Apart from information intermediation, credit ratings are today generally associated with a second major function which serves as a regulatory tool in financial market oversight – one speaks of 'rating-based regulation'. This is often called the certification function. In this view, rating agencies are not asked only to assign a credit evaluation but they also issue a 'license' to access the capital markets or to lower regulatory burdens.

The different worldwide credit crisis such as Asian currency crisis 1997, Enron in December, 2001 and the last financial crisis of 2007-08, led to focus attention on credit rating agencies, and ask many question whether the rating agencies had responded promptly enough to the company's deteriorating financial condition not even there is a broad consensus that credit rating agencies contributed somehow to financial crisis when the agencies underestimated the credit risk associated with structured credit products and failed to adjust their ratings quickly enough to deteriorating market conditions. even though, Continuing criticism of the performance of credit rating

agencies does not deny or scale-down their role as economic institutions.

I- What is credit rating?

A credit rating is an alphanumeric grade that summarizes the creditworthiness of a security or a corporate entity. Credit ratings are generally assigned by credit rating agencies that specialize in credit assessment (Malz, 2011). A credit rating is an assessment of how likely an issuer is to make timely payments on a financial obligation (IOSCO, 2003).

The most prominent CRAs[1] in the world are Standard and Poor's (S&P), Moody's, Fitch Ratings, and Duff and Phelps. Along with a handful of others, they have been granted special recognition by the Securities and Exchange Commission (SEC). At the outset of this exercise in September 1999, it was believed that there might be some 130 agencies world-wide (BIS, 2000).

A credit rating consists of both a letter rating (credit category) and (if provided) commentary. The commentary can include a "credit watch" and/or "credit outlook" modifier, assumptions, criteria, and methods used in determining the rating opinion, conditions under which the rating may or will be changed, and descriptions of the rated company and its lines of business (Frost, 2007). Ratings result from a thorough analysis of public and private information from all relevant sources. Almost all agencies base their ratings on the relative, not absolute, probability of default.

Rating agencies' role in global capital markets has been expanding due to growth in the number of companies issuing securities, the development of complex financial products such as asset-backed securities and credit derivatives; the globalization of financial markets; and the increasing use of credit ratings in financial regulation and contracting.

The rating process involves a quantitative analysis, which looks at the debt structure, financial statement, balance-sheet data and sector information. The qualitative analysis then looks at, a.o., management quality, competitive position, growth prospects. The credit rating is assigned by a rating committee of experts on different domains and is

[1] . CRAs : abbreviation for Credit Rating Agencies.

communicated with the senior management of the issuer that requested the rating. After the first rating assignment, the rating is re-evaluated on an ongoing basis by the agency until the rating is withdrawn.
Credit rating information may be disclosed to the public and/or to subscribers. The three principal CRAs provide extensive, freely-available information on letter ratings and commentary, and also offer, on a subscription basis, fee-based services that provide additional information and data for example, background information on industry conditions and prospects, credit rating databases, ratings histories, and press release archives (Frost, 2007).

II- Credit rating agencies (RCAs)

The issuance of bonds by corporations is a twentieth-century phenomenon. It started at the beginning of the century, at approximately the same time when the first papers and articles were published on the analysis of accounting ratios and diagnosing the financial strength of a company. By the 1920s, this approach had been commercialized and specialized firms started offering their services, and promoting the merits of ratio analysis. This was also the period when Moody's (1909), Standard & Poor's (1916), and other agencies started to rate public debt issues.
Due to the introduction of new financial products which led to the development of new methodologies and criteria for credit rating: Standard & Poor's (S&P) was the first rating company to rate mortgage backed bonds (1975), mutual funds (1983), and asset-backed securities (1985) (Crouhy, Galai & Mark, 2000).
The three major agencies are responsible for 96% of outstanding structured- finance ratings and 98% of all outstanding ratings issued by SEC recognized agencies. There are also several smaller rating agencies that are active in the world, but some of these are active primarily in niche markets (Hunt, 2009).
The RCA’s role has gained importance by the increasing disintermediation since the 1980s. Bank debt has been replaced by publicly rated debt issues (Gestel & Baesens, 2009).
The credit ratings of Moody’s, Standard and Poor’s, and Fitch play a key role in the rating of credit risk and in the delineation of investment strategies. The role of these agency ratings has been further expanded

with the implementation of the Basle II accord, which establishes rating criteria for the capital allocations of banks. (Altman & Rijken, 2004). A short summary of the RCAs is given below.

