THE RATING AGENCIES IN THE INTERNATIONAL POLITICAL ECONOMY

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***Abstract**: The internationalization of the economy, the integration of national markets for goods, services and capital, the internationalization of production and generally augmentation of international movement of factors of production and the growing economic interdependence in recent decades have caused a rapid increase in the construction and use of indicators for assessing countries. Typically the comparative evaluation of countries is conducting, using simple or complex indicators, based on quantitative and / or qualitative variables. The results of comparative evaluation of counties usually concern the policy makers, markets and public opinion. The concentration of information in an index seems to have a practical significance and facilitate comparison between countries. From the position that a country conceives in the list of evaluation has certain economic and political implications. The different evaluation systems (indicators) of countries have however advantages and disadvantages. Many organizations for example publish indicators for the competitiveness of countries. Widely known indicators are competitiveness of World Economic Forum (WEF, Geneva) and the Institute for Management Development (IMD, Lausanne). There are also indicators of corruption, bureaucracy and regulations, investment climate, political risks and security risks. Agencies and organizations like the World Bank, IMF, EU and the OECD publish indicators often for a number of specific issues.*

The indicators and assessment methods of countries are often the basis for empirical economic research, data useful for counseling policy and guide action. For governments evaluation of countries is an important form of information. The advantage is that the indicators reflect complex relationships of world economy. The advantage is at the same time the disadvantage. And this is because they provide only general information. The aim of this article is to evaluate the importance of rating agencies to the configuration of world economy. For this reason, we will study the historical development of rating agencies and the causes of this development. The article also examines the issue of interest conflict and the potential impacts to state economies. Finally, it is examined the impact of rating agencies to international economic crisis.

***Keywords:** Rating Agencies, International Political Economy, International Economic Crisis, Interest Conflict*

JEL Classification Codes: F30, F59

1. INTRODUCTION

The global financial credit crisis of 2008 abruptly halted the development of financial markets which for the period from 1995to 2005 recorded an increase in capital flows by 166.67%; from 6% to 16% of global GDP (Deeg and O'Sullivan 2009). Within just a few months 14 trillion dollars in bonds, with high evaluation rate, were considered junk. As a result the chaos created in the financial market highlighted the phenomenon of global mistrust against global markets assessment system (Scalet and Kelly 2012). At the same time it was obvious that practically globalization was accompanied by an in parallel burst of economic, financial and credit services as a percentage of the total economic activity. Also their influence was expanded over the rest of political economy, a fact certified by the agenda of the newly established Group of 20 (G20), where for the first time it was so intensively expressed the need of formulating policies and rules of operation for these services. (Helleiner and Pagliari 2011).

Bond Credit Rating Agencies have both a dominant role in financial market but also in the debate regarding the causes of global crisis (Papaikonomou 2010). Friedman's publication in New York Times is characteristic by claiming "There are two superpowers in the world today in my opinion. There's the United States and there's Moody's Bond Rating Service. The United States can destroy you by dropping bombs, and Moody's can destroy you by downgrading your bonds. And believe me, it's not clear sometimes who's more powerful ". Especially after the outbreak of the crisis there have been many studies and scientific analyses that deplore the role of bond credit rating agencies in global financial credit crisis (Calomiris and Mason 2009, Pagano and Volpin 2010, Becker and Milbourn 2008, Hunt 2009). They pay special attention in both cases; the bankruptcy of Enron, where all three major bond credit rating agencies have suggested to their clients to invest in Enron bonds, just five days before her bankruptcy; and in the case of Lehman Brothers where she was upgraded shortly before collapsing.

This paper aims in determining bond credit rating agencies' role and overall power over international politics and economy by exploiting a multilevel approach, using the toolbox of international political economy, notably through the analysis of effects and empirical investigation. More particular, the analysis focuses on the investigation of the role and function of rating agencies in market organization but also in evaluation models and methods applied. Also it will investigate all factors that transformed rating agencies, in international economical protagonists and the way they apply influence in economic policy and politics in general. Finally we will try to demonstrate the role of bond credit rating agencies during global financial credit crisis.

