Longevity Rating Agency

AGING ANALYTICS AGENCY

InvestTech Advanced Solutions

What is a Rating Agency?

A rating agency is a company **that assesses the financial strength** of companies and government entities, especially their **ability to meet principal and interest payments on their debts that are related to the default risk**.

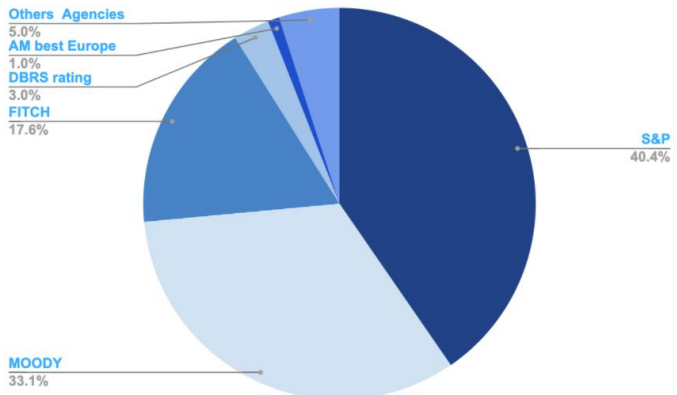
Each agency uses unique letter-based scores to indicate if a debt has a low or high default risk and the financial stability of its issuer. **The debt issuers can be different economic entities** such as sovereign nations, local governments, special purpose institutions, companies, or non-profit organizations.

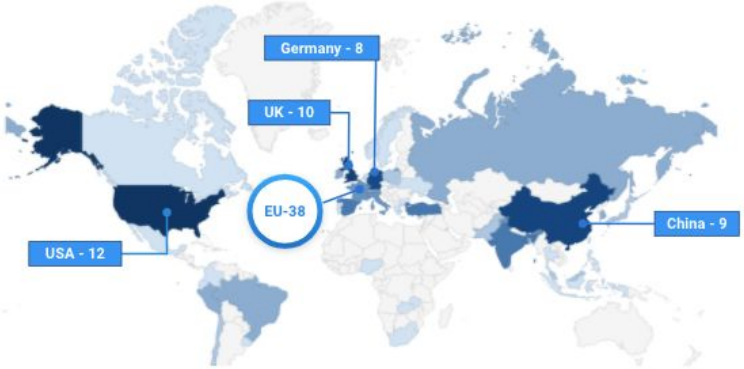
The rating agencies' **scores represent the likelihood that the borrower or issuer will meet its contractual and financial obligations** as they become due and is not a recommendation to buy or sell a security. It also does not address market liquidity or volatility risk.

The Role of Credit-Rating Agencies in Economy

- Credit-rating agencies **assess the creditworthiness of debt instruments** issued by companies, banks, nonbank financial institutions, and governments and sells this information
- Rating agencies are **influencing the firm's future credit quality**. For example, by putting a company on downgrade list the CRA may induce the firm to undertake actions that arrest the possible deterioration in its credit quality
- On the macro level the **Rating has an impact on socio-economic policies** of countries to have a better rating, it helps them to for finance development projects by using government and municipal bonds
- **Provide a sufficient measurement for regulatory and investment limitations**, for example, pension funds are not permitted by law to invest in financial products below a certain rating

Credit Rating Market





Among 27 agencies registered by CRA and active in Europe, **the Big Three** (S&P, Moody, and Fitch) are dominating the market with **91%** of the market share which besides DBRS and Am best Europe increased to 95%. So the rest of the agencies **(22 agencies)** compete for **5%** of the market share.

So generally credit rating market is based on its Herfindahl-Hirschman Index (HHI) which is over 2500 and considered a highly concentrated marketplace. At the same time level of competition among small-size rating agencies is very high and rating agencies try to target different niches of the market by providing services to companies in specific I sectors (startups, SMEs, pharmaceutical companies, etc.) or regions. Also, some companies penetrate the market by innovation in methodology or supplementary services.

There are 120 credit rating agencies in 47 countries of the world. The US, UK, and Germany, with 30 rating agencies, are world market leaders. At the same time, almost half of the agencies are located in the US, UK, and EU. China and India, with 9 and 5 agencies respectively, are covering Asia.

Regulatory Entities

U.S. SECURITIES AND EXCHANGE COMMISSION MCMXXXIV

esma European Securities and Markets Authority

FCA FINANCIAL CONDUCT AUTHORITY

finma

Business Models for CRAs-Mahir

There has been little change in the use of business models since the implementation of the CRA Regulation, i.e. despite the variety of possible business models, issuer-pays remains the dominant business model. The other business models include investor-pays, skin-in-the-game, platform-pays, non-profit ratings, pay-for-performance.

Of CRAs who use a combination of Issuer Pays and Investor Pays models, the majority only use the Investor Pays model upon request by financial institutions, investors, and potential debt-holders.

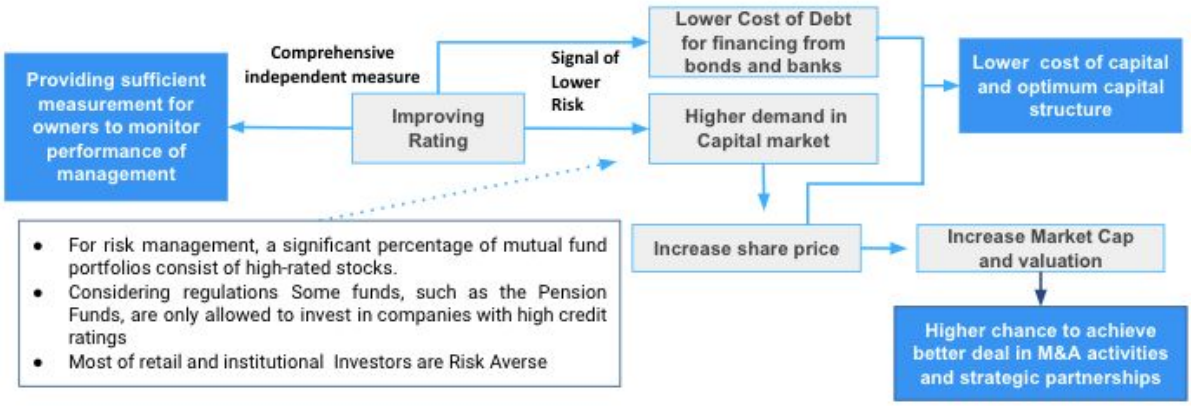
Only one CRA experienced a significant change in its implementation of the models, as it **abandoned** the **investor pays model** due to insufficient demand from investors; other CRAs have seen little to no change in their business since 2010, especially in ratings for Corporate Bonds and Structured Finance Instruments.

- Issuer-pays
- Investor-pays
- Skin-in-the-game model
- Platform-pays model (hybrid structures)
- Non-profit ratings
- Pay-for-performance compensation scheme

Benefits of Rating for Companies

There are the following incentives for companies that receive a rating to pay to Rating Agencies:

- Reduce the cost of debt and cost of equity to reach a lower cost of capital and optimum capital structure
- Higher bargaining power of the company in M&A deals and strategic partnerships by increasing the value of the firm
- Provide a corporate governance mechanism for owners to control the performance of management



Rating Agencies

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