

REFORMING THE REGULATORY REGIME FOR CREDIT RATING AGENCIES IN  
KOREA: ANALYSIS AND PROPOSAL BASED ON RECENT U.S. EXPERIENCE

By

Jungwon Hur

Submitted to the

Faculty of the Washington College of Law



of American University

in Partial Fulfillment of

the Requirements for the Degree of

Doctor of Juridical Science

Chair:

  
\_\_\_\_\_  
Professor Heather Hughes  
\_\_\_\_\_  
Professor Anna Gelpern  
\_\_\_\_\_  
Professor Benjamin Leff  
\_\_\_\_\_  
Dean of the Washington College of Law

4-16-14  
\_\_\_\_\_  
Date

2014

American University

Washington, DC 20016

© COPYRIGHT

by

Jungwon Hur

2014

ALL RIGHTS RESERVED

REFORMING THE REGULATORY REGIME FOR CREDIT RATING AGENCIES  
IN KOREA: ANALYSIS AND PROPOSAL BASED ON RECENT U.S. EXPERIENCE

BY

Jungwon Hur

ABSTRACT

Credit Rating Agencies, which from this point on will be referred to as CRAs, have become hugely important and an integral part of the capital market and regulatory institutions worldwide. This naturally leads to CRAs big influence on financial market and obligations of CRAs to public. Since the financial crisis, they have come under increased scrutiny. They have been criticized for poor performance in their core function – conveying accurate, impartial information about credit quality to potential investors. CRAs have had additional problems such as conflict of interest associated with the issuer-pays, competition, liability, and different fee structure to align incentives. CRAs are not going to be dislodged from this dominant position, despite introduction of Dodd-Frank Act and efforts by G20 to clean house, more specific reforms are badly warranted. The dominance of few CRAs in the market place also poses a serious problem as well.

Currently, The U.S. CRAs such as Moody's, S&P, and Fitch hold sway over the global CRAs industry, crowding out firms from smaller countries and catering to U.S. market needs. Korea has not only all the general problems of the U.S., but also the Korean market specific problems where foreign-owned CRAs dominance holds sway.

Despite the significant differences in scale of economies and policies between the two countries, Korea has accepted the U.S. CRAs legislation without careful consideration and carried out several revisions. These problems symptomatic of a market dominated by CRAs include: (1) being dominated by U.S. CRAs, (2) inaccurate of credit ratings performed by U.S. and Korean CRAs, (3) redundant reforms effectiveness, (4) insufficient efforts to invigorate independent Korean CRAs, (5) inherent problems like Chaebol, and (6) small-scale CRA markets

This study proposes feasible solutions for improving self-development of Korean CRAs by examining four key areas: (1) the current status of U.S. and Korean CRAs, (2) past performances of both countries' CRAs, (3) the current regulatory regimes and the recent reforms and (4) reasons why both reforms reach the limit. By discussing all considerations above, this study proposes feasible suggestions for improving self-development of the Korean CRAs.

## TABLE OF CONTENTS

ABSTRACT .....	ii
LIST OF TABLES .....	iv
CHAPTER	
1. INTRODUCTION .....	1
2. THE FUNCTIONS OF CRAS IN THE CAPITAL MARKETS.....	5
A. Informative Intermediary .....	5
1) General role .....	5
2) Structured finance.....	8
3. THE STRUCTURE OF THE CRA INDUSTRY IN THE U.S. AND KOREA .....	16
A. U.S.....	16
1) Historical Perspective of U.S. CRAs.....	16
2) Overall View of Big Three .....	20
3) The Advent of NRSROs .....	24
B. Korea .....	28
4. THE FAILURE OF CRAS .....	37
A. U.S.....	38
1) Systemic Failure of CRAs Exposed by the U.S. Economic Recession .....	38
2) Poor performance of U.S. CRAs on Korea's credit Outlook .....	44
B. Korea .....	53
1) Poor performances of Korean CRAs .....	53
2) Credit bubbles.....	66
3) Examination through annual default rate.....	69
5. REGULATION OF CRAS .....	72
A. U.S.....	72
1) Initiatives of the CRA Reform Act.....	72
2) CRAs Reform Act of 2006 .....	76

3) Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010...	78
B. Korea .....	85
C. International .....	95
6. FAILURE OF REGULATION.....	98
A. Problematic Issues of Both Countries .....	98
1) Conflict of Interest.....	98
2) Lack of Competition.....	105
3) Immunity of Negligence of CRAs.....	111
B. U.S.....	116
C. Korea .....	121
D. Alternative Proposals and the limits .....	124
7. RECOMMENDATIONS.....	130
A. Adequate Policy for Small and Medium-sized Corporations .....	131
B. Encourage Overseas Expansion .....	136
C. Encourage CRAs to devise and develop their own criteria strengthening competitiveness .....	139
D. A radical overhaul of the liability system in necessary .....	147
E. Create Exclusive Division of CRAs in Financial Supervisory Service.....	157
F. Need to Awaken the Academic Field .....	159
8. CONCLUSIONS .....	163
BIBLIOGRAPHY.....	166

## LIST OF TABLES

Table 1: Examples of Korean rate-dependent regulations .....	87
--	----

## 1. INTRODUCTION

Credit Rating Agencies (“CRAs”) have become vastly important and an integral part of both the market and the regulatory institutions worldwide. By increasing the quantity of complicated financial products and the number of issuers, the importance of the evaluation of the soundness of the securities and the laws that require the assessment has been growing. This leads naturally to big influence on the financial market and obligations of CRAs.

Although CRAs continue to grow their influence in financial markets, they have been criticized for poor performance in their core functions, which include –conveying accurate and impartial information about credit quality to potential investors. Since CRAs are not going to be dislodged from this dominant position, there are serious problems such as (i) lack of competition, (ii) liability, and (iii) different fee structure to align incentives, and (iv) conflicts of interest.

Large U.S. CRAs such as CRAs, Moody’s Investors Service (“Moody’s”), Standard & Poor’s (“S&P”)<sup>1</sup>, and Fitch Ratings (“Fitch”)<sup>2</sup> of the U.S. have firm hold over the global CRAs industry. Their dominance is a serious problem as well since other CRAs do not have the capability or market share to take on the three major CRAs.

---

<sup>1</sup> S&P is a division of McGraw-Hill Cos. Inc.

<sup>2</sup> Fitch is owned by Fimalac (50%) and Hearst Corporation (50%). They are based on France and the U.S.