2. ROLE AND OPERATION OF CREDIT RATING AGENCIES

Bond credit rating agencies are considered key players in modern international capital market. They act as peculiars intermediates between lenders and borrowers. These intermediaries provide information and assessments focused primarily for the future and not for the past. Having as a basic function to increase transparency in capital markets and the mitigation of information asymmetry between borrowers and lenders they produce public good, although they are private entities. The added value of information provided depends on their level of information's access, their manpower and their motivation for quality. Bond credit rating agencies were established for providing investors with reasoned analysis of risks associated with a wide range of investment products such as bonds and other securities, but also for evaluating creditworthiness of government and private firms bonds. Typically, rating agencies are not part of the purchase or sale procedure of securities, but rather they estimate the probability of the issuer to meet its loan obligations (repayments and interest payments). Therefore, their ratings have broad implications in international financial markets.

The development of railway network and companies in U.S. in the mid-19th century, their desire in raising funds from general public and the need for objective public's information triggered the first credit ratings. Thereafter and particularly the global crisis of 1929, significantly increased their effect. Today, of great importance is the credit evaluation of countries (Sovereign Ratings). National governments are the largest customer of international capital markets with over 60% of issued loans. State's credit ratings were established in order to protect lenders, but primarily banks that mainly lend to states, and more generally for ensuring smooth functioning of capital markets.

However, the effects from bond credit rating agencies operation have been amplified dramatically over the past 20 years. Today assessments are associated with financial contracts and investment procedures, thus with the whole regulatory framework. The announcements of these firms have systemic consequences (Bank of England 2011). The firms must balance between stability evaluation and short-term accuracy. The assessment should be modified when also the final credit rating is modified (Löffler 2005) and observation and investigation of crediting rate should be continuous. For mitigating contrast between stability and accuracy, rating firms publish statements of intentions, without however changing rates. It is a common misconception to underestimate the importance of statements compared to rating, although in practice they have almost the same impact on markets (Afonso et al 2011, Alsakka et al 2011, IMF 2011).

3. ANALYZING GOVERNMENTAL CREDIT RATING AGENCIES

All three major rating agencies after the global financial crisis of 2007/8 are considered as key factors in international economics and politics (Sinclair 2008). Initially they suffered aggressive criticism for their extremely favorable (inflationary) of many heavily indebted credit institutions such as Lehman Brothers, and many derivatives and structured financial instruments linked to mortgages. Some market individuals consider bond credit rating agencies as one of the major factors that contributed in U.S., housing bubble and its burst, which triggered the global financial crisis. After year 2010, bond credit rating agencies were linked to the EU's debt crisis, Eurozone's systemic crisis, and also to the effecting management of U.S. government debt. The constant and intense degradation of most EU countries credit rating, but also the deterioration of U.S. rating, for the first time in its history by S&P, provoked strong objections, mainly from the political arena. In some cases, they are accused for aggressive or even for on purpose state downgrading, and conspiratorial attitude towards the euro currency and euro area member states. For example, Gysi, of German party Die Linke, spoke for "war against the European people". Another German Member of Euro Parliament and staff officer of German Christian Democrat Party spoke of "currency war" and for promotion by bond credit rating agencies of "Anglo-American political interests." A former stockbroker, Dirk Müller said: "I am certain that the American rating agencies are in close coordination with the American government, which in turn has been dominated for many years by Wall Street" (http://www.spiegel.de/international/europe/0,1518,809696,00.html).

These developments have given great impetus to relevant scientific research with a large number of publications on their role and functions on capital market organization, their links with large businesses and financial policy, the interests they may serve, the impact of their assessments, the need of auditing or replacing them, their influence on governments and economic policies, etc. Beside scientific research, the, for decades unknown, bond credit rating agencies were suddenly well known to the general public through public media. Furthermore, it seems that two major trends or concepts are being formulated: the first one includes most politicians and a part of researchers and analysts who consider bond credit rating agencies as a factor causing the crisis, due to their dedication in serving specific interests and / or because of certain methodological and operational drawbacks. Consequently, a number of concrete, although divergent, interventions for structural changes in evaluation systems are suggested. But there is also another view which claims that bond credit rating agencies are performing an important work on the functioning of international financial markets, despite the unquestionable drawbacks and omissions of their applied methodologies, and thus they are unfairly blamed for causing crisis; also rejecting any conspiracy theories,. The statement of Stefan Kaiser from Spiegel online is an indicative text for this point of view: «Even if one ignores the lack of evidence, the arguments put forward by the conspiracy theorists are extremely thin. What interest would the US economy have in the euro plunging in value? How would a collapse of the monetary union help? On the contrary: Washington needs the euro. A strong European currency makes American exports cheaper in the euro zone, helping the US to reduce its enormous trade imbalance. In addition, the US could hardly remain unaffected by a deep recession in Europe and the potential break-up of the currency union. That is why US President Barack Obama has repeatedly urged European leaders to act decisively. US banks would also suffer greatly in case the euro zone collapses. Some of them are deeply exposed to the euro. Their balance sheets either contain government bonds issued by ailing euro-zone states or they have issued credit-default swaps, which must be paid out as soon as a euro-zone member state goes bankrupt. According to the Bank for International Settlements, the bulk of such securities have been issued by US institutions. This leaves the US hedge funds, which have supposedly been betting against the euro and want to earn big bucks by doing so. That may be, but are just a few hedge funds enough to organize a great American conspiracy? An alternative interpretation is much more likely. Politicians, authors and bank analysts prefer to present rating agencies as bigger and more powerful than they really are. The beautiful conspiracy theories which result are useful in distracting attention from one's own mistakes(http://www.spiegel.de/international/europe/0,1518,809696,00.html).

