

Credit Rating Agencies and the Protection of the ‘Public Good’ Designation: The Need to Readdress the Understanding of the Big Three’s Output

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*This article is concerned with assessing just one element of how the Big Three Rating Agencies – Standard & Poor’s, Moody’s and Fitch – have been able to remain profitable despite their dreadful performance in the lead-up (and arguably since) the recent Financial Crisis; the article argues that the understanding that the Big Three provide ‘Public Goods’ is systematically protecting their position. As such, the Big Three are being allowed to contribute to hazardous financial practices without the fear of serious reprisals. The article demonstrates this narrative and ultimately explains the effect that this narrative has upon the ability to understand the Big Three Rating Agencies. Ultimately, the article suggests that in order for the regulation of the Rating Industry to be truly effective, the **actual** output of the Big Three Rating Agencies must be clearly recognised, rather than any blanket designation attributed to the Industry as a whole remaining prevalent.*

Introduction

The credit rating industry has been found to be a direct contributor to the Financial Crisis of 2007/08¹. Furthermore, the United States Senate was left in no doubt after its investigations into the financial collapse that the Big Three credit rating agencies had systematically conducted themselves in a manner opposite to that which they are supposed to do, and indeed in a manner in which they themselves promote. However, all three of these agencies have been recording an increased rate of profitability year-on-year, with a small blip during the actual Financial Crisis. There are a number of reasons for this, which include the potential

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¹ United States Senate, Permanent Subcommittee on Investigations *Wall Street and the Financial Crisis: Anatomy of a Financial Collapse* (GPO 2011) 7.

conflict that exists within financial regulators (regarding their personal incentives)², and the demands of investors³ to name but a few. However, for this analysis a more abstract element will be considered. That the Big Three have remained profitable, and have even gone on to strengthen their position, should lead us to ask what may be the foundation for this paradoxical development. It is entirely rational to believe that companies who behave so appallingly, and are found, beyond doubt, to have done so consciously, would suffer potentially fatal consequences. Yet, this is clearly not the case and this article suggests that at the core of this paradox is the notion that the Big Three, in particular, are creating products which are *absolutely necessary* to the functioning of the economy and, as such, any potentially fatal reform, with regard to the agencies, is simply impossible.

The article therefore begins by examining this notion of the output of the Big Three as being vitally important to the economy, and therefore modern society. This has been described in the literature as the agencies providing a ‘public good’, which has been used in both its economic and literal senses. We will see that the use of this narrative is almost absolute in the literature, which gives credence to this allegation that the narrative is intellectually supporting the transgressions of the Big Three. It is worth mentioning here however, before we progress any further, that this article does not seek to admonish those who adopt this narrative; rather, it is contended here that this narrative is simply too easy to follow, and that a more in-depth and careful analysis reveals that, in actual fact, the output of the Big Three does not fit neatly into the ‘public-good’ designation and therefore sells a vision of the agencies which perpetuates their position and influence. After looking at the intricacies of this ‘public good’ notion, and how the industry came to receive that important designation, the article will assess what this narrative is actually based on. It will be argued that the narrative is based on two differing aspects: firstly, it is based on how we collectively *desire* the agencies to operate, and secondly upon how the industry *as a whole* is desired to operate, rather than focusing upon the Big Three; this is argued to be a fatal error as the Big Three make up over 90% of the global output of rating agencies. Finally, the article will assess the *actual* output of the Big Three rating agencies and examine how that output may be altered to fall in line

² Ross Levine ‘The Governance of Financial Regulation: Reform Lessons from the Recent Crisis’ [2012] 12 International Review of Finance 1 ‘We should not assume, therefore, that the private interests of regulators align with the public interest’.

³ Gregory Husisian ‘What Standard of Care Should Govern the World’s Shortest Editorials? An Analysis of Bond Rating Agency Liability’ [1989-90] 75 Cornell Law Review 417.

with the requirements of a number of parties – with the most important being the requirement of the State in representing society (in theoretical terms).