Since 2001, the U.S. which was rocked by the Enron's massive account fraud started to spur on lawmaking to increase the accountability of the CRAs to remain unbiased and independent of companies they served. In 2007, Credit Rating Agency Reform Act of 2006 was enacted and conflicts of interest and unfair trade practices between CRAs and issuers were banned. Since the Act, SEC has been given the authority to supervise and oversee the CRAs. In 2008, myriad of investors were encouraged to buy RMBS that was much over-rated by the major CRAs such as Moody's, S&P and Fitch with credit loans, creating U.S. mortgage backed securities crisis. As public opinion grew that U.S. CRAs were liable for the crisis since they had produced the favorable ratings to the default securities, the U.S. is spurring on imposing the liability to the CRAs and reforming the industry.

In 2010, Dodd-Frank Act brought a big renovation for the financial market, particularly to the CRA industry. The law contains a number of CRAs regulations to improve transparency of the financial market as the main point.

Along with the U.S. and Korea, the CRA issues have been also weighing heavily on G20 and European Commission worldwide. In spite of their efforts, the solution has not yet appeared on the best way to solve the conflicts of interest which is the practical problem of the CRAs. There is a real need to address these problems with specific reforms.

Korea has not only all the problems of the U.S., but also Korean market specific problems where foreign-owned CRAs dominance hold sway. Unlike the U.S., the CRAs industry in Korea was created by the Korean government in the mid-80s. Despite the fact that there are significant differences in the scale of economies and policy priorities between the two countries, Korea accepted the U.S. CRAs legislation. With the U.S. spearheading CRA legislation, Korea followed with substantial policy revisions in 2001 and 2009. In 2001, the securities became the only object of credit ratings and liability and criminal penalty of the CRAs pertaining to their investors and clients were established under the law.

Guided by the Dodd-Frank Act adopted by the U.S., the Korean revision was implemented in 2009. It adopted the regulations to improve accountability and raise transparency for Korean CRA markets. In August 2013, Koreans once again revised CRA regulations. In accordance with the Financial Investment Services and Capital Markets Act (“Capital Markets Act”) which was amended in May 2013.<sup>3</sup> The regulations regarding the scope of work by CRAs, regulatory actions of CRAs have been transferred to the act from the original Use and Protection of Credit Information Act (“Use Credit

---

<sup>3</sup> Jabonshijang-gwa gumyoongtoojaupe gwanhan beobyul [Financial Investment Services and Capital Markets Act], Act No.8863, Feb. 28, 2008, *amended by* Act No.113845, May 28, 2013 (S. Kor.) [hereinafter Capital Markets Act].

Act”).<sup>4</sup> This modification strengthened the regulation of the business conduct and imposed heavy administrative sanctions on the violations of regulations for various obligations.

Despite the active legislative efforts by Korean policymakers, Korea’s CRAs industry has not developed by itself. Currently, Korea’s CRAs still have been dominated by U.S CRAs. The credit ratings doled out by U.S. CRAs have had a tremendous impact on Korean capital market. In a situation where the largest shareholders, the major CRAs, alarmingly extended their powers to the Korean rating industry; did they perform accurately with Korea? The appraisal should be examined. In comparison with the U.S., Korea has a lack of history, as well as research in the CRAs market. Having experienced big financial scandals for years, Korea has only recently acknowledged the importance of CRAs through the recent U.S. experience.

This study will examine the limitations of Korean CRAs and identify systematic solutions for the Korean securities market, specifically in the current situation where the U.S. major CRAs are in control. Through recent U.S. experiences, it is time to come up with more practical solutions to meet current Korea’s needs.

---

<sup>4</sup> Shinyongjoengboui iyong mit bohoui gwanhan beopyul [Use and Protection of Credit Information Act], Act. No. 4866, Jan. 5, 1995, *amended by* Act. No. 11845, May 28, 2013 (S. Kor.).

## 2. THE FUNCTIONS OF CRAS IN THE CAPITAL MARKETS

CRA's collect and process information that private investors such as individuals and institutions cannot collect and process on their own. Credit ratings can save time and provide cost effective tools to identify the soundness of securities for investors. By growing structured securities which are more complex and have higher risk than traditional securities, credit ratings must be assessed with more complicated and professional methodology. Because of the specialized nature of the transactions in structured finance market, credit ratings play a more critical role than the traditional securities market. Since the credit ratings are in high demands by the capital market, its influence has increased tremendously. Despite their importance, CRA's have been negligent in producing accurate and transparent credit ratings. Due to their poor performances, many investors have suffered great loss. By growing need for legal sanctions, international bodies are realizing powerful regulatory measures. In order to rectify the confusion caused by the overloaded credit ratings, the OCC, Dodd-Frank Act, and G20 are removing credit ratings from its rules.

### A. Informative Intermediary

#### 1) General role

Credit ratings reflect the rating agency's opinion as to the creditworthiness, securities and obligations of a particular company during a specific period. The influence

and the importance of credit ratings have expanded significantly beyond the role stated above. Several scholars have described CRAs as a “private organization performing a quasi-public function.”<sup>5</sup> Investors use ratings as a tool to evaluate the default risks related with rated securities and issuers<sup>6</sup>; particularly if the investors have relatively limited information, or if they can barely appraise the value of securities.

As Federal Reserve Chairman Ben Bernanke previously analyzed, at the time of the Great Depression, banks collected and processed their own information for investment and loans, literally- self-organizing the information.<sup>7</sup> During the 1920s, the securities market was not as intricate and individual investors were small in number, thus the banks could carry out roles of both the financial and information intermediaries. Gradually, as the financial market became more complex and the size of the economy

---

<sup>5</sup> See e.g., Lupica, Lois R., *Credit Rating Agencies, Structured Securities, and the Way Out of the Abyss*, 28 Rev. Banking & Fin. L. 639 (2009); Choi, Stephen, *Market Lessons for Gatekeepers*, 92 NW. U. L. REV. 916, 934 (1998); Coffee, John, *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301, 309 (2004) [hereinafter Coffee, *Gatekeeper Failure and Reform*]; Oh, Peter, *Gatekeeping*, 29 J. CORP. L. 735, 742 (2004).

<sup>6</sup> See generally Listokin, Yair and Taibleson, Benjamin, *If You Misrate, then You Lose: Improving Credit Rating Accuracy through Incentive Compensation*, 27 YALE J. ON REG. 91 (2010) [hereinafter Listokin, *If you misrate*]; SEC, *Report on the Role and Function of Credit Rating Agencies in the Operation of the Securities Markets, As Required by Section 702(b) of the Sarbanes-Oxley Act of 2002* (Jan. 24, 2003), <https://www.sec.gov/news/studies/credratingreport0103.pdf> [hereinafter SEC, *Role and Function Report*]; Lee, Wonsam, *Mikook Shinyong phyungga hwesa gaehyukbeobui Jaejeong* [Implications of U.S. Credit Rating Agencies Reform Act to Korean legislation under Korean law], 15 COMP. PRIVATE. L. J. 373, 382-383 (2008) (S. Kor.) [hereinafter Lee, *Korean legislation*]; Yim, Gyungmook, *Chaegwonshijang eseoui shinyongpyungga gineung gaeseoneul wuihan jeongchaekbanghyang* [Recommendations for Developing Function of Credit Ratings in the Korean Bond Market], 28 KOREA DEV. J. 10 (2004) (S. Kor.) [hereinafter Yim, *Recommendations for Developing*].

