

# The Failures of Credit Rating Agencies during the Global Financial Crisis – Causes and Possible Solutions

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**Summary:** The adequacy of credit ratings is crucial for normal functioning of debt markets. Failures of credit rating agencies have strengthened the negative effects of global financial crisis, generating additional systemic risk. The errors of the agencies can be explained by many reasons as business models, conflicts of interest and absent or ineffective regulation of their activities. To overcome these major problems, we can apply different approaches. The best solution is to improve regulatory practices, combining it with limiting the regulatory status of rating agencies.

**Key words:** credit rating, rating agencies, financial crisis, regulation.

**JEL:** G24.

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## Introduction

The development of the global financial crisis put the credit rating agencies (CRA) into the center of discussions regarding the problems of the financial system. Until recently they were considered an instru-

mental factor for the reduction of information problems of the credit markets and for better investment decisions. The Asian crisis and some big corporate bankruptcies in the beginning of the decade put into question the adequacy of the ratings made. The crash of mortgage bonds that led to concussions on the other financial markets and global recession became the reason to increase the criticism. The agencies that were said to be one of the main culprits for the crisis were accused of acting against the investors' interests and of generating system risk in their pursuit of greater profit.

The current problems concerning the adequacy of the credit ratings revealed the great importance they have for the normal functioning of the financial markets. For issuers looking for financing they provide access to broad opportunities for financing, lower price for capital and greater trust on behalf of their counterparties. For investors in debt instruments the ratings provide an assessment of their credit risk, by reducing the information asymmetry and thus enabling them to make more efficient decisions. The regulators of the financial markets use the credit ratings in case of refinancing by central banks, determining capital requirements, restricting the permissible investments and many more activities of the financial

institutions. The value of ratings combined with the statutory requirements explain the crucial role played by CRA on bond markets as their activity affects all participants<sup>1</sup>.

## 1. First indications of problems

Over a long period after their establishment CRA maintained their high authority and determined adequate ratings assessing, with relative exactness, the actual probability of debtor's insolvency. The processes of globalization accompanied by increase of volatility of financial markets that have been going on for the past 20 years put into question the exactness of the credit ratings. During the Asian financial crisis in late 1990s the big CRA were too slow to respond to the processes. They maintained an investment rating of the most affected countries (Thailand, Indonesia and South Korea) until the end of 1997, i.e. 6 months after the beginning of the crisis<sup>2</sup>. During the subsequent response the reduction of ratings was too great in view of the economic conditions. This led to significant increase of the price of external financing and additionally deepened the economic crisis in those countries [10, 1999, pp. 335-355]. There are also some objective reasons for the mistakes of the agencies. Firstly, CRA assessed the Asian issuers for a relatively short period of time and the accumulated historical data was not sufficient to make a reliable rating. Secondly, the reliability of data used by the agencies was not quite high for the standards of local financial markets and the quality of financial reports of the companies was considerably lower than the one of the developed nations.

Although these factors explain to a great extent the inadequate ratings the question of why CRA did not refuse to assess the Asian companies and governments provided they had known of the great risk of mistakes, remain open.

Another critical point for the CRA are the bankruptcies of several big corporations in the developed nations in the beginning of this century. The first such case was Enron in 2001. The company had an investment rating of (BBB-) 4 days before the official bankruptcy despite the fact that the information about problems had been available months in advance. In 2002, the agencies awarded Worldcom an investment rating two months before bankruptcy and in 2003 Parmalat was awarded the same 18 days before bankruptcy. In all three cases the most recent ratings of the agencies determined the companies as stable, without any implication hinting solvency problems. In support of the rating agencies one could state the argument that in all three cases there was fraud and that the information submitted by the companies was false. In contrast to the auditors CRA have no powers to examine the correctness of data and entirely rely on issuer's good faith. Save for these popular cases, in that period, as a whole, they responded slowly to the considerable fluctuations of the financial markets. Research shows that the CRA increased or reduced the rating not only once but at small steps over time [4, 2004, pp. 2679-2714]. The argument of the agencies is that by doing so they follow a policy of "through-the-cycle rating," where ratings remain stable in the course of the economic cycle. For that purpose CRA do

<sup>1</sup> The significant importance of CRA is confirmed by the information about their activity. Standard and Poor's has assessed debt instruments at par value of more than USD 30 trillion, including more than 1 m securities issued by more than 42,000 issuers in more than 100 countries. The figures for Moody's are similar [14, 2006, p. 66].

