HKUST ECON Seminar

December 7 (Mon), 3:00 - 4:30 pm

Competitive Ratings

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Abstract:

Issuers often obtain several preliminary ratings and publish only the most favorable one. We study how this practice shapes the design of ratings. Each of n agencies chooses a conditionally independent experiment about an asset's quality, anticipating that the issuer will publish the best outcome and pay only the agency that produced it. A market of Bayesian investors accounts for selection. The symmetric equilibrium is unique and explicit. Without information costs, no agency is fully informative, but entry makes ratings and the market's posterior belief more informative in the Blackwell order, approaching full revelation as n grows. With posterior-separable information costs, each agency's rating becomes uninformative as the market grows. Yet the market's belief converges to partially revealing limit in which conclusive good ratings arrive as a Poisson event. Information costs thus limit what competition can reveal, and entry need not improve public information.