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The Economic Function of Credit Rating Agencies - What Does the Watchlist Tell Us?

37 Pages

Posted: 17 Feb 2009

Last revised: 14 Jan 2010

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Date Written: July 1, 2009

Abstract


Credit rating agencies do not only disclose simple ratings but announce watchlists (rating reviews) and outlooks as well. This paper analyzes the economic function underlying the review procedure. Using Moody's rating data between 1982 and 2004, we find that for borrowers of high creditworthiness, rating agencies employ watchlists primarily in order to improve the delivery of information. For low-quality borrowers, in contrast, the review procedure seems to have developed into an implicit contract à la Boot et al. (2006), inducing the companies "on watch" to abstain from risk-augmenting actions. The agencies' economic role hence appears to have been enhanced from a pure information certification towards an active monitoring function.

Keywords: Credit Rating Agencies, Credit Rating, Watchlist, Rating Review, Event Study

JEL Classification: G14, G24, G33

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