II-1 Moody's

Moody's was founded by John Moody (1868–1958) in 1900, the same year John Moody & Company published Moody's Manual of Industrial and Miscellaneous Securities. The manual contained statistics and information on stocks and bonds. The manual company did not survive the 1907 stock market crash, but John Moody returned in 1909, instead of just collecting and publishing information he started offering analyses of security values. His conclusions were expressed via letters from mercantile and credit rating systems used by credit reporting firms near the end of the nineteenth century. In 1924, Moody's ratings covered almost the full US bond market. A key driver of Moody's reputation was the low number of defaults during the Great Depression of 1930 for its higher-rated bonds.
Moody's has a very strong market position in the US as well in Europe. Its global coverage is increasing (Gestel & Baesens, 2009). In December 1999, it has been announced that, the company was going to split into two separate parts: a business information unit (the traditional D&B credit information and other businesses), and a credit ratings business (Moody's). On September 30, 2000 the share distribution took place. The two companies were separated, and Moodys became a publicly traded corporation reporting to the SEC (Smith & Walter, 2001). In 2002 it acquired K.M.V. that, a.o., provides quantitative ratings. After the merger, both the names Moody's and Moody's K.M.V. are used.

II-2 Standard & Poor's :

Henry Varnum Poor published his History of Railroads and Canals of the United States in 1860. Poor's company provided financial information to investors. In 1906, the Standard Statistics Bureau was created to provide financial information. Ratings of firm and sovereign debt were assigned from 1916 onwards. The credit analysis of Standard and later Standard & Poor's expanded to municipal bonds, commercial paper, sovereign debt, mortgage and asset based securities, loan-anticipation notes, project finance, bond

insurance. In 1941, Poor's Publishing and Standard Statistics merged to form the Standard & Poor's Corporation (Gestel & Baesens, 2009). Standard & Poor's was an independent company until 1966, when it was acquired by the McGraw-Hill Companies, Inc., a publishing firm active (Smith & Walter, 2001) where this step made a debate in the market. S&P has an important market share in the US and Europe and its global coverage is also expanding. Apart from the credit ratings, S&P also provides other information services to the financial community, e.g., on equity research and financial databases.

II-3 Fitch Ratings, Ltd. :

Is the third major rating agency. It was founded by John Knowles Fitch in 1913 as the Fitch Publishing Company in New York. The company began with publishing financial information and providing financial statistic publications like Moody's and S&P. In 1989, the company was recapitalized by a new management team. Fitch grew significantly in the 1990s. it also grew by mergers and acquisitions to provide a global, worldwide rating service. The merger with the UK-headquartered IBCA strengthened the coverage on banks, financial institutions and sovereigns .

In 2000 Fitch acquired two additional rating agencies. The first was Duff & Phelps, a second-tier US rating agency with significant strengths in a relatively narrow range of issuers. The second was Thomson Financial Bank Watch, an international rating agency concentrating on the financial services sector (Smith & Walter, 2001). In 2000 Fitch made total revenues of USD 260 million, wholly owned by FIMALAC, S.A., Paris (Basel, 2000). It has a strong coverage in Europe.

III- Rating process

The processes used by CRAs vary widely, depending on the CRA itself and the used methodologies. Some CRAs rely heavily on a process whereby analysts form an assessment based on quantitative and qualitative indicators and then report this assessment to a rating committee. Other CRAs emphasize quantitative models, where the assessment process is more mechanical in nature and based on statistical analysis of an issuer's financial disclosures to arrive at a rating. In some cases, the exact processes used by a CRA may be

proprietary. It is important to note that no one method is necessarily superior to another and that any consideration of the activities of CRAs should recognize that new developments (e.g., technological, statistical, or methodological) may yield new and different approaches in the future (IOSCO, 2003).