4. THE CAUSES OF INTERNATIONAL EXPANSION AND OPERATION OF CREDIT RATING AGENCIES

Credit rating agencies had for decades only national dimension, operating just within the U.S. Their appearance on the international stage and development of international power and influence occurred during the last 20 years. The question that arises relates to the factors that contributed to this international emergence. In summary, the key factors of internationalization and strengthening of rating agencies were:

- The debt crisis in Latin America and the banking-currency-financial crises in Southeast Asia in 1997/8.
- The internationalization of financial markets. The interdependence of national money and capital markets, the development of relations between institutions of all countries, the international expansion of commercial banks', investment banks' and hedge funds' activities and networks, the international allocation of national financial products, etc. triggered the creation of an international regime of transparency and information

among market participants. This role was assigned to the experienced and incorporated in the market of U.S. credit rating agencies.

- The need for public and private borrowing in U.S. markets: The international trend of public and private sector to issue bonds and other securities in U.S. dollars, along with their willingness to be funded by U.S. credit institutions due to the largest and deepest capital market worldwide, demanded for institutional and practical reasons, the initial evaluation of certified U.S. agencies.
- The growth of securitization and financialization of international capital markets. The turn from traditional financing through bank loans to finance by issuing new complex structured securities increased the need for evaluating the creditworthiness of issuers and of securities themselves. The creation of structured products and derivatives such as CDS, CDOs and the expansion of covered financing (asset-backed finance, 40% of a purchase of $ 30 trillion) through securities (collaterals) caused a dramatic increase in international financial market and expanded credit rating agencies' activities.
- Institutional arrangements. For decades only U.S. authorities demanded previous assessment of both securities and issuers by certified bond credit rating agencies in order to approve certain methods of financing. Subsequently, similar institutional arrangements were introduced in other countries including EU. In parallel in international level, taking as an example "Basel 2", the evaluation obligation for determining the necessary reserves and banks' risks was established. Therefore, it was the states and the international organizations themselves that contributed in the expansion of international presence and activities of credit rating agencies. After the international financial crisis and Eurozone's debt crisis a significant effort is applied for reducing the importance of external evaluation and promoting internal evaluation procedures of financial institutions.
- The political factor: It is of great intense the criticism often practiced by leading politicians to credit rating agencies that has resulted in an increased effect of their point of view in public opinion. These practices reveal the importance that politicians are giving to credit rating agencies blaming them (rightly or wrongly;) for the economic problems their countries experience. Therefore, it is suspected that credit rating agencies often play the role of a scapegoat. On the other hand, despite intense criticism, in practice, policy makers seem to be decisively influenced by the reviews. It's a characteristic example the peculiar economic diplomacy that is developed in Eurozone, where a group of four countries with AAA rating, meet and consult as a group outside the established procedures of the Eurogroup.

5. CREDIT RATING AGENCIES OPERATIONAL EVALUATION

Rating Methods and their Reliability

Scientific research aims in estimating reliability and completeness of evaluation methodology of the certified agencies. However, agencies constantly refuse in publicizing details regarding the applied methodologies and their evaluation criteria. Only recently there have been certain changes in legislation, in order to ensure greater transparency in evaluation methods. For example, S&P published its June 2011 relevant report (Standard & Poor's 2011).