Intellectual Sustenance

The concept of ‘public good’ is central to this article, so it will be important to clarify what is meant by this term. However, before we do that, a simple understanding of what a credit rating agency actually is, and what it does, will help set the scene for what follows. An understanding of what a rating agency does can be garnered by recognising that ‘a credit rating is an opinion provided by a rating agency for a fee on the credit risk or creditworthiness of the bond issue, which reflects the probability of default of that bond’⁴ – essentially, a credit rating agency provides an opinion on the likelihood of an investor receiving their investment and additional interest back, and within a given timeframe. These said investors will usually be investing in ‘bonds’⁵, which means an agreement between an ‘issuer’ and the investor that details how the investor will loan money to the issuing organisation (‘issuing’ in terms of issuing ‘debt’ i.e. a piece of the company as collateral) with the expressed aim of receiving the money back within a certain timeframe, having accrued interest for the loan in the meantime. Credit rating agencies began in the mid-1800s in the United States (at least as we recognise them today⁶) and they are now synonymous with the accessing of the capital markets, although the so-called ‘sophisticated’ investors, like pension funds, will assimilate the opinions of the rating agencies into their own creditworthiness analyses⁷. The capital markets are the basis of modern capitalism as we know it⁸, and as such the credit rating agencies, particularly the traditional powerhouses of Standard & Poor’s and Moody’s - also known as the ‘Big Two’ - have therefore parasitically grown as a result. Furthermore, this centralised importance has been described in a way that

⁴ Robert J Rhee ‘On Duopoly and Compensation Games in the Credit Rating Industry’ [2013] 108 Northwestern University Law Review 91.

⁵ A discussion on ‘bonds’ is beyond the scope of this article, but a discussion can be found by consulting the following: Les Dlabay and James Burrow *Business Finance* (Cengage Learning 2007) 207; Moorad Choudry *An Introduction to Bond Markets* (John Wiley & Sons 2010).

⁶ For an account of the history of providing creditworthiness opinions see Rowena Olegario *A Culture of Credit: Embedded Trust and Transparency in American Business* (Harvard University Press 2006).

⁷ Gianluca Mattarocci *The Independence of Credit Rating Agencies: How Business Models and Regulators Interact* (Academic Press 2014) 11.

⁸ Larry Neal *The Rise of Financial Capitalism: International Capital Markets in the Age of Reason* (Cambridge University Press 1993).

sees the agencies cemented into the economic and public consciousness, and this narrative is best described as the ‘public good’ narrative.

The ‘public good’ narrative has two different variants, and these are important to understand before we progress. The first understanding, which will be addressed shortly, is the *literal* understanding, in that something is good for the public. This can be seen when something is related to the provision of social aspects such as social infrastructure and energy provision. The second understanding is based on the economic theory of regulation known as ‘public choice’ – a theory developed by economic thinkers like Pigou⁹, Samuelson¹⁰, Stigler¹¹, Olsen¹², Tullock¹³, and Coase¹⁴ - and describes the provision of a public good as the provision of a service which has certain characteristics. For the public choice field, something can be considered to be a ‘pure’ public good if it can be described as *both* nonexcludable and nonrival. Nonrival denotes the phenomenon whereby something can be ‘consumed by an individual without detracting, in the slightest, from the consumption opportunities still available to others from that same unit’¹⁵, with a demonstrative example being Forests and Algae that consume carbon¹⁶. Nonexcludable means that once the product has been provided it is very difficult, if not impossible, to exclude others from receiving the benefit, with the light from street lights providing a good example¹⁷. To provide an opposition in terms of comparison, food and fuel are ‘private goods’ in that they have both rival and excludable properties¹⁸. Before we look at how scholars and onlookers have been using this understanding to attribute it to the output of the rating agencies, which this article posits is incorrect, there is one other theoretical term that we must familiarise ourselves with, and that is an ‘externality’. An externality describes an ‘event which confers an appreciable benefit (or

⁹ Arthur C Pigou *The Economics of Welfare* (Macmillan and Company 1920).