The rating process involves a quantitative analysis, which looks at the debt structure, financial statement, balance-sheet data and sector information. The qualitative analysis then looks at, a.o., management quality, competitive position, growth prospects. Information is obtained from public sources and from the rated company itself during visits and meetings with the senior management.

At the start of the rating process, the CRA will assign a lead analyst to prepare the rating. The analyst requests information from the issuer and researches other available sources for information to provide the analyst with a better understanding of the issuer and its industry/economic environment. Analysts typically meet with senior management (or government officials, if the issuer is a government entity) and visit the issuer's offices.

An important focus is on the human expert part, which is obtained from a detailed analysis by a team of professionals that exchange ideas with and ask questions to the management of the issuer. The rating process is supervised by the leading analyst, who is responsible for the whole process (Gestel & Baesens, 2009). The analyst will then prepare a draft report and recommendation with respect to the issuer and/or its securities. This report is submitted to the rating committee.

The rating is re-evaluated on an ongoing basis by the agency until the rating is withdrawn (Gestel & Baesens, 2009). Usually the ratings are reviewed once a year, based on new financial reports, new business information, and review meetings with management. A "credit watch" or "rating review" notice is issued if there is reason to believe that the review may lead to a credit rating change. A change of rating has to be approved by the rating committee (Crouhy, Galai & Mark, 2000).

IV- Credit rating agencies scales

The rating definitions differ from one agency to another, credit rating levels are considered in industry practice as being more or less comparable. The long-term rating symbols have the following meaning according to the rating agency as follows:

Table 1 : Moody's, Standard & Poor's & Fitch rating summary for long-term rating scales

Moody's	Standard & Poor's	Fitch
Aaa	AAA	AAA
Aa	AA	AA
A	A	A
Baa	BBB	
Ba	BB	BBB
B	B	BB
Caa	CCC	B
Ca	CC	CCC
C	C	CC
	D	C
	NR	RD
		D

Source: prepared by the researcher.

Each indicated symbol in the table above has a definition according to the rating agency as follows:

IV.1 Moody's

Aaa: Obligations rated Aaa are judged to be of the highest quality, subject to the lowest level of credit risk.

Aa: Obligations rated Aa are judged to be of high quality and are subject to very low credit risk.

A: Obligations rated A are judged to be upper-medium grade and are subject to low credit risk.

Baa: Obligations rated Baa are judged to be medium-grade and ubject to moderate credit risk and as such may possess certain speculative characteristics.

Ba: Obligations rated Ba are judged to be speculative and are subject to substantial credit risk.

B: Obligations rated B are considered speculative and are subject to high credit risk.

Caa: Obligations rated Caa are judged to be speculative of poor standing and are subject to very high credit risk.

Ca: Obligations rated Ca are highly speculative and are likely in, or very near, default, with some prospect of recovery of principal and interest.
C: Obligations rated C are the lowest rated and are typically in default, with little prospect for recovery of principal or interest.
Note: Moody's appends numerical modifiers 1, 2, and 3 to each generic rating classification from Aa through Caa. The modifier 1 indicates that the obligation ranks in the higher end of its generic rating category; the modifier 2 indicates a mid-range ranking; and the modifier 3 indicates a ranking in the lower end of that generic rating category.[2]

IV.2 Standard & Poor's

AAA: An obligation rated 'AAA' has the highest rating assigned by S&P Global Ratings. The obligor's capacity to meet its financial commitment on the obligation is extremely strong.
AA: An obligation rated 'AA' differs from the highest-rated obligations only to a small degree. The obligor's capacity to meet its financial commitment on the obligation is very strong.
A: An obligation rated 'A' is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher-rated categories. However, the obligor's capacity to meet its financial commitment on the obligation is still strong.
BBB: An obligation rated 'BBB' exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation.
BB; B; CCC; CC; and C Obligations rated 'BB', 'B', 'CCC', 'CC', and 'C' are regarded as having significant speculative characteristics. 'BB' indicates the least degree of speculation and 'C' the highest. While such obligations will likely have some quality and protective characteristics, these may be outweighed by large uncertainties or major exposures to adverse conditions.
BB: An obligation rated 'BB' is less vulnerable to nonpayment than

[2] For further details see: Moody's Rating Symbols & Definitions, 2017.

other speculative issues. However, it faces major ongoing uncertainties or exposure to adverse business, financial, or economic conditions which could lead to the obligor's inadequate capacity to meet its financial commitment on the obligation.