Some studies conclude that the most heavy weighted variables for these agencies to rate countries' creditability are the per capita GDP, growth rate, public debt and deficit. (Afonso / Gomes / Rother 2011, Pagano / Volpin 2009). They seem however to offer less weight, in factors of great importance such as liquidity, debt composition, currency imbalances, asset prices etc. that however are useful for estimating and predicting debt crises (Detragiache / Spilimbergo 2001). Also, they do not measure important indicators such as competitiveness and real wages.

Reinhart studied 62 country cases and concluded that the macroeconomy indexes were more accurate for predicting a debt crisis, than the estimates of S&Ps (Reinhart 2002, Goldstein et al 2000).

Regarding ratings' accuracy it is noted that all these evaluations are directed linked to probabilities. For example, as it can be clearly shown by an empirical observation, an issuer with a bad score can avoid bankruptcy, while a high rated can bankrupt. An AA degree means a low probability of bankruptcy, while BBB indicates a higher one. The evaluators do not publish exact ratios. Consequently, their reliability cannot be measured in individual cases, but rather in comparison between each case. Thus research needs to be performed for linking probabilities and temporal checks, something that have not been done so far.

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One of the major issues for evaluating Eurozone countries refers to the lack of experience and a well defined methodology for assessing a single country inside the monetary union. Much more this statement is valid for assessing the risk of transmission of a debt crisis (domino effect) in other countries inside the monetary union.

Regarding the correlation of evaluations of all agencies, Cantor and Packer (1996), found that three incumbent firms evaluate in a common gait. Strong correlation can be observed in S&P's and Fitch's evaluations in downgrading Greece (0.98) and S&P's and Moody's for Ireland and Portugal.

Also it was found that evaluations show strong correlation when the economy is in growth phase while they divergent when the economy is in recession (Croce / Lugo / Faff 2011, Cantor / Mann 2007, Wang 201).

Conflict of interest and biasing

Credit rating agencies as profit making companies are paid by issuers (principle "issuer-pays»). The publisher orders to a credit rating agency the evaluation of the securities he issues or just an interim or ongoing assessment. This practice was established during the seventies. Previously credit rating agencies were paid by investors through subscriptions («subscriber-pays»). The leak of information and the inability to in depth analyses led to this change in fees model, thus payment for the investor to the issuer (borrower). Also, according to the Congressional Research Service, this shift in payment from the subscriber to the publisher was supported by the observation that loan publishers were more willing to pay for the valuation of their securities. The information is offered to the investing public free of charge. The fact that the issuer pays adds an important point of criticism to credit rating agencies for conflict of interest in the sense that the one who pays for the relevant rating might demand a more favorable evaluation, resulting in tricking investors (Wighton 2009). Inflationary assessments for a number of institutions and securities in the U.S. are used to substantiate this criticism. The favorable treatment of publishers has been pointed by another company that is still based on the subscriber pays principle (Egan-Jones Ratings Company). American Enterprise Institute is also more favorable of this principle. In defense of the practice applied however it is the opinion that long-term reputation and credibility of credit rating agencies is much more important considered to the hypothetical economic benefits of favoring a loan publisher.

The oligopolistic market structure and its implications

The bond credit rating market is dominated by three large companies, the so-called Big Three. Their share in the relevant market is approx 95% (2010).

The three big agencies appear to be US orient. For example, 54%of Moody's turnover originates from U.S. market where is located the 52% of its total manpower. The same figures for Fitch are 42% and 35% respectively. Due to the oligopolistic market structure their profit margin appears to be extremely high (45% for S&P, 38% for Moody's and 30% for Fitch for year 2010). Because of their dominant position for more than 100 years, new entrants have failed to take significant shares of the market. It is noted that firms evaluate different types of publications, not just countries. For example, Fitch announced that during 2009-10 has evaluated 6,000 financial institutions 2,000 non-financial corporations, 100 states and 200 communities, 300 bond issues for infrastructure construction projects, 46,000 U.S. municipal bond issues and 8,500 publications of structured products (Annual Report of Fimalac 2009/10). There are strong suspicions that lower charged fees by credit rating agencies converge, which indicates a concerted practice. On the other hand, however, regular customers negotiate their payments, which lessen the importance of harmonized taxes (Bolton et al 2009)

Oligopolistic structure of the credit rating market is a further point of criticism for excessive force, for existence of artificial entry barriers, for low evaluations quality due to lack of sufficient competition, etc. The debate regarding the oligopolistic structure however has not primarily to deal with the presence of just three companies, or with the indications for abusive pricing policy, but rather with the quality of the applied assessment methods and ratings accuracy. According to a survey, competition reduced the quality of assessments; they often have common assessments (Becker / Milbourn 2010). In the absence of competitors may be little fear of reliability loss in the case of occurred errors. For example, despite their inaccurate rankings during 2008 crisis, all three houses retained their market shares.