<sup>2</sup> The Asian financial crisis started on July 2, 1997 with the devaluation of the Thai baht.

not change their assessments of debtor's creditability if only temporary changes have occurred in his financial condition. Thus the rating reflects not the current assessment of the probability of bankruptcy, but the one in the long run, which better meets the investors' interests. An additional argument to support the ratings' stability is that by doing so one contributes to the reduction of fluctuations of the bond markets. However, the maintaining of stable ratings must not be at the expense of their exactness. In times of great changes of the market conditions the ratings "lag behind" the actual situation and in some more extreme cases such as the aforesaid they can be entirely inadequate.

## 2. Failures during the global financial crisis

While in the case of the Asian financial crisis and the concussions in 2001-2003 there were also some objective reasons for CRA's wrong decisions, the global financial crisis of the past three years demonstrated that the problem concerning the inaccuracy of the credit ratings could be due entirely to their mistakes. Some cases again deal with bankruptcy of big corporations. In September 2008, Lehman Brothers went bankrupt while the investment bank's rating was an investment one (A-). The insurance company AIG had the same rating (A-), when it was bailed out by the state's financial aid and in both cases no fraud and no submission of false information has been found, the companies were public and operated on the most developed financial market, with the highest standards of transparency and the deterioration of their financial condition was

not temporary but permanent. In these cases the mistake of the rating agencies is beyond any dispute.

Despite the individual cases of inadequate ratings the agencies' ratings of corporate bonds as a whole do reflect the actual level of credit risk. For the period 1981-2009 the average of Gini coefficient used to measure the adequacy of awarded ratings<sup>3</sup> was above 77 % for the bonds in case of a three-year time horizon. As a whole the index has not fallen below 75 % over the years<sup>4</sup>, as in some years it exceeded 90 % [16, 2010].

The most significant failure of CRA is, however, the assessment of the risk mortgage-backed securities and mostly of collateralised debt obligations (CDO). In the middle of 2007, Moody's and Standard and Poor's reduced the rating of structured financial instruments (SFI) to the amount of USD 26,7 billion issued in 2006. Some of them were from old tranches that had a rating of AAA, and a great part of the remaining ones had an investment rating. Until the end of the year the agencies reduced the ratings of securities for another USD 69 billion and placed instruments amounting to USD 105 billion under monitoring [8, 2008, pp. 81-110]. By the development of the crisis the reduction of the ratings on a global scale affected issues amounting to USD 3 trillion. The CDO are quite problematic. For the period 2006-2007, 66 % of the issues had reduced rating as 44 % the reduction of the rating was from investment into speculative one, including insolvency [18, 2008]. Such large-scale and considerable reduction of the ratings happening only 1-2 years after their issuance has not been observed in history in

<sup>3</sup> Generally, the meaning of these coefficients is to reflect to what extent the probability of insolvency assessed by the ratings coincides with the actual one, see. [12, 2008, pp. 339-341].

<sup>4</sup> The exceptions are 1982 with a value of 68 % and 2008 when it was 60 %.

other instruments and apparently points to some crucial mistakes upon observation. The failure is intensified by the fact that most SFI were issued with the advice of the rating agencies so that they have permanent rating (mostly investment one). The reduction of the rating evidenced the fully erroneous concepts of credit risk measurement applied by the agencies.

The weakness of CRA in the ratings of SFIA is confirmed by the Gini coefficient. Over the past 15 years its values have not dropped below 80 %. However, a dramatic drop was observed by the start of the global financial crisis: 67 % in 2008 and 44 % in 2009. The values of CDO are even lower: in 2009 their coefficient was only just 15 % [17, 2010].

### 3. Reasons for the mistakes of rating agencies

**D**etermining inadequate credit ratings, especially in case of structured instruments, which considerably contributed to the scale of the crisis, calls for defining the reasons that led to such failures. They can be summarized in the following directions:

- *“Issuer Pays” business model* and the conflicts of interests related thereto. The fees for determining a major part of the ratings are paid by the issuer of the securities as CRA become dependent on them. The agencies have an incentive to overrate the creditability of the debtors and to determine a rating higher than the actual one because by doing so they will attract more clients and will not lose present ones who would go to another agency. This is in conflict with the investors’ interests requiring adequate assessments of the issuer. The problem with the business model is aggravated in the case of SFI because a great part of their issues

are controlled by a few big investment banks ensuring a substantial portion of CRA’s income.