¹⁰ Paul A Samuelson ‘The Pure Theory of Public Expenditure’ [1954] 36 *The Review of Economics and Statistics* 4.

¹¹ George J Stigler ‘The Theory of Economic Regulation’ [1971] 2 *Bell Journal of Economics and Management Science* 3.

¹² Mancur Olson *The Logic of Collective Action: Public Goods and the Theory of Groups* (Schocken Books 1968).

¹³ Gordon Tullock ‘The Welfare Costs of Tariffs, Monopolies, and Theft’ [1967] 5 *Western Economic Journal* 3.

¹⁴ Ronald H Coase ‘The Lighthouse in Economics’ [1974] 17 *Journal of Law and Economics* 2.

¹⁵ Richard Cornes and Todd Sandler *The Theory of Externalities, Public Goods, and Club Goods* (CUP 1996) 8.

¹⁶ Peter Drahos ‘The Regulation of Public Goods’ in Keith E Maskus and Jerome H Reichman *International Public Goods and Transfer of Technology Under a Globalised Intellectual Property Regime* (CUP 2005) 46.

¹⁷ Cornes and Sandler (n 15).

¹⁸ *ibid.*

inflicts an appreciable damage) on some person or persons who were not fully consenting parties in reaching the decision or decisions which led directly or indirectly to the event in question'¹⁹, with a more palatable definition being that an externality is an activity that 'has a consequence that confers a (nonpriced) cost or benefit on a nonparticipant'²⁰.

To digress for one moment, the issue of actually *providing* these public goods has been a point of contention within the economic field for some time. Pigou's most celebrated work in this field was based upon the notion that it is the state's responsibility to provide a public good, particularly when a private party will not, or cannot provide it²¹. However, Ronald Coase suggested that it is not necessarily the case that the state will be the best provider of a public good, mostly due to a number of constraining features that affect the ability of the state to provide a public good in comparison to a private provider²². In order to negate the issue of a private provider being unwilling to provide the public good, essentially because they cannot *capture the benefit* of doing so, one scholar has noted that the state will 'incentivise' the private providers by initiating what they call a 'public-private-partnership', which entails the state's facilitation of allowing the private entity to essentially change the dynamic of the public good so that it loses, at least to some degree, its nonexcludable or nonrival properties²³ - this phenomenon also relates to the understanding of a 'quid pro quo'²⁴.

This brings us onto the provision of credit ratings. There are a number of scholars who relate the provision of credit ratings to the provision of public goods in the economic sense, with Ulrich Schroeter providing perhaps the best example:

By informing the financial market about their rating opinions, credit rating agencies increase the market's efficiency and lower costs for both issuers and investors. Once published, credit ratings possess the characteristics of a public good – their use by one

¹⁹ *ibid* 39.

²⁰ James A Caporaso and David P Levine *Theories of Political Economy* (CUP 1992) 93.

²¹ Pigou (n 9).

²² Coase (n 14) 359.

²³ Helmut Willke and Gerhard Willke *Political Governance of Capitalism: A Reassessment Beyond the Global Crisis* (Edward Elgar Publishing 2012) 18.

²⁴ Johan Gustav Knut Wicksell *Finanztheoretische Untersuchungen nebst Darstellung und Kritik des Steuerwesens Schwedens* (Jena 1896). See also Richard A Stanford *An Economist's Meditations on Economy and Christianity* (Lulu 2011) 157 for some further analysis of the concept.

individual does not reduce their availability for use by others (non-rivalry), and no one can effectively be excluded from using them (non-excludability)²⁵.