<sup>7</sup> Bernanke, Ben, *Nonmonetary Effects of the Financial Crisis in the Propagation of the Great Depression*, 73 AM. ECON. REV. 257, 276 (1983).

grew much larger, the information asymmetries and the basic collective action problem between private investors loomed larger. Contrary to banks, in individual capital markets, the investors have a direct relationship with the investment target and face collective action problems like free-riding.

In the current securities market financial information pour in, it is virtually impossible for private investors such as individuals and institutions to collect necessary information organize the data and connect with their investment in a smaller time frame. If investors overlook the securities trends or the important business information in a timely manner, this oversight may result in large losses on investments. In the securities market interconnected by skilled securities analysis, statistics, math programs, and securities law, it is indisputable that private investors were able to get the information readily provided by the CRAs. In these circumstances, credit ratings seem to be convenient information providers for private investors.

As a matter of fact, CRAs do play significant roles in our securities markets.<sup>8</sup> Their primary function is to facilitate the flow of information by processing public information at a lower cost than the individual investor would incur.<sup>9</sup> They play a

---

<sup>8</sup> See Pinto, Arthur, *Control and Responsibility of Credit Rating Agencies in the United States*, 54 AM. J. COMP. L. 341 (2006) (“[a] rating simply helps investors determine the relative likelihood that they might lose money on a given fixed income investment”) [hereinafter Arthur, *Control and Responsibility*]; See also FIGHT, ANDREW, THE RATINGS GAME 230 (2001).

<sup>9</sup> See Husisian, Gregory, *What Standard of Care Should Govern the World’s Shortest Editorials: Analysis of Bond Rating Agency liability*, 75 CORNELL. L. REV. 411, 416 (1990) [hereinafter Husisian, *What*

verification function in the fixed income markets by designating alphabetical ratings of debt.<sup>10</sup> Corporations request the ratings and investors invest their funds based on the result. Given that the securities ratings are an evaluation of the ability to redeem the securities, and that the effect of good ratings is reduced interest rates, it is reasonable for the corporations to decrease the costs of issue.<sup>11</sup> The value of an agency's rating lay in its independent and reliable evaluation of a company's financial data.<sup>12</sup> In short, CRAs are able to collect credit information and assess the credit quality that investors cannot do on their own.

## 2) Structured finance

In theory, many people believe that CRAs help people save time and money because investors do not need to learn, study, and analyze the credit risks.<sup>13</sup> In the present structured finance market, analyzing the securities and the evaluation of credit risks is very complex and important. The representatives of structured finance products are

---

*standard liability*] (...“[i]nstead of being held to a negligence standard, CRAs receive full first amendment protection as a member of the media”) [hereinafter Husisian, *What Standard of Care*]; However, there is a scholar who has a different opinion, see Partnoy, *Siskel and Ebert*, *infra* note 34.

<sup>10</sup> Partnoy, Frank, *How and Why Credit Rating Agencies Are Not Like Other Gatekeepers*, LEGAL STUD. RES. PAPER No. 07-46 59, 60 (2006) [hereinafter Partnoy, *How and Why CRAs*] (stating that “CRAs belong within the broad classification of financial market gatekeepers”).

<sup>11</sup> Husisian, *What standard liability*, *supra* note 9, at 413 (explaining the function of rating services).

<sup>12</sup> *Id.* at 426.

<sup>13</sup> See Sy, Amadou N. R., *The Systemic Regulation of Credit Rating Agencies and Rated Markets* (IMF, Working Paper No. 09/129, 2009).

asset-backed securities (“ABS”), Collateralized Debt Obligations (“CDOs”) and Residential Mortgage Backed Securities (“RMBS”). Credit ratings play a more important role in the finance structured market. Through the ABS process, the reason can be verified.

As an example of ABS, in order for asset-backed securitization, first, a special purpose company (“SPC”) should be temporarily established. After securities corporations or banks receive the speculative-grade bonds, the SPC issue the ABS as collateral and release it to a securities market. When the ABS transaction is complete, the SPC shall be dissolved. In the transaction, the cash flows of underlying assets and trenching structure of backed securities are analyzed. Based on these assessments, credit ratings are produced, and the securitizations and trade cost come and go between companies and investors. If the credit ratings are high grades, the transaction would be easier.

RMBS, CDO or other structured finance products require superior knowledge and expertise. Let us consider the case of ABS that demand a strict credit rating process to determine the possibility of default of issue stocks, and operates on the premise of a certain rating level.<sup>14</sup> Generally, the credit ratings regarding the possibility of default of ABS depend on the fundamental capital amount, flow of funds, solvency, and overall

---

<sup>14</sup> JOHNSON, STAFFORD, BOND EVALUATION, SELECTION, AND MANAGEMENT 343-344 (2010).



structuring of the ABS.<sup>15</sup> Furthermore, it requires an overall comparison and analysis of the facts.<sup>16</sup> In essence, the credit ratings of ABSs are designed to provide overall evaluations and analysis of fundamental assets, participants, transaction structures, cash flows and legal bases.<sup>17</sup> Additionally, through the credit rating services, investors can access non-public information of issuers,<sup>18</sup> whereas the issuers can extend their chances of raising funds by receiving the credit ratings. In their position of supervisory authority of the security market, they can recognize the trends of credit ratings of individual securities, and then establish a standard to supervise financial transparency.<sup>19</sup> These theories show how important CRAs are and how methodical they have to be when rating financial products both directly and indirectly.

As such, credit ratings are summary reports that collect and analyze tremendous amounts of financial information of companies and the financial soundness of their issued securities from time to time. Such means can be quite competent for investors on the assumption that the assessment has undergone correct and transparent procedures. In the

---

<sup>15</sup> Park, Hwonil, *Shinyongpyunggae ddarun sonhaebaesangcheongguui beobjeok moonjae* [Legal Issues on the Breach of Contract or Tort Claims against Erroneous Credit Ratings], 14 BUS. ADMIN. & L. J. 129, 134 (2004) (S. Kor.) [hereinafter Park, *Erroneous Credit Ratings*]; Asset-backed securities typically are created through the securitization of trade receivables, operating leases, royalty income, mutual fund fees, aircraft leases, utility bills, etc; See Partnoy, *The Siskel and Ebert*, *infra* note 34, at 665.