High market share concentration does not necessarily mean lack of competition. Other markets, highly concentrated, (eg Coca-Cola and Pepsi Co., Financial Times and Wall Street Journal, Thomson Reuters and Bloomberg, Boeing and Airbus) have intense competition. It is possible, that financial markets do not desire different scoring methodologies difficult to comparison among them. According to the relevant World Bank publication, "there may be a benefit in having a limited number of global credit rating agencies" (Katz, Salinas, and Stephanou 2009). According to another opinion, credit rating agencies do not prevent themselves new firms' entry. It is the long time since their establishment, the necessity for word of mouth and the necessary amount of investment in capital that really set the most important barriers to entry in this market (White 2002).

Also, the fact that the two largest companies (S&Ps, Moody's) have their headquarters in the U.S. and are subsidiaries of major investment banks or other commercial enterprises raises objections for their impartiality, but also feeds conspiratorial theories for aggressive practices against euro and in fond of dollar. Against these conspiratorial theories, stands, for example, the fact that S&Ps downgraded U.S. ratings during a critical period of time, the fact that they have subsidiaries outside U.S. or that Fitch is a subsidiary of Fimalac, a French company. After the downgrading of U.S. creditability by S&Ps on August 7, 2001, the U.S. finance Minister Timothy Geithner said that S&Ps "shown really terrible judgment and they've handled themselves very poorly».

Table 1: Basic Business Data of the Rating Agencies

Year 2010	S&Ps	Moody's	Fitch	Others
Proceeds (Million USD)	1,696	2,032	657	n/a
Operating Profits	762	773	200	-
Market Share	43%	44%	11%	2%
Outstanding Assessments	1,190,500	1,039,187	505,024	81,888
Analysts & Supervisors	1,345	1,202	1,049	392
Percentage of Total	34%	30%	26%	10%

Source: http://conversableeconomist.blogspot.gr/2011/11/credit-rating-agencies.html

6. THE ROLE OF CREDIT RATING AGENCIES IN THE INTERNATIONAL FINANCIAL CRISES

Many academics, researchers, politicians, journalists, etc. believe that credit rating agencies have an enormous responsibility in causing the global financial crisis. According to U.S. Congress, credit rating agencies, including investment banks, have the primary responsibility for the real estate bubble and the following collapse of financial markets causing a widespread global recession.

Specifically, credit rating agencies are not blamed that much for their inability to foresee the coming crisis, but rather for their extremely favorable (inflationary) gradations of many investment banks, derivatives and toxic products. Although S&Ps and Moody's on 2003 warned the public for malfunctions in the property market, continued to give high ranks to involved companies and securities, thus contributing to the continuation and expansion of the speculative bubble and as a result it contributed in the fraudulent of end-investors. Benmelech and Dlugosh (2009) examined 4,000 Collateralized debt obligations-CLOs and found that 4/5 of these were assessed by AAA, despite the fact that the average assessment of collaterals was B +. Not surprisingly, their value fell by 70% between 2007-8 (Pagano / Volpin 2010).

A number of researchers estimates that this is due to the fact that rating reports are been paid by investment banks and other issuers of securities (http://hsgac.senate.gov/public/_files/ Financial_Crisis/FinancialCrisisReport.pdf., Partnoy 2009).

Also, credit rating agencies failed in properly rating mortgage market issues, since their reviews didn't link individual investment bank cases with the possibility of a general decline in the U.S. financial market. In other words, the evaluations focused only on microeconomic data, without studying their interactions with the macroeconomic ones. For example this was the case of Lehman Brothers, AIG, Washington Mutual's etc.

