Foreign Ownership and the Credibility of National Rating Agencies: Evidence from Korea

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Nov 2011

The paper in a Nutshell

Global Rating Agencies (GRAs) have gained and hold high reputation capital consolidated over time. On the contrary, National Rating Agencies (NRAs, with a much shorter history) have a relatively limited reputation capital but a much stronger business specialization, i.e. in-depth knowledge of local markets. How financial markets evaluate the information value of reputation versus in-depth local knowledge?

- The paper investigates the Korean bond market reaction to rating changes by the two groups of agencies using an event study methodology. Results show that in most cases the two GRAs affiliates are dominated by the only independent, Korean owned, NRA.

Discussion I

- Since 2001, KIS has been affiliated to Moody's (50% + 1 share) whereas KR has been affiliated to Fitch (started with 9.01% and increased to 54.4% in 2007). Using data before 2001, it would be interesting to compare the (cumulative) abnormal returns of KIS and KR before and after their affiliation with GRAs.
- In Table 3, the abnormal return of NICE at $t = -3$ is 0.076 whereas all the other abnormal returns (excluding $t = -3$) are in the range of -0.02 to 0.003. I find this value particularly surprising for a downgrade. It clearly affects all the cumulative abnormal returns from $t = -3$ onwards. I believe that the mixed evidence for all Downgrades in Table 3 is due to this abnormal return. More interestingly, it disappears when only 1-notch downgrades are considered.

Discussion II

- In general, the choice of the event-window is quite arbitrary, and in this case a 21-days window can be considered a quite wide one. I would suggest to use a shorter event-window, say [-5, 5]. From the evidence shown around the event date, I think that the new window would provide an additional confirmation of your results.
- The 21-days window around a given agency rating-change may overlap with the 21-days window rating change event operated by another agency. Then, variations in yield premia could (in part) contain information on multiple-agency rating changes. It would be interesting to quantify (or to disentagle) this additional effect.