- *The lack of powers to ensure and examine the information.* The credit ratings are determined based on information provided voluntarily by the issuer. CRA have no powers to examine the veracity of the information, and they can not require any additional information by compulsion. Thus, there is a risk that the issuer can conceal unfavorable information which enables overrating.

- *Lack of competition.* The ratings market is an oligopoly of the three biggest companies (Standard & Poor’s, Moody’s and Fitch), that control 95 % of it globally [12, 2008, pp. 384-386]. This restricts the possibility that the investors receive more alternative opinions as regards an issue, reduces the diversity of applied risk assessment approaches and models as well as business models. In an environment where competition is missing, cartel agreements could be easily made to maintain monopolistically high prices for the services and to conduct coordinated policies for market segmentation.

- *Through-the-cycle rating approach.* As specified, in the case of that approach the CRA do not get influenced by the current situation. Such conduct, however, is instrumental for a slow response and quite late change, mostly as regards the reduction of ratings. Moreover, in the case of that approach the judgment of when the deterioration of creditability is temporary and when it is permanent is, to a great extent, a subjective one. This problem is aggravated especially in times of quick changes and crisis situations. The maintenance of stable rating in SFI has also procyclic effects. In case of deterioration of the economic situation, in order to maintain the same rating the leverage of those securi-

ties must be reduced and the average rate of return must be increased as a guarantee for the higher risk. In its turn, such increase will lead to higher rates of interest on loans and reduced supply of credit which will additionally deteriorate the situation.

- *The status of quasi-regulatory bodies.* The regulators make wide use of the credit ratings upon their regulation of financial institutions, as their application is in several directions.

Firstly, a number of financial institutions (insurance companies, pension funds, mutual funds on the monetary market) are allowed to invest in debt instruments only if they have investment rating made by an established CRA.

Secondly, when determining the capital requirements for banks and other financial institutions the risk weights of various instruments are determined based on their credit rating as a higher rating of assets owned means lower requirements for minimum capital.

Thirdly, when granting refinancing of commercial banks the central banks require that the collateralized debt securities have a minimum credit rating.

By these regulations, the rating agencies acquire, in practice, regulatory power as the change of the credit rating (especially the reduction thereof below the investment one) has considerable impact on the decisions of a number of investors. The regulatory status of the ratings has especially unfavorable effect and creates systematic risks because it stimulates the financial institutions to invest in overrated securities. Thus, they can assume risks greater than the regulated ones, maintain lower capital and realize greater margin of profit. This effect is

quite strong in the case of SFI which are used mostly for regulatory arbitrage. The regulatory status of the ratings enables a dangerous match of the interests of issuers and investors towards overrating.

- *Combining rating and consulting services.* Usually CRA not only determine issuer's rating but they also advice him of how his rating would be affected by his different actions. Thus the agency's dependence on the issuer increases because it receives additional income from the issuer. The problem is quite serious in the case of structured instruments because there CRA consult the originator or arranger bank as to what securitization parameters should be in order that the securities to be issued have certain rating. Then, the same agency assesses the securities' rating. Obviously, provided that it gave an opinion and received payment to structure the transaction the agency could hardly give an independent assessment of the rating.

- *Lack of alternative assessments.* In a number of cases the ratings are the only assessment of the credit risk of instruments. The investors cannot compare them to other indices and thus they cannot judge their extent of adequacy. A typical example are the primary markets for debt instruments. With respect to investment on secondary markets of corporate bonds the issue is not that serious because some of them are quite liquid in order that one can obtain information about the spreads of return. For other bonds the credit risk can also be assessed by the spreads of Credit Default Swap (CDS). Again, the most problematic are SFI for which either there is no secondary market, or it has quite low liquidity. Thus the opinion of CRA remains without any alternative and the exactness of ratings is of crucial importance.

- *Use of inadequate mathematical models.* This problem is typical for the assessment of structured instruments. In contrast to traditional bonds where the rating is awarded based on a fundamental analysis and expert's assessment of issuer's financial condition, in the case of structured finances the CRA rely only on mathematical models, by which the probability of insolvency of different tranches is modeled. To obtain an exact rating, the model must take into account all risk factors. The events during the global financial crisis showed that in most cases the models used are incomplete. They do not account for the presence of asymmetry of the information among borrowers, originator banks, financial institutions securitizing them (arrangers), rating agencies and investors. A typical example is the so-called originator risk. Originator banks have an incentive to deceive the arrangers and the rating agencies s regards the true creditability of borrowers. For the information is not examined, there is created a moral risk that the originator banks provide false information as well as reduce the criteria upon lending of loans. The problem further deteriorates due to the fact that after securitization the lending banks do not assume the credit risk any more. Thus, there is no incentive for them to maintain high standards upon lending. As a result of that risk the actual probability of insolvency under individual loans is bigger than the one implied in the model and the credit rating is too optimistic.