7. CONCLUSIONS

During the last few decades the influence of markets was boosted over politics. The liberalization of financial markets, the deregulation and reduction of control and supervision of financial institutions, the creation of new complex financial products, the exponential growth of the derivatives market, the international interconnection of markets, the increased speed of disseminating information and international capital transactions, the decrease of state influence in modern mixed economies in favor of markets and the acceptance of markets as the primary mechanism to exercise discipline against policy (market discipline), limited the interventionist role of the state and largely subdued economic policy, and up to a certain point democracy, functioning according to markets' desires (Rodrik 2011). Furthermore, increased competition among national systems e.g. national fiscal, social, environmental, regulatory, etc. based on the criterion of which system is more favorable for financial markets. Therefore, it is overlooked the fact that for most countries markets were at first chosen as a mean for more efficient allocation of resources and increase of economic performance of their economic system, and not as an end in itself or as a general and absolute component of sociopolitical organization.

As a consequence we observe a constant alignment of economic policy with the priorities of the markets and the abandonment of its key objectives such as growth, employment, social and environmental protection, stability and general interests of society as a whole. Thus, we downgrade to a false primary objective for economic policy which is to satisfy markets and the subjugation of all others players to their needs. On the other hand, market failures, as expressed in the form of constantly repeated crises, put into test economic policy, which often shares the responsibility for these crises, which in its effort to deal with these situations shifts costs to society as a whole.

Our experience from financial bubbles indicates that financial markets do not function rationally. The constant cultivation of an optimistic attitude leads in stock market bubbles the bursting of whom is accompanied by panic and over-pessimism that leads to complete collapse. The phenomenon of herd behavior in markets may be the result of evaluations methodologies. The information channel that credit rating agencies are almost exclusively operating is able to engage in the same direction all the investors and thus causing herd behaviors (Berleman / Vöpel 2011). The U.S. stock market surveillance authorities are investigating whether the rating agencies poured insider information to brokers in order to speculate. Moreover, all dominant credit rating agencies are associated with large banks and hedge funds. The S&Ps is a subsidiary of McGraw-Hill, whose shareholder is the investment firm Capital World Investors. Moody's shareholders list includes Berkshire Hathaway, Warren Buffett, who is also a participant in Goldman Sachs. Finally Fitch is a subsidiary of French Fimalac, who is also involved in various forms of gambling activities.

A typical example of market domination over politics is the Eurozone case. Its member countries established a system where central banks are prohibited from providing liquidity to public sector and, therefore, the Eurozone countries may be funded only by financial markets. Given the international mobility of capital, countries that do not follow markets' wishes have the option of borrowing more expensively or not finding any funding available. Consequently, the euro area Member States voluntarily accepted their absolute dependence on markets. As it was made obvious after the 2009 crisis, all crisis management efforts aim to "reassure the markets" or "to persuade the markets" through rescue packages, through governments of technocrats, who "have more confidence in the markets", by prohibition of statements that "disturb the markets", by implementing policies that would "convince" markets about their intensions and so on. No real discussion is made regarding democracy and policies consistent with national and social interests.

In periods of crisis there is generally an overreaction from money and capital markets. The same was the case during the recent crisis in eurozone. A significant increase in interest rates was triggered of falling prices of bonds on secondary markets and this effect was not limited only in countries which faced real dept problems. Further it was observed a dramatically availability decrease of private funding to financial institutions and enterprises, thus exacerbating the problem of liquidity and hence recession in these countries became more severe. The pressure that came from the markets has led the northern EU countries, to largely finance the into crisis countries and actually save the markets or in some cases, such as the Greece case, limited their losses. Important role in this situation was played by credit rating agencies' reports and forecasts which influenced the behavior of markets, as long as risk premiums markets, without having any democratic legitimacy.

The question here relates to the real role of credit rating agencies. Does the practice of evaluations strengthen the domination of markets over politics? Does the failure to adapt to markets' priorities and desires or implementing market-friendly policies leads to downgrades that in the aftermath strengthen markets' power? Are credit rating agencies parts of the financial markets system or they simply act as objective intermediaries between politics and markets?

In the debate on the importance and function of credit rating agencies the regulatory framework plays an important role (IMF 2010, Basel Committee on Banking Supervision 2010, Financial Stability Board). On the one hand, the institutional integration in a series of financial transactions and arrangements of credit rating upgraded their role as principal actors in international capital markets. On the other hand, in recent years politics are attempting to establish national and international rules and framework for their operation and supervision. However the debate regarding regulating credit rating agencies is much older. As soon as the end of Asian crisis in 1997/8 strong criticism was applied regarding agencies wrong practices, but the suggested improvements for controlling and supervising their operation did not proceed. The same thing happened in 2001 after the dot.com crisis.