<sup>16</sup> *Id.*

<sup>17</sup> Yim, *Recommendations for Developing*, *supra* note 6, at 9-11 (noting that the function of CRAs).

<sup>18</sup> SEC, *Role and Function Report*, *supra* note 6, at 25; Lee, *Korean legislation*, *supra* note 6, at 382-383.

<sup>19</sup> KOREA RATINGS, *Sinyongpyung-gau ihaewahwalyong* [PRACTICE OF CREDIT RATINGS] 30 (2008) (S. Kor.).

current financial market, it is undeniable that credit ratings are very important and are an unrivaled measure of the investment value.

The role of credit ratings is growing more important with respect to the value of securities worldwide. Regardless of international boundaries, the credit ratings have been used as a criterion in consideration of company's commitments both the long-term and the short-term. If a conglomerate has several affiliates, the rating results of one of the affiliates could have a great influence on the ratings of other affiliates, the conglomerate, and subcontractors because these constitute an interconnected system. If the conglomerate is a multinational corporation, the rating results carry much clout worldwide. As CRAs embody assessments of future potential performances, the long-term effects might be unforeseeable. However, unlike fortune-telling, the credit ratings rely on delicate data from specific periods, which is analyzed by financial experts in economics and mathematics. Therefore, the issue of responsibility regarding CRAs should be treated in a way that corresponds to their incredible powers and revenues.<sup>20</sup>

### B. Quasi-Regulator

As a result of CRAs' monopoly and their poor performance, the U.S legislators sought to reform CRAs. The Dodd-Frank Act, for example, is the keystone policy response. It is aimed to reduce reliance on credit ratings. Recently, the SEC started

---

<sup>20</sup> See *infra* Chapter 3. A. 2

deleting credit ratings from its rules as a result of the act. As this act was implemented, several international organizations have been making policies to reduce dependence on credit ratings.

The G20 convened to discuss regulations of credit ratings and implementing like policy as Dodd-Frank Act. At the G20 summit in 2010, leaders agreed on Basel III reducing dependence on credit ratings.<sup>21</sup> In 2013, the G20 summit discussed reducing reliance on CRA ratings and strengthening the oversight.<sup>22</sup> These have been mandated to end the regulatory delegation, but there is a long way to go until they reach the goal.

Another example is the bank regulation in the Office of the Comptroller of the Currency (“OCC”), a department of the U.S. Treasury. The OCC was the prime agency that expanded and activated credit ratings to the public. During the 1930s, CRAs expanded under the new U.S. government financial policy.<sup>23</sup> When the U.S. economy was devastated by the Great Depression, the stock and bond markets collapsed. In

---

<sup>21</sup> Senior committee and board of institutional investors have obligations to make certain of their investment risks and methodologies that they use in risk assessment processes; *see* Financial Stability Board, *Principles for Reducing Reliance on CRA Ratings* (Oct. 27, 2010), [http://www.financialstabilityboard.org/publications/r\\_101027.pdf](http://www.financialstabilityboard.org/publications/r_101027.pdf).

<sup>22</sup> Financial Stability Board, *Credit Rating Agencies Reducing Reliance and Strengthening Oversight* (Aug. 29, 2013), [http://www.financialstabilityboard.org/publications/r\\_130829d.pdf](http://www.financialstabilityboard.org/publications/r_130829d.pdf).

<sup>23</sup> *See generally* Partnoy, *Siskel and Ebert*, *infra* note 34, at 643 (mentioning that Moody’s and other agencies were able to earn their authority during the 1930s); Lee, *Korean legislation*, *supra* note 6, at 381 (explaining the historical background of U.S. CRAs).

response to this crisis, the U.S. government entered the securities market to control the chaos.

In 1931, the pivotal decision mandating that the OCC would begin counting on credit rating served as a catalyst to the rating business's future prosperity.<sup>24</sup> In 1936, the OCC created formulae based on credit rating results to organize the value of the U.S. national bank's bond portfolios<sup>25</sup>; thus, preventing the banks from buying securities with lower credit rating results.<sup>26</sup> This rule had heavy impact on financial institutions and the securities market, and still applies to banks to this day.<sup>27</sup> Now, banks must search for an agency that will give a rating above a certain grade rather than multiple ratings from different sources. This marked the beginning of rate-dependent regulation and since then, the role of CRAs has continued to expand.

---

<sup>24</sup> Flandreau, Marc et al., *Ratings Performance, Regulation and the Great Depression: Lessons from Foreign Government Securities* (CEPR, Discussion paper No. 7328, 2009) [hereinafter Flandreau, *Rating Performance*]; Partnoy, Frank, *The Paradox of Credit Ratings* 79 (San Diego L. & Econ., Res. Paper No. 20, 2001) ("[T]he U.S. Treasury Department started to use credit ratings as the official marker of quality of the national banks' bond accounts.") [hereinafter Partnoy, *Paradox credit ratings*]; See White, *How did we get here*, *infra* note 34.

<sup>25</sup> See Flandreau, *Rating Performance*, *supra* note 24, at 2 (explaining the process of the reliance of credit rating results of the U.S. government).

<sup>26</sup> Under the influence of the regulation, the insurance institutions followed the footsteps of banks that the insurance companies were required to use ratings afterward. See GILBERT, HAROLD, BOND RATINGS AS AN INVESTMENT GUIDE: AN APPRAISAL OF THEIR EFFECTIVENESS 6 (1938) ("[S]pecifically, the Comptroller ruled that bonds rated BBB or an equivalent rating) or higher could be carried at cost, but bonds with lower ratings(including defaulted bonds) required fractional write-offs.").

<sup>27</sup> See White, *How did we get here*, *infra* note 34 at 3 n.11 (describing that saving institutions were required to apply this rule in 1989 to sell substantial holding of junk bonds.).

The U.S. economy became devastated as a result of the sub-prime mortgage crisis in 2008 and the public at large believed that excessive reliance on credit ratings was one of the causes. Accordingly, the OCC decided to get rid of the reliance on credit ratings in June of 2012. The essential point of the law is to reduce reliance on credit ratings amending the part of “investment grade” in 2 C.F.R parts 1, 16, 28, and 160.<sup>28</sup> Therefore, The OCC deleted the reference requirement to credit ratings provided by Nationally Recognized Statistical Rating Organizations (“NRSRO”) and ordered national banks and Federal saving association to develop their own criteria for evaluating the transparency of securities in lieu of credit ratings.<sup>29</sup> Although the OCC’s rulemaking in the early 20<sup>th</sup> century enabled the credit ratings to flourish, the OCC was dealt a heavy blow by unfavorable public opinions and had to issue warnings about the excessive reliance on credit ratings.