- *Missing or insufficient information.* For the determination of the credit rating of SFI depends entirely on mathematical models, the quality of the final result depends on the quality of input information. For many parameters of securitized loans there is no information or the information is available for relatively short periods of time, in which

different possible scenarios are not realized. For instance, in the case of the mortgage loans the information covers a past period when the prices of real estates have not fallen significantly. Thus in the models are included too optimistic parameters as regards the insolvency under individual loans and the correlations among them as a result of which the SFI's rating is too high.

- *Missing or inefficient regulation of CRA's business.* Although the credit ratings play an important role for the normal functioning of the financial system, their business was not regulated for a long time depending entirely on self-regulation. This situation is paradoxical if it is considered that the supervisory bodies award "official status" to the credit ratings upon the regulation of many financial institutions. The aforesaid problems could be hardly resolved only on the basis of CRA's voluntary action as confirmed by the practice. The first formal regulations were introduced in the USA in 1975 as in order that the ratings are recognized the CRA must be approved by the Securities and Exchange Commission (SEC). For there are no clear rules as to how such approval is made the regulation actually deepens the problems for it creates an additional barrier for entry of new competitors. Moreover, there are virtually no requirements concerning transparency, conflict of interests and quality of CRA's business. It was not until 2006 that such requirements were introduced and then supplemented in 2010. In Europe, the approach has been liberal for a longer time. Until 2009, the agencies; operations were subject to self-regulation by voluntarily compliance with the Code of Conduct of the International Organization of Securities Commissions (IOSCO), in force since 2004. [11, 2004]. It was not until September 2009 that the EU adopted a regulation to regulate the business of CRA in detail.

The specified problems explain the reasons for which CRA determine inaccurate ratings. Taking into consideration the fact that such problems are especially serious in the case of SFI the agencies' failure in that field is natural. This failure substantially contributed to the rise and scale of the present global financial crisis. The issue and investments in overrated risk mortgage-backed securities would not be of that great volume without the CRA. On the one hand, the investors would not have invested large amounts into such securities if they weren't overrated because their return would not be that high compared to the risk assessment. On the other hand, the banks would not have that inclination to securitize their loans because at a lower (realistic) rating they would have obtained lower prices for them. thirdly, the big investment banks arranging that process would have made less profit because the spread between the return they receive under securitized loans and the one they pay under tranches would have been lower if the tranches' rating were lower. The adequacy of the credit rating is of crucial importance for the motives of each of the parties and its overrating artificially stimulates the issue of SFI, thus creating conditions for the rise of a large-scale financial crisis. The situation is further deteriorated by the agencies' slow response to adjust the ratings at the beginning of the crisis due to their policy of "through-the-cycle rating." Although the agencies warned in their reports of some problems concerning the risk mortgage-backed loans was early as in the beginning of 2005, they failed to correctly account for the scale of economic downturn and did not reduced the ratings until mid 2007. This enabled the issuance of much greater amount of overrated SFI and consequently the loss for the financial

institutions having invested in them was much greater<sup>5</sup>.

#### 4. Possible approaches for addressing the credit rating issues

The critical role played by the CRA for the stability of present-day financial markets requires that a number of measures be taken to overcome the problems related to their business. A number of proposals have been suggested to reform the sector, which can be summarized in three possible approaches: 1) a radical change of the existing system; 2) improvement of the existing system by means of stricter regulations; 3) establishment of alternatives to credit ratings.

The *first approach* aims at a sweeping change of the way to determine and pay for the ratings. There are various proposals here:

- Elimination of the "issuer pays" model and restoration of the "investor pays" model. Thus the conflict of interests will be eliminated because the agencies will not be interested in overrating. If their ratings are incorrect they will lose clients. The problem with that approach is that the ratings are public goods and their consumption may not be excluded for the information about the ratings quite easily becomes accessible to the general public. In order to overcome that shortcoming the ratings could be issued with the participation of a government body selecting an agency by auction. The costs for the rating issuance will then be covered by fees to be paid by investors upon the purchase of securities [13, 2009, pp. 1011-1089]. Thus, the process gets considerably complicated and there are no guarantees

<sup>5</sup> Indeed the main portion of the loss realized by the financial institutions during a crisis is due to the investments in risk mortgage-backed securities issued in 2005-2007.

that the State will select the agencies on a transparent, unbiased and competition basis. Another shortcoming is that not only the purchasers of debt benefit from the ratings and thus the costs are not fairly allocated. Moreover, the “investor pays” model creates incentives for awarding lower-than-actual ratings.

