Credit assessment and consulting in rating agencies

Business, Management

Credit Assessment and Consulting in Rating Agencies Credit Assessment and Consulting in Rating Agencies The potential for conflictof interest facing Credit Assessment and Consulting in Rating Agencies can significantly interfere with the independence and objectivity of their analysis. Conflict of interest emanates, when a rating agency tenders consulting, or related advisory services to issuers it rates as the insurers could be improperly pressured to obtain advisory services in return for an enhanced rating(Crockett, Harris, Mishkin & White, 2004).

Other conflict of interest may stem from instances in which credit-rating agencies also avail ancillary consulting services whereby debt issuers request rating agencies to direct them on the manner to structure their debt issues with the aim of securing a favorable rating (Crockett, Harris, Mishkin & White, 2004). In such circumstances, the credit-rating agencies are in effect auditing their own work. Moreover, credit-rating agencies may deliver favorable ratings so as acquire extra clients for the ancillary consulting business.

The Implications of Conflict of Interest on the Stakeholder’s Benefits

Much of the challenges associated with Credit Assessment and Consulting in Rating Agencies relate to the reliability and integrity of ratings. Investors utilize credit ratings that mirror the probability of default to ascertain the creditworthiness of certain debt securities (Langohr & Langohr, 2008). Conflict of interest can yield a decrease in the flow of reliable information centering on either concealment of the information, or dissemination of misleading information (Brooks & Dunn, 2010). This has dire consequences on the value of stakeholder’s benefits.

Alternatives Practices that Enhance Ethical Corporate Social Responsibility Practices

The markets can in some instances ameliorate the impacts of conflicts of interest within financial services firms and cannot always contain the incentives to exploit conflicts of interest. Some of the approaches to remedying conflict of interest encompass: “ leaving it to the market” or letting market forces resolve the conflict by penalizing financial firms that exploit conflict of interest and instituting new institutional means to contain conflict of interest (Brooks & Dunn, 2010). The other approaches encompass regulating for transparency through mandatory disclosure and supervisory oversight. Additional approaches towards remedying conflicts of interest within credit rating agencies encompass separation of functions and socialization of information production.

In conclusion, there is a need to enhance accountability of Credit Rating Agencies so as to negate the pitfalls associated with conflict of interest (Werther & Chandler, 2006). Reputation remains one of the key mechanisms that contain opportunistic behavior. Disclosure strategy can contribute significantly towards reducing conflict of interest and enhancing accountability.

References

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