Another example is Basel II standardized approach. The Basel Committee issued important standards on banking supervision three times over past 10 years. Basel I which was released in 1995 had a significant impact on the global banking regulatory regime. However, the Basel I had not responded appropriately in risk management by applying an excessive standardized risk on corporations that have different credit ratings. To

---

<sup>28</sup> Alternatives to the Use of External Credit Ratings in the Regulations of the OCC, 77 Fed. Reg. 35253, 35259 (June 13, 2012) (to be codified at 12 C.F.R. Parts 1, 5, 16, 28, and 160).

<sup>29</sup> *Id.*

complement these limits, the committee issued developed standards known as Basel II in 2004. These new standards include supervisors' review added regulations and market discipline. According to Basel Committee 711(i) in Basel II, interest rate risk assessments required to receive at least two CRAs, which showed a heavy reliance on credit ratings in determining the risk factor of bank assets and capital adequacy.<sup>30</sup> In 2009, the committee discussed the weaknesses of the Basel II and then announced more developed standard known as Basel III in 2010.<sup>31</sup> Basel III aimed to tighten the banking supervision and reduce reliance on external credit ratings.<sup>32</sup> In order to enhance banks' capital buffers, the committee proposed several banking supervisory approaches that banks could use.<sup>33</sup>

---

<sup>30</sup> Basel Committee on Banking Supervision of Bank for International Settlements, *International Convergence of Capital Measurement and Capital Standards* (June 2006), <http://www.bis.org/publ/bcbs128.pdf>.

<sup>31</sup> Basel Committee on Banking Supervision of Bank for International Settlements, *Consultative Document: Revisions to the Basel Securitization Framework* (Dec. 2012), <http://www.bis.org/publ/bcbs236.pdf>.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

### 3. THE STRUCTURE OF THE CRA INDUSTRY IN THE U.S. AND KOREA

Due to the needs of the U.S. market, the CRAs were established in the 1900s and the credit ratings have become an important component in the capital markets. Since the 1970s, as various regulations required the use of credit ratings, and CRAs, especially the Big Three made a fortune. As the U.S. economy struggled through the Enron scandal and the mortgage crisis, lawmakers have sought to reform and regulate CRAs. Nevertheless, the Big Three CRAs continue to raise lots of revenue. The Korean CRA industry began in the mid-1980s and was led by government policies. The Korean CRAs were established hand in hand with foreign CRAs, because of the lack of assessment methodology and capital. This led foreign CRAs to make deep inroads into Korean CRAs market and this holds firm to this day. In the late 1990s, with the IMF crisis in full swing, Korea started recognizing the importance of credit ratings, and from the 2000s, the Korean government kicked in the more strict mandates regulating domestic CRAs.

#### A. U.S.

##### 1) Historical Perspective of U.S. CRAs

Even though there are currently many CRAs in the world, U.S. CRAs such as Moody's, S&P, and Fitch have received by far the widest name recognition.<sup>34</sup>

---

<sup>34</sup> My discussion of the history of U.S. CRAs is considerably indebted to Baklanova, Viktoria, *Regulatory Use of Credit Ratings: How It Impacts the Behavior of Market Constituents*, 10 INT'L FIN. REV. 65 (2009) [hereinafter Baklanova, *How It Impacts*]; Hill, Claire, *Regulating the Rating Agencies*, 82 WASH. U. L.Q. 43

In 1900, John Moody & Company created their own manuals for securities which included information on stocks and bonds of public services, financial institutions, and government agencies.<sup>35</sup> They sold the manuals to businesses seeking to manage their company's finances.<sup>36</sup> Based on this experience, John Moody started to estimate the value of securities in the early 1900's. Moody's was established as the first U.S. rating agency in 1909;<sup>37</sup> and in 1914, the Moody's Investors Service which is the Moody's parent of Moody's Corporation was incorporated. Moody's then expanded their business to rate bonds issued by the U.S.<sup>38</sup>

Henry Poor first published a book titled "*History of the Railroads and Canals of the U.S.*" that eventually led to "Poor's Manual of the Railroads of the U.S."<sup>39</sup> His publication company, The Poor Company, later issued their first credit ratings in 1916

---

(2004) [hereinafter Hill, *Regulating Rating Agencies*]; Partnoy, Frank, *Siskel and Ebert of Financial Markets? Two Thumbs Down for the CRAs*, 77 WASH. U. L.Q. 619 (1999) [hereinafter Partnoy, *Siskel and Ebert*]; Partnoy, *Paradox credit ratings*, *supra* note 24; White, Lawrence, *The Credit Rating Agencies: How Did We Get Here? Where Should We Go?*, 4 CPI ANTITRUST CHRONICLE(1) (2012), available at <https://www.competitionpolicyinternational.com/file/view/6654> [hereinafter White, *How did we get here*].

<sup>35</sup> LEVICH, RICHARD ET AL., RATINGS, RATING AGENCIES AND THE GLOBAL FINANCIAL SYSTEM 24 (2002).

<sup>36</sup> *Id.*

<sup>37</sup> White, Lawrence, *The Credit Rating Agencies: Understanding Their Central Role in the Subprime Debacle of 2007-2008* (NYU, Working Paper No. EC-09-06, 2009) [hereinafter White, *Understanding Their Central Role*]; Yim, *Recommendations for Developing*, *supra* note 6, at 12.

<sup>38</sup> *See supra* note 6.

<sup>39</sup> *History of S&P Credit Rating Services*, STANDARDANDPOORS.COM, <http://www2.standardandpoors.com/aboutcreditratings/>.



and expanded their business.<sup>40</sup> In 1922, Standard Statistics Company was founded;<sup>41</sup> and in 1941 merged with Poor's Publishing, to form Standard & Poor's Corp,<sup>42</sup> and has since become a world renowned rating agency.

John Knowles Fitch founded Fitch Publishing Company in 1913 and began publishing financial statistics for consumers such as the New York Stock Exchange.<sup>43</sup> Fitch Publishing Company began rating bonds in 1924,<sup>44</sup> and then in 1997, Fitch changed ownership by becoming a part of Fimalac, a French conglomerate.<sup>45</sup>

Through these processes, the major U.S. CRAs have been advising investors for more than a century. The 1970s saw an explosion in the number of CRAs.<sup>46</sup> In 1970, The Penn Central Transportation Company, the largest nonfinancial company in the U.S., had large amounts of commercial paper outstanding when it ran into financial difficulty.<sup>47</sup>

---

<sup>40</sup> *Id.* Moody's Investors Service spun off Dun & Bradstreet and become a public company in 2000.

<sup>41</sup> White, *Understanding Their Central Role*, *supra* note 37.

<sup>42</sup> The S&P was absorbed by McGraw-Hill in 1966. *Id.*

<sup>43</sup> *The History of Fitch Ratings*, FITCHRATINGS.COM, <http://www.fitchratings.com/jsp/creditdesk/AboutFitch.faces?context=1&detail=3>.

