Rating Watchlists and the Informational Content of Rating Changes

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Abstract
Credit rating agencies do not only disclose simple ratings but announce watchlists (rating reviews) and outlooks as well. This paper questions whether and, if so, how the review procedure has affected the agencies’ information provision. Using Moody’s rating data between 1982 and 2004, we find that the information content of rating changes has indeed increased after the introduction of the watchlist instrument. Rating reviews do not appear to “buy time” for an eventual rating action. Rather, they seem to establish implicit contracts between agencies and borrowers similar to Boot, Milbourn, and Schmeits (2006) and as such allow the transmission of a higher quality of information.

Keywords: Credit Rating Agencies; Watchlist; Market Reactions; Event Study

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