- Preservation of the “issuer pays” model but creation of a centralized mechanism for selection of CRA [15, 2009, pp. 101-115]. In such case the issuer willing to obtain a rating turns to a specialized centralizing institution and pays it a fee. In its turn, the institution assigns the rating to a licensed agency. The selection can be random or based on quality criteria. This model also has some serious problems because if the selection is made on a random basis the CRA have no incentive to improve the quality of their performance. If based on quality requirements, the problem arises as to the objectivity of such criteria.
- Public funding of ratings. The argument is that the ratings bear the characteristics of public goods and thus the conflicts of interest are eliminated. The shortcoming of that proposal is that funding through taxes will place burden on all individuals while only a small part of them will make use of the benefits from the ratings. Moreover, there are no guarantees that there will actually be funded the top quality agencies making the most adequate ratings.
- Establishment of a government credit rating agency<sup>6</sup>. The idea is that the competition among the existing big agencies

will thus increase because such agency will give an alternative independent opinion. The problem here is whether the government agency will manage to generate quality ratings to be used by the investors because the profit and reputation-related incentive is missing. Another shortcoming is the inability of governmental organization to follow financial innovations which is a major part of CRA’s operations [6, 2003, pp. 1-73].

Most ideas of a total change of the present-day system, on the one hand, resolve existing problems, but, on the other hand, they create new ones. This gives rise to great uncertainties and their application would threaten the stability of the financial system. In this regard, the *second approach* aiming at the improvement of the existing practice by changing the regulations is less risky. Proceeding from the fact that when regulation was weak or missing the CRA made some serious mistakes the states turned to much more detailed and stricter regulations that limit the possibilities of new failures in the future<sup>7</sup>.

This process started in the USA where in 2006 a special law<sup>8</sup> introduced requirements on the transparency, conflicts of interest and quality of CRA’s performance. The regulations of CRA were further developed and detailed in mid 2010 when the bill reforming the US financial system was signed into law<sup>9</sup>.

In September 2009, EU adopted a special regulation [3, 2009] which regulates in detail the operations of the CRA and contains mechanisms ensuring the quality of ratings. In

<sup>6</sup> There is a similar proposal for establishment of a European Credit Rating Agency which is considered by the European Commission. See [5, 2010].

<sup>7</sup> The evolution of regulation process is examined in more detail by R. Kirilov [1, 2006].

<sup>8</sup> Credit Rating Agency Reform Act of 2006 [7, 2006]. The law has effectively applied since mid 2007 after the adoption of the respective delegated legislation.

<sup>9</sup> Dodd–Frank Wall Street Reform and Consumer Protection Act [9, 2010].



June 2010, the European Commission brought a proposal for amendment of the regulation to the European Parliament [2, 2010] in view of the improvement of supervision, and especially the supervision of SFI, and it is expected that the proposal will be adopted until the end of the year.

In addition to the USA and EU, the remaining developed nations have also introduced similar legislation to regulate CRA. As a whole the rules applied by different countries are similar and aim at resolving the problems in the following directions:

- Increase of competition. To that end there have been established some clear statutory rules for registration of CRA that are equally applied to all. The CRA are prohibited to make the issuers use their services by reducing the ratings or selectively change the methodologies used to determine the ratings. The use of unsolicited ratings is regulated. In the case of structured instruments the CRA are obliged to ensure access to all available information that is used to determine the rating of an instrument to any other registered agency willing to get such access.
- Restriction of conflicts of interest. As a general rule the CRA are obliged to make clear all conflicts of interests that may lead to determination of inadequate ratings and to organize their operations so as to avoid such conflicts. In particular, any persons related to or receiving remuneration from the issuer or other party interested therein are prohibited from participating in the determination of the rating. Moreover, the remuneration of persons preparing the ratings may not be dependent on the income received by the agencies from the companies under assessment. A rotation of credit specialists has been introduced so that an expert does not participate in

determining the rating of an issuer for a continuous period. The CRA are prohibited to provide additional consulting services with respect to any matters directly influencing the credit rating, including with respect to the design of SFI. CRA are obliged to appoint a compliance officer to see to the compliance with all statutory requirements as well as to maintain a review function monitoring the adequacy of the applied methodologies. The activity and remuneration of the compliance officer and the review function must be independent from the rating award activity, including with respect to payment.

