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Critical Review > A Journal of Politics and Society Volume 21, 2009 - Issue 2-3: Causes of the Financial Crisis

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Essays

THE CREDIT-RATING AGENCIES AND THE SUBPRIME DEBACLE

Lawrence I. White

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agencies excessively optimistic in their ratings of subprime mortgage-backed securities? A combination of their fee structure, the complexity of the bonds that they were rating, insufficient historical data, some carelessness, and market pressures proved to be a potent brew. This combination was enabled, however, by seven decades of financial regulation that, beginning in the 1930s, had conferred the force of law upon these agencies' judgments about the creditworthiness of bonds and that, since 1975, had protected the three agencies from competition.

Notes

- 1. This rule did not apply to savings institutions until 1989. Its application to them in that year forced them to sell substantial holdings of "junk bonds" (i.e., below investment grade), causing the crash of the junk-bond market.
- 2. In the early 1990s, the S.E.C. again made use of the NRSROs' ratings when it established safety requirements for the short-term bonds (e.g., commercial paper) that are held by money-market mutual funds.



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