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PRESS RELEASE

Is there a difference between solicited and unsolicited bank ratings and if so, why?

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Unsolicited ratings are defined as ratings that credit rating agencies conduct without being formally engaged to do so by the issuer. As such, and contrary to solicited ratings, unsolicited ratings do not imply the payment of a rating fee and do not involve any formal meetings between the credit rating agency and the entity being rated. Over recent years, there has been considerable controversy surrounding the issue of unsolicited ratings. The main concern is the fact that unsolicited ratings do not appear to be empirically as favourable as solicited ratings. In addition, many issuers also believe that credit rating agencies assign a lower unsolicited rating to persuade them to pay for a solicited rating.

This paper investigates whether there is a difference between Fitch Ratings' ("Fitch") solicited and unsolicited bank ratings and, if so, why. The analysis makes use of bank ratings assigned in Asia, i.e., the only region for which a significant portion of Fitch's bank ratings are unsolicited. After confirming a difference between the unsolicited and solicited ratings assigned to similar banks, the paper tests two hypotheses.

The first hypothesis is the “self-selection hypothesis”, which states that solicited ratings tend to be higher than unsolicited ones because better-quality issuers decide to obtain rating services. If this is found not to be the case, then there are at least two alternative interpretations. First, unsolicited ratings may be lower to “punish” banks which otherwise would not purchase ratings coverage. Second, unsolicited ratings may be lower because they are based only on public information and, as a result, tend to be more conservative than solicited ratings. The latter interpretation suggests the second hypothesis which is tested by the paper: the “public disclosure hypothesis”. According to this hypothesis, banks which choose not to request a rating and which disclose a low amount of information will receive a lower rating than will similar banks which have solicited a rating. However, a bank which discloses a high enough amount of information may have an unsolicited rating which does not differ from similar banks with unsolicited ratings. The results of this paper are found to support the public disclosure hypothesis: banks with unsolicited ratings but a high amount of disclosure receive ratings that are not different from the ratings of similar banks which have solicited a rating.

These findings are important for several reasons. First, possible regulatory rules concerning the use of unsolicited ratings are currently being discussed at the European and U.S. levels. The results of this paper suggest that credit rating agencies should be required to clearly label their unsolicited ratings as such. Second, the New Basel Accord, which is due to be implemented by G-10 banks at the beginning of 2007, aims at increasing public disclosure by banks in order to ensure that market participants can better understand banks' risk profiles and the adequacy of their capital positions. It is therefore necessary that financial institution managers understand the need for more disclosure and move in this direction on their own. This paper provides an incentive for bank managers to disclose information, as it documents the potential impact of public disclosure on credit ratings. Public disclosure not only appears to have a positive effect on credit ratings, but it also seems to eliminate the downward bias observed in unsolicited ratings.

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