B: An obligation rated 'B' is more vulnerable to nonpayment than obligations rated 'BB', but the obligor currently has the capacity to meet its financial commitment on the obligation. Adverse business, financial, or economic conditions will likely impair the obligor's capacity or willingness to meet its financial commitment on the obligation.

CCC: An obligation rated 'CCC' is currently vulnerable to nonpayment, and is dependent upon favorable business, financial, and economic conditions for the obligor to meet its financial commitment on the obligation. In the event of adverse business, financial, or economic conditions, the obligor is not likely to have the capacity to meet its financial commitment on the obligation.

CC: An obligation rated 'CC' is currently highly vulnerable to nonpayment. The 'CC' rating is used when a default has not yet occurred, but S&P Global Ratings expects default to be a virtual certainty, regardless of the anticipated time to default.

C: An obligation rated 'C' is currently highly vulnerable to nonpayment, and the obligation is expected to have lower relative seniority or lower ultimate recovery compared to obligations that are rated higher.

D: An obligation rated 'D' is in default or in breach of an imputed promise. For non-hybrid capital instruments, the 'D' rating category is used when payments on an obligation are not made on the date due, unless S&P Global Ratings believes that such payments will be made within five business days in the absence of a stated grace period or within the earlier of the stated grace period or 30 calendar days. The 'D' rating also will be used upon the filing of a bankruptcy petition or the taking of similar action and where default on an obligation is a virtual certainty, for example due to automatic stay provisions. An obligation's rating is lowered to 'D' if it is subject to a distressed exchange offer.

NR: This indicates that no rating has been requested, or that there is insufficient information on which to base a rating, or that S&P Global Ratings does not rate a particular obligation as a matter of policy.

Note: The ratings from 'AA' to 'CCC' may be modified by the addition of a plus '+' or minus '-' sign to show relative standing within the major rating categories.[3]

IV.3 Fitch

AAA: Highest credit quality ratings denote the lowest expectation of credit risk. they are assigned only in cases of exceptionally strong capacity of payment of financial commitments. this capacity is highly unlikely affected by foreseeable events

AA: Very high credit quality denote expectations of very low credit risk. They indicate very strong capacity for payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.

A: High credit quality denote expectations of low credit risk. The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to adverse business or economic conditions than is the case for higher ratings.

BBB: Good credit quality indicate that expectations of credit risk are currently low. The capacity for payment of financial commitments is considered adequate but adverse business or economic conditions are more likely to impair this capacity.

BB: Speculative indicate an elevated vulnerability to credit risk, particularly in the event of adverse changes in business or economic conditions over time; however, business or financial alternatives may be available to allow financial commitments to be met.

B: Highly speculative indicate that material credit risk is present.

CCC: Substantial credit risk indicate that substantial credit risk is present.

CC: Very high levels of credit risk indicate very high levels of credit risk.

C: Exceptionally high levels of credit risk indicates exceptionally high levels of credit risk.

Note: the modifiers "+" or "-" may be appended to a rating to denote relative status within major rating categories. Such suffixes are not

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[3] For more details see: S&P Global Ratings Definitions, 2016.

added to the 'AAA' obligation rating category, or to corporate finance obligation ratings in the categories below 'CCC'. [4]

V- Conflicts of interest

A potential conflict of interest arises when a credit rating agency has an economic interest in the mission of credit rating. "Perhaps the single greatest concern facing CRAs is identifying and addressing potential and actual conflicts of interest that may inappropriately influence the rating process." IOSCO states (IOSCO, 2003).
RCAs acknowledge that conflict, thus, the debate is not over whether the existence of this potential conflicts, but over whether the agencies are managing them adequately. The most common potential areas where conflicts interest may arise are cited below:

V.1 Issuer Fees

The most common conflict of interest is that the RCAs are paid by the issuers or originators of the products they are rating. The way analysts are compensated for the services they provide can create pressure on their independence and objectivity. A research analyst's salary or bonus might be linked to the profitability of other corporate and trading services. This might give the analyst an incentive to provide positive research reports and recommendations, which may foster the client company's continued relationship with the analyst's firm and increase the analyst's compensation. Alternatively, an analyst's compensation might be linked to the profitability of the firm as a whole (Corporate Law Economic Reform Program, 2009).
Although, rating agencies argue that this is not the problem because they have far more to lose by imperiling their reputation for objectivity than they have to gain by pleasing any single client (Hunt, 2009). RCAs added that they are careful of this potential conflict of interest and attempt to mitigate its influence by ensuring that no particular issuer constitutes any significant portion of the CRA's overall revenue.
There is few empirical studies conducted on the subject examined the effect of the potential interest conflict such as (Covitz & Harrison, 2003) concluded that the bond market anticipates rating changes, but

[4]. More details on: Fitch Ratings: Definitions of Ratings and Other Forms of Opinion, 2014.

there is no evidence consistent with rating agencies acting in the interests of issuers due to a conflict of interest. Instead, rating agencies appear to be relatively responsive to reputation concerns and so protect the interests of investors. the authors affirm that conflicts of interest may manifest in ways they do not test, such as biased rating levels.

V.2 Access to Non-Public Information/Insider Trading

CRA's access to non-public information is a potential conflict of interest, insofar as CRA staff may be tempted to use the information to trade securities on their own account. CRAs attempt to manage this potential conflict by adopting internal procedural safeguards to protect non-public information and by restricting or prohibiting CRA staff from engaging in financial activities (including securities trading) where a conflict of interest may arise.

After the 2007-2008 financial crisis there has been a recent movement to blame modeling, so the RCAs have made their rating process more qualitative. (Griffin & Tango, 2009) see that this step is in the wrong direction, even after the crisis, rating agencies are careful not to disclose all the details on how they rated past or current deals. Data on key inputs, outputs, and the rating modeling process should be made more, not less, transparent. The modeling box could then be opened and debated. and upward adjustments should not be allowed. If a model is flawed or incomplete, it should be formally corrected.

CRAs attempted to replicate by Standard and Poor's (S&P) President in his testimony before Congress: "there is no evidence of any misconduct by our analysts or that the fundamental integrity of our ratings process has been compromised. It is also worth repeating that no single analyst, has the ability to determine ratings on his or her own as all of our ratings are determined by committee"(Sharma, 2008).

Griffin & Tango (2009) found that "Adjustments to the CRA credit risk model are positive, amounting to an additional 12.1% AAA for the average collateralized debt obligations (CDOs). Adjustments are not explained by likely candidates such as manager experience or credit enhancements".

V.3 Ancillary Advisory Services

Some CRAs have developed and provided ancillary advisory services that capitalize on their reputations and expertise in risk

analysis. offering ancillary business services can raise potential conflicts of interest issues. A CRA's rating decisions could be influenced by whether or not an issuer purchases additional services offered by the CRA. . One critic states that the CRA is "highly unlikely to downgrade a bank's risk capabilities if the bank has bought one of its risk systems" (IOSCO. 2003).
In addition, regardless of whether or not the purchase of ancillary services has an impact on a rating output, issuers may be pressured into using these services which could improve a rating or, conversely, out of fear that their failure to do so could adversely impact their credit rating.
Conflicts of interest are a very important issue for the RCAs rating objectivity and reputation. Researchers should more carefully examine the different points affecting RCAs rating process and modelling so authorities can make regulation more detailed and deep by introducing additional transparency and disclosure requirements for rating agencies, this point will be discussed in the coming section (6.2).

VI- Critics on credit rating agencies

Notwithstanding the important role of CRAs in the market, a number of criticisms have been made of them.