<sup>44</sup> See White, Lawrence, *A New Law for the Bond Rating Industry - For Better or For Worse* (NYU, Working Paper No. EC-06-19, 2006) [hereinafter White, *For Better or For Worse*]; see also White, *Understanding Their Central Role*, *supra* note 37.

<sup>45</sup> See LIU, QIAO ET AL., *FINANCE IN ASIA: INSTITUTIONS, REGULATION AND POLICY* 545 (2013).

<sup>46</sup> See Partnoy, *Siskel and Ebert*, *supra* note 34 at 648; see also White, *For Better or For Worse*, *supra* note 44, at 2-3.

<sup>47</sup> MARKHAM, JERRY, *A FINANCIAL HISTORY OF THE U.S.* 5-6 (2002).

The company defaulted on over \$80 million of commercial paper which caused investors to begin demanding more sophisticated levels of research.<sup>48</sup>

With increased regulatory dependence on credit ratings in 1973, the SEC adopted Rule 15c3-1, which is the first SEC regulation related to credit rating results.<sup>49</sup> The rule states that broker-dealers must apply a lower haircut to securities held by a broker-dealer that were appraised by NRSRO-CRAs, since the SEC considered those securities to be safer than securities with a lower ratings.<sup>50</sup> Since Rule 15c3-1 was created, the status of CRAs has increased greatly. Presently, the three major CRAs, Moody's, S&P, and Fitch enjoy an enormously powerful presence in the financial markets.

Thomas Friedman made a legendary comment on CRAs:

“[T]here are two superpowers in the world today. There's the U.S. and there's Moody's Bond Rating Service. The U.S. can destroy you by dropping bombs, and Moody's can destroy you by downgrading your bonds. And believe me; it's not clear sometimes who's more powerful.”<sup>51</sup>

---

<sup>48</sup> *Id.*

<sup>49</sup> Partnoy, *Paradox credit ratings*, *supra* note 24, at 13-15 (stating that SEC applied haircut word of credit rating decision about net capital requirement of broker-dealers under Rule 15c3-1 of Securities Exchange Act of 1934).

<sup>50</sup> SEC, *Role and Function Report*, *supra* note 6 (noting that credit ratings play a significant role in the securities market as the impediment in determining the investment of securities for investors, the enormous influences and significance).

<sup>51</sup> Friedman, Thomas, PBS interview (Feb. 13, 1996), <http://www.pbs.org/newshour/gergen/friedman.html>.

Indeed, the banking, the pension funds, the insurance companies, and other institutions have had to rely on credit ratings to determine whether the institutions are allowed to hold assets. As economist Thomas Friedman remarked 16 years ago, not only were the U.S. securities markets rated by those three U.S. CRAs but the global financial markets were as well.<sup>52</sup> It is undeniable that the CRAs function as a barometer of economic conditions: in other words, the CRAs must remain impartial under all circumstances.<sup>53</sup> The controversy of rate-dependent regulations will be discussed in the next chapter. The history of the reliance covers more than 70 years. Recently, the U.S. government has been trying to remove the rate-dependent regulations by enacting the Dodd-Frank Act.<sup>54</sup>

## 2) Overall View of Big Three

When Thomas Freidman warned of the enormous influence of CRAs on the world economy<sup>55</sup>, he should have raised concern regarding the monopoly of the three major

---

<sup>52</sup> For example, as of Sept. 2013, Moody's rates over 110 sovereign nations, 13,000 corporate issuers, 22,000 public finance issuers and 94,000 structured finance obligations. *See Moody's expands African ratings coverage assigning sovereign ratings to Kenya, Nigeria and Zambia*, MOODY'S.COM (Sept. 3, 2013), [https://www.moodys.com/research/Moodys-expands-African-ratings-coverage-assigning-sovereign-ratings-to-Kenya--PR\\_259338](https://www.moodys.com/research/Moodys-expands-African-ratings-coverage-assigning-sovereign-ratings-to-Kenya--PR_259338).

<sup>53</sup> SEC, *Role and Function Report*, *supra* note 6, at 6 (noting that credit ratings play a significant role in the securities market as the impediment in determining the investment of securities for investors, the enormous influences and significance).

<sup>54</sup> For more detail regarding Dodd-Frank Act, *see* Chapter 5. A.4.

<sup>55</sup> *See supra* note 51.

CRAAs as well. It is estimated that there are between seventy and one-hundred-fifty CRAAs worldwide<sup>56</sup>; however, the power within the rating industry is highly concentrated.<sup>57</sup> Moody's, S&P and Fitch currently issue over 99% of all ratings for ABS and government securities.<sup>58</sup>

The major CRAAs do not need to compete at all because of their established dominance and the influence of rate-dependent regulations. Among these three CRAAs, Moody's and S&P have especially dominated the rating industry. Even though Fitch has become incorporated into the major group-to be one of the Big Three, Still, Moody's and

---

<sup>56</sup> Some people asserted that as of 2011, there are 76 CRAAs worldwide. To look at the lists, please see *Credit Rating Agencies—Globally*, DEFAULTRISK.COM, [http://www.defaultrisk.com/rating\\_agencies.htm](http://www.defaultrisk.com/rating_agencies.htm); The late Professor Herwig Langohr mentioned in 2008 that there were about 150 local and international CRAAs around the world, See LANGOHR, HERWIG & LANGOHR, PATRICIA, *THE RATING AGENCIES AND THEIR CREDIT RATINGS: WHAT THEY ARE, HOW THEY WORK AND WHY THEY ARE RELEVANT* (2008) (explaining an overview of the CRAAs industry).

<sup>57</sup> My discussion of the monopoly of the three major CRAAs is considerably indebted to Lynch, Timothy, *Deeply and Persistently Conflicted: Credit Rating Agencies in the Current Regulatory Environment*, 59 CASE W. RES. L. REV. 227 (2009) [hereinafter Lynch, *Current Regulatory Environment*]; *Report of the Senate Committee on Banking, Housing, and Urban Affairs to Accompany S. 3850, Credit Rating Agency Reform Act of 2006*, S. Report No. 109–326, 109th Cong., 2d Sess. (2006)(describing Moody's and S&P as a “duopoly” or “partner-monopoly”) [hereinafter Senate, *Report of CRAAs of 2006*]; SEC, *Annual Report on Nationally Recognized Statistical Rating Organizations as Required by Section 6 of the CRA Reform Act of 2006* (June 2008), <http://www.sec.gov/divisions/marketreg/ratingagency/nrsroannrep0608.pdf> [hereinafter SEC, *Annual Report on NRSRO 2008*]; Listokin, *If you misrate*, *supra* note 6.

