



Journal of Economic Perspectives

ISSN 0895-3309 (Print) | ISSN 1944-7965 (Online)

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Markets: The Credit Rating Agencies

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JOURNAL OF ECONOMIC PERSPECTIVES

VOL. 24, NO. 2, SPRING 2010

(pp. 211–26)

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Article Information

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Abstract

This paper will explore how the financial regulatory structure propelled three credit rating agencies -- Moody's, Standard & Poor's (S&P), and Fitch -- to the center of the U.S. bond markets -- and thereby virtually guaranteed that when these rating agencies did make mistakes, these mistakes would have serious consequences for the financial sector. We begin by looking at some relevant history of the industry, including the series of events that led financial regulators to outsource their judgments to the credit rating agencies (by requiring financial institutions to use the specific bond

creditworthiness information that was provided by the major rating agencies) and

ing agencies shifted their business model from "investor pays" to

now these ingredients combined to contribute to the subprime mortgage debacle and

associated financial crisis. Finally, we consider two possible routes for public policy

with respect to the credit rating industry: One route would tighten the regulation of

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the rating agencies, while the other route would reduce the required centrality of the rating agencies and thereby open up the bond information process in a way that has not been possible since the 1930s.

Citation

White, Lawrence J. 2010. "Markets: The Credit Rating Agencies." *Journal of Economic Perspectives*, 24 (2): 211–26.

DOI: 10.1257/jep.24.2.211

Choose Format:



JEL Classification

G01 Financial Crises

G24 Investment Banking; Venture Capital; Brokerage; Ratings and Ratings Agencies

G28 Financial Institutions and Services: Government Policy and Regulation

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