Manns continues this theme, by discussing how ‘ratings fit squarely within understandings of what constitutes a public good’, in that the consumption of the ratings is nonrival because there is no marginal cost to expanding its scope of proliferation once created, and that it is almost impossible to stop consumers of ratings disseminating the information within the rating to those who have not paid for the service²⁶. The focus from scholars regarding this issue of the ratings representing public goods is squarely upon this notion of nonexcludability because, as Smith and Walter note, agencies generate ‘positive externalities’ with their ratings via reducing information costs and ‘dramatically enhancing both static and dynamic market efficiency’. The only ‘pressure point’, as the scholars call it, that the agencies have, is the ability to charge fees to the issuers of debt, rather than to the investors in debt, who could just as easily disseminate the information to non-paying investors²⁷ – a process known as ‘free riding’²⁸. This phenomenon began in the late 1960s and early 1970s after the collapse of Penn Central, a company which was given the highest standard of creditworthiness by a competitor of the rating agencies, the National Credit Office²⁹, and which would subsequently fail; this led to the marketplace requiring another form of ranking creditworthiness, and the rating agencies of S&P and Moody’s were there to meet the demand. At the same time, the relatively rapid increase in the public exposure to photocopying technology³⁰ essentially forced the hand of the agencies, as they had just lost their ability to exclude people from receiving the benefit of their products. This switch from the ‘investor-pays’ remuneration model, to the ‘issuer-pays’ model, was certified by the Securities and Exchange Commission in 1975 with its official ratification of the top two rating agencies who had recently altered their remuneration models³¹, and thus the creation of

²⁵ Ulrich G Schroeter ‘Credit Ratings and Credit Rating Agencies’ in Gerard Caprio *Handbook of Key Global Financial Markets, Institutions, and Infrastructure* (Academic Press 2013) 385.

²⁶ Jeffrey Manns ‘Rating Risk after the Subprime Mortgages Crisis: A User Fee Approach for Rating Agency Accountability’ [2007-08] 87 North Carolina Law Review 1060.

²⁷ Roy C Smith and Ingo Walter ‘Rating Agencies: Is There an Agency Issue?’ in Richard M Levich, Giovanni Majnoni, and Carmen Reinhart *Ratings, Rating Agencies and the Global Financial System* (Kluwer 2002) 293.

²⁸ Andrew Crockett *Conflicts of Interest in the Financial Services Industry: What Should We Do About Them?* (Centre for Economic Policy Research 2003) 45.

²⁹ Andrew Fight *Understanding International Bank Risk* (John Wiley & Sons 2004) 48.

³⁰ Eva H Wirten *No Trespassing: Authorship, Intellectual Property Rights, and the Boundaries of Globalisation* (The University of Toronto Press 2004) 61.

³¹ The term ‘Nationally Recognised Statistical Rating Organisation’ (NRSRO) was declared by the SEC in the amendments to Rule 15c3-1, see *Notice of Revision Proposed Amendments to Rule 15c3-1 under the Securities Exchange Act of 1934*, Release No. 34-10, 525, 1973 SEC LEXIS 2309 (Nov. 29, 1973).

a ‘Public Private Partnership’ in the field of credit ratings was officially born (although it is worth noting that the state had tried before, but the environment was not susceptible to the partnership³²).

Many scholars have stated that this element - the element of now providing a product that is seemingly nonrival, because everyone can enjoy the benefits of the products and is also nonexcludable, because now the issuers pay for the products – is the key determinant to categorising the agencies’ products as being ‘public goods’ in the economic sense³³.

However, there are others who attribute a broader understanding of the term ‘public good’ to the equation, and that understanding is just as important for our analysis. Mohammed Hemraj has stated that rating agencies have ‘become a public good that serves the interest of the entire financial system’³⁴, whilst Duan and Van Laere note that ‘credit ratings are therefore better viewed as an infrastructure matter, much like roads, air traffic control, and the public education system’³⁵. Other scholars have connected the act of rating to the idealistic properties of the marketplace moreover, with Botsch stating that the ‘transparent rating of assets and liabilities is a public good in open and transparent markets’³⁶. There are a number of other scholars who have designated the agencies and their output as being part of a broader

³² Marc Flandreau and Joanna K Sławatyniec ‘Understanding Rating Addiction: US Courts and the Origins of Rating Agencies’ *Regulatory Licence (1900-1940)* [2013] 20 *Financial History Review* 3 238.