<sup>58</sup> See e.g., SEC, Section 6 Report, *supra* note 57, at 35; Hill, *Regulating Rating Agencies*, *supra* note 34 at 60–63, Lynch, *Deeply*, *supra* note 57, at 41(explaining the concentration of rating agencies); Senate, *Report of CRAAs of 2006*, *supra* note 57, at 6 (describing Moody's and S&P as a “duopoly” or “partner-monopoly”).

S&P's power is far from being shared, as their management scales and revenues are enormous.<sup>59</sup>

According to the report from OECD in 2010, The S&P's revenue of 2009 amounted to \$2,610 million and Moody's to \$1,797 million.<sup>60</sup> Their revenues are far ahead of those of Fitch, which earned \$613.5 million.<sup>61</sup> The CRA industry is subjugated to two major CRAs.

Moody's states that their "[r]atings and analysis track debts covering more than: 110 countries, 12,000 corporate issuers, 25,000 public finance issuers and 106,000 structured finance obligations."<sup>62</sup> The S&P employs approximately 10,000 people including wholly owned affiliates, located in 23 countries.<sup>63</sup> Fitch has relatively low total revenue compared to the two major CRAs, but it is still on the top group as a third global CRAs.

---

<sup>59</sup> Moody's and S&P both currently dominate 80% of rating markets; for the detailed explanation regarding the concentration of the Moody's and S&P. See JEWELL, JEFF & LIVINGSTON, MILES, A COMPARISON OF BOND RATINGS FROM MOODY'S S&P AND FITCH IBCA 6 (1999), <http://onlinelibrary.wiley.com> ("Studies of bond ratings have been largely confined to the two largest raters—Moody's and S&P.").

<sup>60</sup> OECD, *Hearings: Competition and Credit Ratings* (Oct. 5, 2010), <http://www.oecd.org/daf/competition/sectors/46825342.pdf>.

<sup>61</sup> *Id.*

<sup>62</sup> *Moody's Role in the Capital Markets*, MOODYS.COM, <http://v3.moodys.com/Pages/atc002.aspx>.

<sup>63</sup> *Speculative-Grade Composite Spread Expands to 647 Basis Points*, STANDARDANDPOORS.COM, <http://www.standardandpoors.com/ratings/articles/en/us/?assetID=1245226681637>.

The three major CRAs have earned substantial amount of profits. Moody's and S&P have made a profit every year, and Fitch has maintained the ranking over the years. In particular, among NRSROs, the revenues of the three major CRAs are going higher. According to the SEC report, the 2011 revenues of NRSROs were increased by 5.1 billion compared to 2010.<sup>64</sup> Three major CRAs occupied 94% of the total revenue of NRSROs in 2011 and 94.7% of that in 2012.<sup>65</sup>

As CRAs have been condemned in many areas and were required to reform since 2008, it was commonly expected that their revenues would be greatly reduced. Although the government implemented mandates to reduce reliance on credit ratings, CRAs bucked the expectations and their income rose dramatically.

How could they build up these lucrative businesses? Their highly regarded reputations and the rate-dependent regulations, which will be discussed below, led the CRAs to be lucrative. As the revenue chart displays, these three CRAs made money because there were no competitive CRAs to challenge them for the throne. Particularly, the Moody's and the S&P have been dominant forces in the CRAs industry. It cannot be denied that the two major agencies such as Moody's & S&P have the highest reputation among CRAs.

---

<sup>64</sup> SEC, *Annual Report on Nationally Recognized Statistical Rating Organizations as Required by Section 6 of the CRA Reform Act of 2006* (Dec. 2013), at 14~15 [hereinafter SEC, Annual Report on NRSRO 2013], <http://www.sec.gov/divisions/marketreg/ratingagency/nrsroannrep1213.pdf>.

<sup>65</sup> *Id.*

Historically, these two CRAs have developed and managed their reputations since the 1890s, when they started their businesses. That is just one of many factors why more than 100 countries, thousands of investment banks, and corporations worldwide have relied on these two rating agencies even though they have domestic CRAs in their own countries.

The oligopoly is one of big challenges that hinder the development of the CRA industry. The high concentration of CRAs rise to three potential problems: first, the dominant CRAs impede the competition among the CRAs by restraining entry into the market in order to maintain their position; second, they may make light of the quality of the services their potential competitors provide; third, as this vicious cycle is repeated, it stiffens the whole securities market. Due to these concerns, the SEC and the legislative have enacted diverse regulations to force competition to improve the quality of the rating results.

### 3) The Advent of NRSROs

In 1975, the first securities rule formally incorporated the credit ratings, and thereby approved the use of certain CRAs as NRSROs by the SEC.<sup>66</sup> The term NRSRO was mentioned in Rule 15c3-1, the Net Capital Rule which was the first securities

---

<sup>66</sup> See e.g., References to Ratings of Nationally Recognized Rating Organizations, 74 Fed. Reg. 52374 (proposed Oct. 9, 2009) (to be codified at 17 C.F.R. pts. 229, 230, 239, 240, 242, 249, 270, and 275)[hereinafter References to Ratings]; Partnoy, *Paradox credit ratings*, *supra* note 24, at 74-77 (stating that Moody's, S&P and Fitch have been registered as NRSROs first); SEC, *Role and Function Report*, *supra* note 6, at 5.

regulation to be required credit ratings in 1973<sup>67</sup>, but the definition of the term does not appear in the regulation. The term is merely defined that “NRSRO means any nationally recognized statistical rating organization.”<sup>68</sup> The SEC stated that only the ratings of NRSROs would be necessary to determine the broker-dealers’ requirement in Rule 15c3-1. After creation of this rule, regulators applied the NRSRO concept to other financial regulations. This has led to the acquisition of status by CRAs; various acts enforcing regulations that require credit ratings graded by NRSROs have expanded while excluding other agencies.

In other words, without the NRSRO designation, non-NRSRO CRAs are likely to be ignored as long as it is stipulated that those regulations require financial institutions to use credit ratings performed by NRSRO. The creation of “NRSRO” meant that the U.S. government would control the securities market by using the recognized rating manuals and granting a few NRSRO CRAs distinct powers compared to non-NRSRO CRAs.<sup>69</sup> Since the NRSRO was created in the 1970s,<sup>70</sup> there have been obvious barriers regulating

---

<sup>67</sup> See Partnoy, *Siskel and Ebert*, *supra* note 34 at 690 (describing the post-1973 regulations of the CRAs).

<sup>68</sup> 17 C.F.R. § 270. 2a-7 (2011).

<sup>69</sup> For the detailed discussion of the NRSRO, *see* Chapter A. 3.