VI.1 Lack of competition

The credit rating industry is characterized by high entry barriers and limited competition which has caused several issues, On the one hand, it gives rise to the fear that the dominant agencies are in a position to abuse this lack of competition by increasing their prices. On the other hand, however, it also raises concerns with respect to the quality of the ratings, as the dominant agencies do not have to fear any significant qualitative cut-throat competition (Uwe Blaurock, 2007).
When the market is not competitive this leads to that issuers pay too much for capital because they are underrated; and, investors are not provided with sufficient warning about failing firms such as Enron, WorldCom, and Parmalat, since the rating-business is dominated by only three major rating agencies, this constitutes an oligopoly and makes the market high concentrated. The three leading players control over 94% of the global market (OECD, 2010).

Up until recently, there has been a fairly obvious regulatory barrier to entry into the rating market, and reducing that barrier was the principal focus of the 2006 Act of the SEC. That barrier has been the SEC.s process for designating rating agencies (Nationally Recognized Statistical Rating Organizations (NRSROs)). The NRSRO designation arguably is a barrier because only NRSROs can issue ratings that carry official weight under SEC and other agency rules (Hunt, 2009).
Even though, a delegate from the European Commission indicted that an oligopolistic market does not necessarily create a competition problem, because where competition existed in the market, this led automatically to an inflation in the ratings since the RCAs are using almost the same models in the rating process, so competition is not the real problem .
Hunt (2009) concludes that the mere existence of many competitors does not guarantee quality unless there is something causing high-quality producers to benefit and low-quality producers to suffer. Thus, the official focus on increasing competition can be interpreted as reflecting faith in the ability of reputation to bring about good results under the right circumstances.
Sean Egan (Managing Director, Eganjones Ratings Co.) during Hearing before U.S. House of representatives (2004) stated the following changes in order to reform the ratings industry, first, recognize some rating firms which have succeeded in providing timely, accurate ratings. Second, wean rating firms from issuer compensation. Three, adopt a code of standard practices for participants in the credit rating process, and four, encourage SEC action, the costs of delaying the recognition of additional rating firms is far greater than the benefit of additional study.

VI.2 Lack of transparency

Regulators were interested in promoting rating-agency transparency before the 2007-08 crisis, and they have become much more interested since the crisis began. The topic includes two types of transparency: Methodological transparency which refers to an outsider's ability to tell just how the agencies reach the ratings they award, and Performance transparency which is the ability to discern how well the ratings perform (Hunt, 2009).

Likewise, transparency in the rating process, providing investors and issuers with different information about the procedures, methodologies and assumptions that result in a credit rating report, benefits both investors and issuers. Investors are given information to help assess the quality of a CRA's opinion for the purposes of their investment decision-making. Issuers, on the other hand, are reassured of the fairness of the rating process and encouraged to provide issuers with the information CRAs need in forming their opinions (IOSCO. 2003).

In order to improve the reliability of the CRAs' rating methodologies regulators will have to introduce improved transparency measures. CRAs are now subject to extensive disclosure requirements. They have to disclose their models, methodologies, and the basic assumptions on which their ratings are based. They must demonstrate that they have carried out their assessments on the basis of all the information available from reliable sources.

An annual transparency report must also be published detailing not only their financial figures but also their systems of rotation, their supervisory or administrative board must include at least two independent members whose remuneration is not linked to the CRA's performance. At least one member must be an expert on securitization and structured finance instruments. The Regulation also sets periods during which former analysts may not take up certain positions within entities that they have rated (Siegfried Utzig, 2010).

VI.3 Notching

Notching refers to the practice of credit rating agencies to honor ratings of their rivals for components of securitizations that they had not directly rated in the past, provided they adjust downward these ratings by a predefined number of notches or grades (Sangiorgiy & Spattz, 2017). According to Standard & Poor's "The practice of differentiating issues in relation to the issuer's fundamental creditworthiness is known as "notching." Issues are notched up or down from the corporate credit rating level"(Standard & Poor's, 2013). An issuer with a B rating, e.g., can receive different ratings on single debt issues notched up or down. A highly secured bond would

receive a higher rating, such as B+, an unsecured bond might be downgraded a notch to B.-

There is also an important distinction between notching up and notching down. When a debt issue is judged to be junior to other debt issues of the company, and, therefore, to have relatively worse recovery prospects, that issue is assigned a lower rating than-that is, it is “notched down” from the corporate credit rating. In contrast, issue ratings are enhanced -nothing up-above the corporate credit rating if a comprehensive analysis indicates the likelihood of full recovery—100% of principal—for that specific issue .