³³ For just a small representative sample of the scholars who follow this line of reasoning see Gregory Husisian ‘What Standard of Care Should Govern the World’s Shortest Editorials? An Analysis of Bond Rating Agency Liability’ [1989-90] 75 *Cornell Law Review* 456; Frank Partnoy ‘The Siskel and Ebert of Financial Markets? Two Thumbs Down for the Credit Rating Agencies’ [1999] 77 *Washington University Law Quarterly* 3 653; Lawrence J White ‘The Credit Rating Industry: An Industrial Organisational Analysis’ in Richard M Levich, Giovanni Majnoni, and Carmen Reinhart *Ratings, Rating Agencies and the Global Financial System* (Kluwer 2002) 43; Katharina Holzinger *Transnational Common Goods* (Palgrave Macmillan 2008) 57; Yair Listokin and Benjamin Taibleson ‘If You Misrate, Then You Lose: Improving Credit Rating Accuracy Through Incentive Compensation’ [2010] 27 *Yale Journal on Regulation* 96.

³⁴ Mohammed Hemraj *Credit Rating Agencies: Self-Regulation, Statutory Regulation and Case Law Regulation in the United States and European Union* (Springer 2015) 1.

³⁵ Jin-Chuan Duan and Elisabeth Van Laere ‘A public good approach to credit rating – from concept to reality’ [2012] 36 *Journal of Banking & Finance* 3240.

³⁶ Andreas Botsch ‘Enhancing Governance of Financial Markets Through Regulation: A Ten Point Agenda’ in Sigurt Vitols and Norbert Kluge *The Sustainable Company: A New Approach to Corporate Governance* (ETUI 2011) 233.

‘public good’³⁷, but it is worth asking an important question at this stage: this scholarly support for the agencies and their product is consistent and extremely supportive of the agencies’ position, but what if it is based on the wrong perception? What if what these scholars focus upon is what they *desire* the agencies to be, rather than what they *actually* are? The repercussions of this misaligned focus would be catastrophic in theory, and the financial crisis, unfortunately, provides the practical demonstration of that theoretical understanding.

The Desired Version of the Rating Industry

The credit rating industry has a number of desired qualities which differ depending upon one’s position. For issuers, credit rating agencies allow for the transmission of sensitive information in a codified form, so that they can attract investment without revealing sensitive information – this is known as ‘signalling theory’³⁸. For investors, rating agencies provide easily understandable and easily assimilated information upon which they can make investment decisions quickly. It also allows dispersed shareholders to constrain the actions of their ‘agents’³⁹, so that they may only invest in a certain category of debt, or that certain instances may ‘trigger’⁴⁰ investment actions (like divestment if a company receives a rating downgrade, for example). For the state, the rating agencies are required to act in a responsible and consistent manner so that they can be included within a regulatory framework, upon which larger economic policies can be executed – this may also be referred to as a system containing ‘gatekeepers’⁴¹.

There are also broader, perhaps even systemic requirements that onlookers have identified. Scalet and Kelly note that ‘in the early twentieth century, credit ratings developed as a

³⁷ For just a small sample of scholars who attribute this broad understanding to the term ‘public good’ when referring to rating agencies see Tara Vishwanath and Daniel Kaufmann *Toward Transparency: New Approaches and Their Application to Financial Markets* [2001] 16 *The World Bank Research Observer* 1 45; Steven L Schwarcz ‘Information Asymmetry and Information Failure: Disclosure Problems in Complex Financial Markets’ in William Sun, Jim Stewart, and David Pollard *Corporate Governance and the Global Financial Crisis: International Perspectives* (CUP 2011) 104; Raquel G Alcubilla and Javier R del Pozo *Credit Rating Agencies on the Watch List: Analysis of European Regulation* (OUP 2012) 249; Panayotis Gavras ‘Ratings Game’ [2012] 49 *Finance and Development – International Monetary Fund* 1 34.

³⁸ Listokin and Taibleson (n 33) 96.

³⁹ Rhee (n 4) 91.

⁴⁰ Alcubilla and del Pozo (n 37) 13.