The necessity of rating for conducting certain financial transactions was initiated by SEC (Securities and Exchange Commission) in the U.S. in 1936. In 1975 the U.S. established the Nationally Recognized Statistical Rating Organization (NRSRO), which approves these firms whose evaluations are approved by the SEC. The actions of international credit rating agencies, although their ratings were recognized as a prerequisite for institutional bond issuing, for approving acceptance or securities by central banks in open market policy, for determining capital adequacy of banks etc remained unregulated for decades however. After the initiation of the international financial crisis, many countries such as Japan, Australia, Hong Kong and the EU established national frameworks for regulating credit rating agencies' operation. These arrangements however have limited effects because of the territorial application of the law, and since most powerful credit rating agencies are U.S. based and therefore subject to American law.

In 2010, under the Dodd-Frank Wall Street Reform and Consumer Protection Act (http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf), new rules were adopted in order to improve the institutional framework for evaluations and the functioning of credit rating agencies. These include among others:

- Annual internal audit reports of credit rating agencies
- Checks for conflict of interest
- Publication of evaluation and statistics methodologies
- Penalties and sanctions coding

In international scope, in 2008 IOSCO (The International Organization of Securities Commissions) revised its Code of Conduct Fundamentals for Credit Rating Agencies in order to resolve operational issues of credit rating agencies such as independence, conflict of interest, transparency and competition. Basel Committee requires from banks to perform their own assessments and downsize the importance of evaluation by outside firms. The Financial

Stability Board (2011) published a set of principles for limiting the weight of assessments from credit rating agencies in rules, laws and regulations.

In the EU the effort to create a new regulatory framework for credit rating agencies was initiated by EU Parliament even before the international crisis of 2008 (Katiforis Report 2004). But only in 2009 the first regulation was adopted, which was amended in 2011 (Regulation 1060/2009 of 16 September 2009, OJ 17.11.2009. Regulation 513/2011 of 11 May 2011 amending Regulation (EC) No. 1060/2009 on credit rating agencies, OJ 31.05.2011).

The 2009 EU regulation demands from credit rating agencies their registration and constant supervision, defines their operating framework, sets rules for their management and operation, requires declaration for possible conflicts of interest and disclosure of major customers, together with providing vital information regarding the applied methodology, rating models and assumptions. With the 2011 amendment ESMA (European Securities and Markets Authority) undertakes the supervision of credit rating agencies and establishes rules similar to those of the U.S. SEC. By August 2011, 10 out of 22 credit rating agencies had applied for registration in the ESMA. However none of the 3 big agencies did so.

For economic policy and, especially, for the interventionist role and effectiveness of monetary policy, of significant importance is the role that central banks gives to ratings of government bonds issued by credit rating agencies. That is, whether in the framework of interbank lending, ownership of rated state titles is taken under account. For example, the U.S. Federal Reserve (FED) does not take account of bonds rating, in contrast to the ECB and Basel Committee on Banking Supervision. Also, the European Directive UCITS III (Undertakings for Collective Investment in Transferable Securities), which regulates the distribution of active investment funds, requires the evaluation of investments by authorized credit rating agencies.

As a result rating agencies have an excellent market position in EU, due to her legislation, which despite the new regulations their influence is not restricted. For example, EU law does not affect the most important element of the functioning of credit rating agencies, the principle of “issuer pays” (Lannoo 2010). Preserving this principle, it is the power of the 3 large incumbent firms that is supported.

In addition, in order to upgrade ratings quality and and reduce or even eliminate the conflict of interest phenomena, the important issues of agencies’ liability and the compensations they must submit in case of important mistakes, has to be promoted and resolved. The civil liability was established in the U.S. by Dodd-Frank-Act, but the SEC, for a number of reasons was not put into practice. We should also keep in mind that no legal action has been approved against rating agencies in response of lawsuits from victims of bankrupt financial institutions.

From all those mentioned above it is obvious that there is a fragmented regulatory framework, with little efficacy. Also, many regulations appear to have contradictory effects. Furthermore, there is not a uniform international approach to a global phenomenon affecting all countries. Therefore, the need for a thorough evaluation of the previously introduced legislation is recognized. Finally, the possibility of establishing a common international regime that will regulate the issue of credit rating and the agencies and businesses that carry them out should be investigated. Also, from the legal and ethical point of view, it is of great importance the question over agencies’ civil liability and financial compensation, in case of misleading the investing public.

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