Credit rating agencies role in financial crisis

Business, Company

1. Credit rating agencies present one of the key problems in reconfiguring the global financial architecture. Why? What are the options? What is the most likely solution? * The rating agencies present one of the key problems because they were behind the rating of the complex CDOs as well as taking an active part in creating these mortgage-related products which created conflict of interest. The ratings given to the CDO tranches did not effectively disclose the true credit quality of the underlying securities which contained a much higher default probabilities. * Options: * More regulations by SEC to control the " issuer pays" model. " To correct the competition problem within the " issuer pays" model, the SEC could place limits on the competition that occurs among the rating agencies. " (Acharya & Richardson, 2009) * " An alternative structure (…) would be for the SEC to create a department that houses a centralized clearing platform for rating agencies. " (Acharya & Richardson, 2009) * Another option is to deregulate the industry and allow free-market competition forces to shape its further growth and development which could bring in players like Bloomberg that would offer bond rating as a value-added services to its clientele. Most likely solution: * Although it is a very complex situation and it would require a series of regulatory changes, a regulatory oversight agency that would closely monitor the rating agencies and act as an intermediary in matching the issuers with the rating agencies.
2. Greece is in trouble. Why? Fast-forward 5 years and describe the most likely outcome of the current problems and their consequences for global banking and financial markets. * Greece is in trouble because it has failed to keep under controls its ballooning debt and accumulated a total national debt of over 113% of the country's GDP.

In April and May of this year Greece has to repay a total of $23 billion of its maturing government bonds which raised the question of whether it will be able to refinance the debt at its current financial state. * It has come to light that Greece used a series of financial transactions facilitated by Goldman Sachs to make its financials appear much nicer to adhere to the EU requirements of the member countries having to maintain the budget deficit under 3% of GDP. "…concerns about Greece's high level of debt led the three main international credit ratings agencies to downgrade Greek government bonds in January, so when Greece issued its bonds, it had offer them at much higher interest rates (five percent higher than those offered on benchmark German bonds) in order to attract investors. " (Fleeson) * Depending on how EU deals with the Greece problem, the Euro zone could become stronger in the outcome or it could face a moral hazard when more of the problematic EU countries (Portugal, Ireland, and Spain) encounter the same problem as Greece and will expect EU to bail them out. If Greece is allowed to default on its international debt it will put pressure on the entire Euro zone and will make it more problematic for Portugal, Ireland, and Spain, who have " ratios of debt to gross domestic product that are three times higher than the EU ceiling of three percent", to borrow in the near future. (Fleeson) * If EU backs Greece, it will be more easier for the country to borrow at favorable rates and it will ease the pressure from the speculators which were betting against Greece and aggravating the problem even more. On a more positive note, the fact that the euro has weakened during the past four months as a result of the situation with Greece has the made the European goods relatively cheaper and export conditions more favorable. *

Most likely outcome is that EU will eventually back Greece in some shape or form, once the member countries can agree on the measures, to keep it from defaulting and impose stricter economic rules on the members to adhere to in order to create sounder economic environments. "…analysts say that supportive talk (and even credit guarantees) will probably not be enough to salvage Greece's finances and that ultimately the country is likely to need a package of loans put together by other EU governments and the International Monetary Fund (IMF). " (Fleeson) * " As part of the deal being forged in Brussels, Germany and France are demanding that the eurozone rewrite its rule book about economic convergence, including sanctions against governments (such as Greece's) that deceive their EU partners about their real financial situation. (Maudave) * " The emergence of changes of this sort, including effective measures of discipline against offending eurozone countries, the new fiscal discipline and beginning of collective economic governance among the eurozone countries, could be an important step forward to the EU's global clout. Such progress toward economic coherence and credibility could amount to progress on a par with the Lisbon treaty – and, for the long run, a silver lining to the current economic hardship being inflicted on the EU economies. (Maudave) References Viral Acharya, Matthew Richardson. " Restoring Financial Stability: How to Repair a Failed system. " New Jersey: John Wiley & Sons, Inc. , 2009. Print Tony Spadaccia. " U. S. is Resembling Greece's Economic Decline. " The Breeze, March 18, 2010. Web. Sat. 20 March, 2010 ; http://breezejmu. org/2010/03/18/us-is-resembling-greeces-economic-decline/; Will Fleeson. " Sovereign Debt Liable to Overwhelm System in the EU's Five " PIIGS". " The European Institute,

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