A rating agency assesses the ability of a borrower—be it a company, a state, or a local authority—to repay its debt. The three main agencies are Moody's Investor Service (Moody's), Fitch Ratings (Fitch), and Standard & Poor's. Recently, Scope Ratings, a European agency, has been approved by the European Central Bank.

Rating agencies exist because risk comes at a price, known as the risk premium, which is added to the interest on a debt. The riskier a debt security is, the lower its rating will be. Thus, the rating assigned by a rating agency directly influences the price of the debt.

The highest rating is triple A. In response to criticism aimed at these agencies, the European Union has implemented stricter regulations for them since 2008.

# 1. **Introduction to Credit Rating Agencies**

Credit rating agencies (CRAs) are private companies whose main activity is to evaluate the ability of debt issuers (such as companies, states, and local authorities) to meet their financial obligations. They exist because risk has a price, known as the risk premium, which is added to the interest on a debt. The role of these agencies is to assess this risk premium.

The first rating agencies emerged in the 1920s. Their activity of selling financial information is similar to that of financial analysts. Following the 1929 crisis, these agencies began to focus on analyzing the credit quality of issuers or borrowers. The three main agencies are Moody’s Investor Service (Moody’s), Fitch Ratings (Fitch), and Standard & Poor’s (S&P).

Various financial scandals (such as the Enron case in 2001 and the financial crisis of 2007-2008, which affected the U.S. mortgage sector, known as the subprime crisis) have highlighted the risks associated with the role of rating agencies in the financial system.

# 2. **The Role of CRAs**

Credit rating refers to the activity of publishing an assessment of an borrower’s risk of default. The agency evaluates whether the borrower is solvent and will be able to repay their debt. To measure the risk of non-repayment, they construct financial forecasts that include the future structure of the borrower’s costs and revenues. It’s important not to confuse credit rating agencies with auditing firms that verify and certify company accounts.

Key criteria used to assess financial risk include overall financial profitability, return on invested capital, debt levels, financial flexibility, and liquidity. More recently, non-quantitative criteria such as governance, corporate social responsibility, and strategy have also come into play.

The three major rating agencies are of Anglo-Saxon origin and are rooted in that culture. This positioning is justified by the size and importance of Anglo-Saxon capital markets, but it can sometimes make it more difficult to account for regional particularities. For example, commitments related to employee pensions are classified by Anglo-Saxon accounting as loans or obligations, which may seem somewhat restrictive.

Rating agencies play a critical role in financial markets, but they face significant scrutiny and regulatory challenges.

# 3.

Rating agencies provide and disseminate financial information for the needs of the market and investors. They rely on the information supplied by issuers.

The rating obtained is crucial for a company seeking financing or issuing bonds in the market. The higher the rating, the more likely the company is to find cheap funds at low interest rates. Ratings can fluctuate throughout the life of the bonds; they represent a statistical estimate of credit risk at a specific moment in time.

Bonds issued by states are sought after by investors because they are considered to carry almost zero risk, with the best possible rating being triple A. For example, France's rating was downgraded to "AA-" by Fitch in April 2023, while Standard & Poor’s maintained it at "AA" in June 2023.

# 4.

These criticisms can be categorized into three main areas:

1. The subprime crisis of 2007-2008 revealed conflicts of interest involving some agency employees who were linked to the commercial relationships of the issuers under analysis. Furthermore, since the 1970s, the revenue of rating agencies has primarily come from debt issuers (the issuer-pays model).

2. Each agency aims to maintain its market share, which results in limited transparency regarding their rating methods and the weight given to each indicator. Due to the opacity of their rating methodologies and the timing of rating announcements or changes, rating agencies have been accused of exacerbating the Greek public debt crisis and the eurozone crisis between 2009 and 2011.

3. The relevance of agency ratings in assessing sovereign risk has also come into question. Agencies have been criticized for failing to anticipate abrupt declines in borrower solvency (e.g., the Asian crisis of 1997-1998, Enron in 2001, the subprime crisis in 2007-2008).

The three major agencies—Moody's, Fitch, and S&P—hold a dominant position, with over 90% market share. In November 2023, the European Central Bank decided to approve Scope Ratings, a European rating agency based in Berlin. The entry of this new player could make the market more dynamic.

After the 2008 crisis, the European Union sought to regulate the actions of rating agencies. A regulation adopted in 2010 established improved oversight, which is the responsibility of the European Securities and Markets Authority. Now, agencies must be registered in the countries where they operate and are required to be more transparent by publicly disclosing their models, methodologies, and the key assumptions underlying their ratings.

**Credit Rating Agencies**

**1. Introduction to Credit Rating Agencies**

Credit rating agencies (CRAs) assess the ability of borrowers—companies, states, or local authorities—to repay their debt.  
The main agencies include:

* Moody's Investor Service (Moody's)
* Fitch Ratings (Fitch)
* Standard & Poor's (S&P)

Scope Ratings, a European agency, was recently approved by the European Central Bank.

**2. The Role of CRAs**

CRAs evaluate the risk premium associated with debt, which influences interest rates. The highest rating is AAA.  
CRAs emerged in the 1920s, focusing on credit quality post-1929 crisis.  
Financial scandals like Enron and the subprime crisis revealed risks in their assessments.

**3. Credit Ratings Explained**

Credit ratings assess a borrower's risk of default. Key criteria include:

* Financial profitability
* Return on invested capital
* Debt levels
* Financial flexibility
* Liquidity

Non-quantitative criteria like governance and corporate social responsibility are increasingly important.

**4. Importance of Ratings**

Ratings influence a company’s ability to secure financing. Higher ratings lead to lower interest rates.  
For example, France's rating was downgraded to "AA-" by Fitch in April 2023.

**5. Criticisms of Rating Agencies**

Criticisms include:

* Conflicts of interest due to the issuer-pays model.
* Lack of transparency in rating methodologies.
* Failure to predict declines in borrower solvency.

The EU has implemented regulations to improve oversight and transparency since the 2008 crisis.

**6. Conclusion**