- Ensuring transparency of CRA's operations. In relation thereto the regulations require the agencies to disclose detailed information about: the legal structure and ownership, big clients, income from rating assessments, income from additional services; the potential conflicts of interests and the system to overcome them; the awarded ratings, the methodology used; the quantitative models and the assumptions therein; the percentage of companies having gone insolvent by separate rating categories as well as other data necessary for the assessment of ratings' adequacy; the results from the assessment of compliance with the regulations, etc.

- CRA's liability. In case of breach of the requirements of the law the regulatory bodies have powers to seek liability from the CRA, including by imposing different penalties such as fines, periodic financial sanctions, temporary ban to award credit ratings, suspension of the use of ratings for regulatory purposes, termination of agency's registration. In USA where a practice used to exist to protect CRA against individual claims, the affected persons were granted an opportunity to seek indemnity for suffered damages at the court.

Indisputably, these detailed regulations will significantly reduce the errors and bad business practices of the CRA. The stricter rules are, however, related to three problems:

Firstly, there are no guarantees that the regulatory bodies will effectively apply them. As shown by the events from the past years one of the reasons for the rise of the crisis is precisely the regulators' inability to carry out supervision of the compliance with the existing rules.

Secondly, the strict regulations reduce the agencies' flexibility in relation to the organization of their structures and operations which increases the costs for determination of the ratings.

Thirdly, restricts the innovations with respect to the development of new, more efficient methods for assessment of creditability. The great transparency and publicity of CRA's operations greatly reduces the value of their investments in intellectual products such as the one offered by them.

In order to limit such problems the development of regulations must be combined with increase of the purely market mechanisms for disciplining the CRA. This *third approach* requires their market power to be reduced by restricting or eliminating their regulatory status. To that end the supervisory bodies must repeal the requirements to the financial institutions, based on credit ratings and replace them by their own internal mechanisms for credit risk assessment. Thus, the opinion of CRA will

not have the force of a final "verdict" and the interest in the artificial maintenance of high rating will disappear. For the presence of certain rating will not be a sufficient condition of security, the investors will start to look for alternative approaches for credit risk assessment. One of the options is to develop their own methodologies for internal ratings or to base their approach on the information obtained from the spreads under the bonds or CDS. The other option is to turn to external advisors (including the existing CRA) and pay them for the prepared assessments. The investors' desire to pay for such services will create conditions for entry of new participants and increase of competition, application of new business models overcoming the conflict of interests<sup>10</sup>, stimulation of innovations and improvement of the methodologies used. Regardless of what the selection of the financial institutions will be the supervisory bodies will have to assess whether the applied approaches correctly assess the risks and whether the risks assumed are not too high.

Although the approach to limit the ratings' regulatory status is the most efficient one, it is still unable to generate support on a global scale. Among the bigger nations only the USA apply them in practice. The law reforming the financial system adopted in 2010 removes the statutory requirements for use of external credit ratings and obliges all federal regulatory bodies to do the same in their federal legislation within one year. In contrast to the USA, EU is still discussing the issue and no single opinion has been made.

<sup>10</sup> The CRA business is quite similar to the one of the media and especially the one of the newspapers. The present "issuer pays" model is quite similar to the model of free newspapers supported by advertising only. The "investor pays" model is the same as the one used by a newspaper supported only by income generated from sales to readers. The third option is the model where both parties (issuer and investor) pay for the rating similarly to a newspaper that receives income from sales to readers and advertising. The "advertiser pays" model, where the information about ratings is accompanied by paid advertising, could be borrowed from the electronic media [15, 2009, pp. 110-111].

## Conclusion

For a long time the CRA have demonstrated their reputation and ensured important information for the participants in the bond markets. The inadequate regulation made credit ratings a critical component of the financial system, without introducing mechanisms aiming to ensure their objectivity. This set up conditions for the rise of a number of conflicts of interests which stimulated many market participants to create or invest in overrated financial instruments. The process inevitably ended by a global financial crisis, which made the question of resolving the problems related to CRA's operations a critical one. The stricter regulations introduced can be an answer only if accompanied by measures for a greater importance of the alternatives to credit ratings.

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