In 2002, Fitch accused Moody’s and S&P of “punitive notching” that is automatically adjusting downward the ratings on structured finance bonds if they themselves did not originally rate those bonds. Issuers fear such practice and as a result choose to have all their bonds rated by the two market leaders rather than a competitor (Dittrich, 2007).

In 2003, responded to allegations of “unfair notching” Moody’s commissioned an independent research study, by the National Economic Research Associates (NERA), of the ratings process for structured financial products where the study’s authors defined Notching as “The industry practice whereby one agency adjusts ratings of structured finance collateral from other agencies for the stated reasons of (1) bringing them in line with ratings it believes it would have assigned to the collateral and (2) adjusting for uncertainty and perceived differences in monitoring practices (Carron, Dhrymes, & Beloreshki, 2003).The study’s authors finds no conclusive evidence of abusive notching but academic commentators still have remained concerns.

VI.4 Timeliness

CRAs have been criticized for not providing credit ratings on timely basis. The rating agencies have been criticized for being slow to lower Asian sovereign ratings in 1997 during the Asian currency crisis. Rating agencies should be faster in scrutinizing new information and changing ratings accordingly (Dittrich, 2007).

CRAs have been most vociferously criticized, in their ongoing ratings, their upgradings and downgradings. Consider Enron, WorldCom, the Asian Flu, for example where downgrades came much too late when it is over and actions can be done. But in the agencies’ defense,

upgrading and downgrading ratings is a great deal harder than rendering an initial rating (Hill, 2004). After being criticized for downgrading too slowly and not providing early warning signals in Enron and the other debacles, the rating agencies greatly accelerated their pace of downgrading; the agencies were then criticized for downgrading too quickly.
A survey conducted by the (AFP, 2002) reveals that most respondents, whether they work for a company with rated debt or use ratings for investment decisions, do not believe that ratings reflect changes in a company's finances in a timely fashion. Only 40 percent (40%) of corporate practitioners from companies with rated debt believe that changes in their company's ratings have been timely.

VI.5 Tying

Tying is another anticompetitive behavior, tying is the practice of a seller conditioning the purchase of one product on the purchase of another product (Viscusi, Vernon & Harrington, 2005). A rating agency might only issue a rating if the issuer also buys ancillary services. Another form of tying would be conditioning one rating on others, so an issuer effectively needs to buy all his ratings from the same agency. The concern about tying is that the market becomes more concentrated and as consequence hinders competitors from accessing the market and that the free choice of issuers is limited.

Conclusion:

The main aim of this article was to explore the credit rating agencies and their role in the market as a financial intermediary. since their starting 100 years ago, they have taken an important place in rating different issues. and became the reference for economic agents to make decisions according to rating reports.

The credit rating business is a major contributor to financial market efficiency, bringing about important reductions in information costs and improving market efficiency but the highly concentrated nature of the ratings business and barriers to entry facing new competitors issues, where only three major CRAs dominate the 94% of the global

market, creates real concern and provide conflicts of interest in the agencies industry.

A long time the major credit rating agencies have preserved a reputation for professional conduct in providing bond ratings however, they have made mistakes in recent years, there has been dramatic growth in the demand for ratings especially ratings of highly complex securities and new financial instruments issued by different parties countries and corporations. This increasing demand has disrupted the RCAs and let things go out of control. The consequences were heavy for the global market such as the last crisis 07-2008 where RCAs still accused of major contribution when they gave "false" evaluation of certain issues.

The nature of the CRAs market led to other criticisms we focused on (1) Lack of competition: since only three major RCAs dominate the global market, (2) Lack of transparency: RCAs should disclose their rating methods and respect methodological transparency and performance transparency instructions, (3) Notching: regulators ask RCAs to be cautious where they provide notching, (4) Timeliness: as an information provider RCAs have to react in real time of market changes by keeping ongoing monitoring, (5) Tying: client is "forced" to buy extra services not requested as result supporting extra charges.

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