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Policy Brief

CENTRE FOR COMPETITION POLICY

March 2017

Does the disclosure of unsolicited sovereign rating status affect bank ratings?

British Accounting Review

Does the disclosure of unsolicited sovereign rating status affect bank ratings?

KEYWORDS: Bank ratings, Rating agency regulation, Unsolicited ratings, Sovereign-bank rating channel

TYPE OF PUBLICATION: Journal article

SUGGESTED CITATION: Klusak, P., Alsakka, R., Gwilym, O. A. (2017) Does the disclosure of unsolicited sovereign rating status affect bank ratings? The British Accounting Review, 49(2), pp. 194–210. doi: https://doi.org/10.1016/j.bar.2016.08.004

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BACKGROUND

- Credit Rating Agencies provide internationally recognisable risk assessments which set the foundations for investment decisions.
- Sovereign ratings affect long-term investment and international lending decisions as this assesses the creditworthiness of nations.
- By downgrading ratings, issues arise, including rising credit costs and obstructed market access.
- Regulation has been implemented by the European Commission in order to reduce the financial instability they create.

METHODOLOGY

- The paper combines three topics: regulation, unsolicited credit ratings and the sovereign-bank rating ceiling.
- The paper uses a dataset which consists of S&P ratings of 147 listed banks from 42 sovereigns in Europe, Asia–Pacific and Latin America for January 2006–January 2013. This was used to determine whether the regulatory changes had a negative impact on bank ratings in specific countries whose sovereign rating were changed to unsolicited.

KEY FINDINGS

- Using the dataset, banks that are in states whose ratings changed to unsolicited status display higher probabilities of rating downgrades and lower probabilities of rating upgrades in relation to other banks.
- Downgrades to sovereign ratings negatively impact bank ratings due to the rating channel.

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POLICY ISSUES

- The strong ceiling affect has fallen under the radar of regulation. With the regulation created in 2011 EU regulators failed to connect the issues of unsolicited rating and sovereign-bank linkages.
- Future regulatory reforms need to be undertaken with caution as they might further aggravate the conditions for debt issuers.

THE CCP

The Centre for Competition Policy (CCP), at the University of East Anglia, undertakes competition policy research, incorporating economic, legal, management and political science perspectives, that has real-world policy relevance without compromising academic rigour.

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