⁴¹ Hemraj (n 34) 4; John C Coffee *Gatekeepers: The Professions and Corporate Governance* (OUP 2006) 2.

response to the demands of an investing public that wanted reliable information about purchasing securities... Historically, the development of credit ratings included the ethical undertone that this information provides a measure of fairness and equality to an investing public⁴². This ‘ethical undertone’ alludes to the founding of the commercialised rating industry by Lewis Tappan, an Evangelical businessman who incorporated piousness into the first rating agency⁴³ (although that is a particularly simplistic and perhaps misleading understanding⁴⁴). Scalet and Kelly continue by affirming that ‘reasonably accessible investing information is not merely a public good in this respect but an important component for creating conditions of justice in a capitalist society, akin to making voting reasonable accessible to all in a democratic society’⁴⁵, which is a representative viewpoint of the esteem with which the rating industry is held by concerned scholars. However, the issue for this article is that this reverence for what the rating industry is supposed to represent provides an intellectual foundation upon which the current rating agencies continue to transgress. The scholars who talk of the rating industry in these terms are aware that the current rating agencies fall short of this idealistic understanding, of course, but in continuing to prevail with this notion of what the industry *should be*, the narrative provides the agencies with an ideal at which it can claim to aim to, thereby solidifying its importance in the minds of the influential. For this article, this is an almost central reason as to why the agencies are allowed to transgress without a substantial penalty, with the proposed solution being to do away with the narrative altogether – we need to only see the rating agencies as they *actually* are, and then continue on that basis.

The Actual Output

The narrative described by this article, namely that rating agencies produce ‘public goods’ and are therefore extremely important to society, uses the term ‘rating agencies’ in a broad sense, as we have already seen. However, we should make clear here that the Big Three – Standard and Poor’s, Moody’s, and Fitch Ratings – control over 90% of the global rating

⁴² Steven Scalet and Thomas F Kelly ‘The Ethics of Credit Rating Agencies: What Happened and the Way Forward’ [2012] 111 *Journal of Business Ethics* 489.

⁴³ Bertram Wyatt-Brown ‘God and Dun and Bradstreet, 1841-1851’ [1966] 40 *The Business History Review* 443.

⁴⁴ Bertram Wyatt-Brown *Lewis Tappan and the Evangelical War Against Slavery* (Atheneum 1971).

⁴⁵ Scalet and Kelly (n 42).

market between them, with S&P and Moody's controlling the vast share. Therefore, this article asks whether it is appropriate to attach such generalised understandings to an arena that bears no comparison to that generalised understanding. There are two elements which support this viewpoint of a divergence between what people *desire* of the agencies, and what they *actually* do, and both provide clear evidence to show that the public good narrative is providing support to a particularly dangerous industry.

One of the key elements to the public good narrative is that the agencies, in providing free and open access to investors, satisfy the required characteristic of a 'public good' in that they does not exclude people from using the service, and that consumption of the rating does not affect the ability to consume for others. The agencies are keen to support this understanding and affirm that anyone can receive the full information on a credit rating⁴⁶, but research shows that this is misinformation. In reality, Langohr and Langohr found that 10% of the agencies' revenues come from investors paying to access information that is secluded behind pay-walls, and that the information that can be accessed by everyone is often outdated, lacking detailed information, and lacking the rationale for the decision – the scholars therefore suggest that what is freely available is nothing more than 'advertising messages' for investors to purchase the more detailed information⁴⁷. This is clearly at odds with the 'access to rating' aspect that supports the perpetual understanding that credit ratings constitute public goods. This technical element alone should be enough to show that the *current* rating agencies do not act in accordance with the public good narrative, and therefore the narrative should be abandoned. However, the track record of the agencies in terms of their *actions* provides more; it provides evidence that not only are the rating agencies operating in contrast to the public good moniker that has been attributed to them, they are actually a public hazard.

The credit rating industry, with particular reference to the Big Two, have been commonly recognised as being a major figure in the creation and continuation of the recent financial crisis⁴⁸. The U.S. Department of Justice (DoJ), who had taken the lead on punishing the

⁴⁶ S&P claim that anyone can contact their office and receive a report, which indicates the availability of their products, Securities and Exchange Commission *Role and Function of Credit Rating Agencies in the U.S. Securities Markets* (Public Hearing, Nov. 15, 2002).

⁴⁷ Herwig P Langohr and Patricia T Langohr *The Rating Agencies and Their Credit Ratings: What They Are, How They Work, and Why They Are Relevant* (John Wiley & Sons 2010) 173.

⁴⁸ United States Senate (n 1).

agencies due to the criminal aspect of their conduct, recently concluded a multi-year investigation into the actions of the Big Two and eventually settled with the two firms for over \$2 billion combined, which represented a record fine for the industry⁴⁹. During the investigation, the DoJ found multiple instances of the two firms conspiring with issuers *against* the position of investors, which is in no way demonstrative of the firms providing a public good in the generalist terms some have appropriated. The most famous examples are the agencies' assisting in creating 'special purpose vehicles' within which large and regulatory-constrained investors invested⁵⁰. In settling with the DoJ, for a lesser amount than Standard and Poor's owing to a divergence in record-keeping procedures, Moody's admitted to publishing information, regarding the processes involved in creating ratings, that was different to the *stated* methodologies, ultimately meaning that whilst issuers knew of the parameters being used by rating agencies to develop ratings, investors were being told something completely different, to their detriment⁵¹. Moody's is not alone in this, with S&P being banned from rating a certain category of financial products recently because they were consciously informing investors that the agency was using a certain set of parameters to rate commercial mortgages, whilst in reality they were using different parameters that had only been transmitted to the issuers of the mortgage-backed securities⁵².

These aspects alone, forgetting the fact that the agencies receive 90% of their income from issuers of debt for just one moment, are clear examples of why the article is calling for the public good narrative to be abandoned. The rating agencies that the narrative talks about simply do not exist. What does exist are two very large and very influential agencies which have *consciously* acted against investors since the moment they began charging issuers for

⁴⁹ For a review on the two cases see Daniel Cash 'Why the U.S. Department of Justice Must Act Against Moody's Corp' [2016] 37 Business Law Review 6; Daniel Cash 'The Conclusion of the Department of Justice's Investigation into Moody's: Financial Penalties but No Deterrent' [2017] 38 Business Law Review 3.

⁵⁰ *King County, Washington, and Iowa Student Loan Liquidity Corporation v. IKB Deutsche Industriebank AG, Moody's Investors Service, Inc., The McGraw Hill Companies, Inc., Fitch, Inc., and Morgan Stanley & Co. Incorporated* [2012] 863 F.Supp.2d 288 (May 4). See also the resulting case taken by CalPERS, the American pension organisation, *Complaint for Negligent Misrepresentation under Common Law & California Civil Code §§ 1709 & 1710 & Negligent Interference with Prospective Economic Advantage at 23, Cal. Pub. Employees' Ret. Sys. v. Moody's Corp. (and others)*, No. CGC-09-490241.

⁵¹ Department of Justice 'Justice Department and State Partners Secure Nearly \$864 Million Settlement with Moody's Arising from Conduct in the Lead Up to the Financial Crisis' [2017] Office of Public Affairs.

⁵² Securities and Exchange Commission *Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Section 8A of the Securities Act of 1933 and Sections 15E (d) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order* [2015] Release No. 9705; 74104, File No. 3-16348.

their ratings⁵³. Therefore, the understanding that the agencies include the fact that they operate in a manner akin to a public good in their official information, which we have seen they do not, is proof that the public good narrative is providing intellectual support to the continuation of these organisations that played a facilitative role in one of the most socially-damaging financial crashes on record. Scholars who contribute to this narrative clearly aim to promote an ideal of what rating agencies *should* be, and for that reason no blame can be attached to the proponents of the narrative – however, what the agencies *should* be is not what they are, and their actions provide clear evidence that the agencies have no interest in changing; why should they? They are currently experiencing the most profitable chapter in their history and are not being punished appropriately for their transgressions. What is required now is for the narrative to change, and for the scholarly community to represent one understanding – these agencies are venal and self-interested and, based upon their *consistent* actions, cannot be trusted to place anyone’s interest above their own in any form. We, as a discipline, are quick to criticise financial regulators for lack of action, or for taking the wrong action, but sometimes it is the case that they are misguided by what they understand, and in this instance financial regulators are hamstrung by an ideological understanding that promotes the rating agencies onto a pedestal that many cannot imagine scaling in order to remove them – it is vitally important that this ideological understanding is dismantled so that the agencies can be correctly regulated before they become involved in the next systemic breakdown.

Conclusion

There are a number of reasons for why the rating agencies were in the centralised position that they were prior to the Crisis, and also many other reasons as to why they continue to be profitable despite such poor performance. In terms of reasons for the agencies’ survival after the Crisis, there are a number of important aspects which have been considered in the literature, ranging from the usage of ratings by investors⁵⁴, the consistent accuracy of

⁵³ Research has found that the incorporation of the issuer-pays model had a *direct* effect on the classification of bond ratings, with ratings paid for by issuers being fundamentally higher than investor-paid ratings, see John (Xuefeng) Jiang, Mary H Stanford, and Yuan Xie ‘Does it matter who pays for bond ratings? Historical Evidence’ [2012] 105 *Journal of Financial Economics* 3 2.

⁵⁴ Rhee (n 4) 91.

corporate bond ratings as opposed to *structured bond* ratings⁵⁵, and the lack of a viable alternative⁵⁶, to name but a few. The reasons for why the market continues to adopt the ratings of the agencies are therefore many, but they are often of a ‘practical nature’ – they can be used by dispersed shareholders to restrict the actions of managers, to provide just one example. Yet, in this article we attempted to analyse the situation in a more conceptual fashion by looking at just one potential reason for why the agencies have managed to play a central part in an era-defining crisis but continue to post record profits. By looking at what serves as a foundation for the generalised understanding that we, as a market-focused society, *need* the agencies, this article has attempted to provide yet another reason for this paradoxical industry.

There is little argument to be had regarding the suggestions that rating agencies survive because there is, at present, few viable alternatives or that the accuracy of corporate bond ratings are so accurate that the inaccuracies of structured bond ratings have been partitioned as a separate event (which is a particularly dangerous understanding, but one digresses) to name but a few reasons; now, however, it is being claimed that there is an underlying sentiment of usefulness that actively supports the continuation and subsequently eliminates all alternatives before they are even conceived. As a result of the analysis in this article, it is suggested that when we speak of ‘rating agencies’, we do so in a targeted fashion and stick to the reality of the situation, which *should* then begin to change the *generalised* understandings of these massively influential organisations. The Big Two agencies did not just transgress alongside a number of other financial actors before 2007, they have been doing so since they come into commercialised existence. The Big Two agencies do not act with the interests of investors at the forefront of their minds, only non-profit or investor-pays rating agencies can do that. Once we begin to systemically focus on the Big Two instead of ‘rating agencies’, the picture will dramatically change – not only is it inaccurate to group all rating agencies together, it actively prevents smaller, more responsible agencies from growing into a viable threat to the hegemony of the Big Two. This ideological underpinning is not a purposeful endeavour, as we have seen in this article, but is a syntactic error that the Big Two have exploited to the detriment of the financial system, and society moreover; changing this

⁵⁵ Iain MacNeil ‘Credit Rating Agencies: Regulation and Financial Stability’ in Thomas Cottier, Rosa M Lastra, Christian Tietje, Lucia Satragno *The Rule of Law in Monetary Affairs* (CUP 2014) 180.

⁵⁶ Daniel Cash ‘The International Non-Profit Credit Rating Agency: The Viability of a Response’ [2016] 37 *The Company Lawyer* 6.

understanding can refocus our attention correctly, onto one of the very few *key* perpetrators of the financial crisis.

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