<sup>70</sup> SEC adopted Rule 15c3-1 addressing the concept of NRSRO. *See* References to Ratings, *supra* note 66.



entry into the rating market because of the high requirements.<sup>71</sup> At that time, the SEC designated seven CRAs as NRSROs, but several CRAs have merged into Moody's and Fitch over the years.<sup>72</sup>

Currently, nine CRAs have registered as NRSROs.<sup>73</sup> A.M. Best, DBRS, Fitch, Japan credit rating agency ("JCR"), Moody's, S&P registered on September 24, 2007. Subsequently, Egan-Jones Ratings Company joined in the group on December 21, 2007. Kroll Bond Rating Agency, Inc. and Morningstar lastly participated in the NRSRO each in February 11, and June 23, 2008 respectively.<sup>74</sup> Thus, these CRAs were running the NRSRO group for some time. Originally, the Rating and Investment Information, Inc. ("R&I") was one of their members, but they notified the SEC of withdrawal from the NRSRO registration on October 13, 2011.<sup>75</sup>

A number of credit rating analysts who enrolled in NRSRO CRAs reflect the size of the business of the NRSRO CRAs. As of 2012, there are 126 analysts in A. M. Best

---

<sup>71</sup> Hunt, *Worldwide Credit Crisis*, *infra* note 118, at 624.

<sup>72</sup> *Rating the Rating Agencies: The State of Transparency and Competition: Hearing Before the Subcomm. on Capital Mkts., Ins. & Gov't Sponsored Enters. of the H. Comm. on Fin. Servs.*, 108th Cong. 10 (2003).

<sup>73</sup> SEC, *2012 Summary Report of Commission Staff's Examinations of Each Nationally Recognized Statistical Rating Organization As Required by Section 15E(p)(3)(C) of the Securities Exchange Act of 1934* (Nov. 2011), <http://www.sec.gov/news/studies/2012/nrsro-summary-report-2012.pdf>.

<sup>74</sup> *Id.* at 4.

<sup>75</sup> See SEC, *Notice of Effectiveness of Rating and Investment Information, Inc.'s ("R&I") Withdrawal from Registration as a Nationally Recognized Statistical Rating Organization ("NRSRO")* (Nov. 2011), <https://www.sec.gov/news/digest/2011/dig112811.htm>.

while 93 analysts, 1092 analysts, 1,123 analysts, and 1,436 analysts are enrolled in DBRS, Fitch, Moody's and S&P respectively.<sup>76</sup>

Regarding the NRSRO, Rules 17g-1 through 17g-7 under Securities Exchange Act of 1934 are implementing. Rule 17g-1 specifies application for registration as a NRSRO. It requires how to follow the registration procedure.<sup>77</sup> Rule 17g-2 is about records to be made and retained by nationally recognized statistical rating organizations.<sup>78</sup> It describes the importance of the records of credit ratings.<sup>79</sup> Rule 17g-3 stipulates about annual financial reports to be furnished by nationally recognized statistical rating organizations, which file requested and unaudited annual reports.<sup>80</sup> Rule 17g-4 is about prevention of misuse of nonpublic information.<sup>81</sup> It emphasizes implementing written policies and procedures to prevent inappropriate dissemination and person's impropriety regarding issuing of credit ratings.<sup>82</sup> Rule 17g-5 is about conflicts of interest. In order to decrease the conflicts of interest, the law indicates what

---

<sup>76</sup> SEC, *Annual Report on NRSRO 2013*, *supra* note 64.

<sup>77</sup> Securities Exchange Act of 1934, Application for registration as a nationally recognized statistical rating organization, 17 C.F.R. § 240.17g-1 (2007).

<sup>78</sup> 17 C.F.R. § 240.17g-2 (2009)

<sup>79</sup> *Id.*

<sup>80</sup> 17 C.F.R. § 240.17g-3 (2009).

<sup>81</sup> 17 C.F.R. § 240.17g-4 (2007).

circumstances can be construed as conflict of interest.<sup>83</sup> Rule 17g-6 prohibits NRSROS from involvement from issuing threats or participating in unfair practices.<sup>84</sup> Rule 17g-7 requires NRSRO to make a report which includes any information of the representations, warranties and enforcement mechanisms with regard to asset-backed securities.<sup>85</sup>

### B. Korea

The U.S CRAs were naturally developed as credit ratings were needed for the market; however, the Korean CRAs were introduced to the market due to the financial market improvement policy that was spearheaded by the government. Unlike the U.S. where CRAs were developed based on market demand and recognition, the Korean credit rating industry began in the 1980s when CRAs were founded in part, by the government policy to spur the development of the financial market. The development of a direct financial market was an attempt to escape from the financial market system that was dominated by an indirect financial market based primarily on banks until the 1970's. More specifically, the development of a direct financial market was focused on short term and long-term markets such as CP and corporate bonds. In support, the Korean

---

<sup>82</sup> *Id.*

<sup>83</sup> 17 C.F.R. § 240.17g-5 (2009).

<sup>84</sup> 17 C.F.R. § 240.17g-6 (2007).

<sup>85</sup> 17 C.F.R. § 240.17g-7 (2011).

government since 1985, supported the CRAs to be established and instituted to satisfy the requirement of credit ratings to issue securities.<sup>86</sup>

After IMF intervention in 1998, the Korean government expanded the scope of issuing corporate bonds to facilitate the raising of the funds by corporations by promoting financial liberalization and corporations issued unsecured debentures at that time. In view of the fact that stocks of corporations fluctuated simply by virtue of the pronouncements from these foreign major CRAs, the Korean national policies changed, and began to join hands with the major U.S. CRAs in the late 1990s.

After 1999, the CRA businesses grew and structured securities such as ABS were introduced. In order to boost the finance of the companies, the government encouraged issuing unsecured corporate bonds. This led to the securities market expansion and the credit ratings' vitalization. Given the circumstances, Koreans needed specific regulations on credit ratings.

Consequently, the IMF program served as a timely catalyst of CRA regulations to be enacted. In 1997, when the financial crisis was in full swing, Korea's credit ratings by foreign CRAs plummeted. Moody was one of those that gave unfavorable review. Moody's dropped Korea's long term credit rating from A1 to A2 in October, and 3

---

<sup>86</sup> See Cheung, Stephen & Chan, Bob, *Bond Markets in the Pacific Rim: Development, Market Structure and Relevant Issues in Fixed-income Securities Markets*, 9 U.N. ASIA-PAC. DEV. J. 13-15 (July 2002).

months later, fell Baa (junk). At that time, the credit ratings had not been recognized by the public and the government also hadn't taken serious notice of the CRAs. The drop of credit ratings eventually led to many Korean companies to go bankrupt sequentially. Korean economy which had been sustained mainly by trading was paralyzed due to the junk credit ratings. Korea was described as "heavy reliance on export markets" in 2001 and had been evaluated as much into present time.<sup>87</sup> A country which is highly dependent on trade like Korea can achieve faster economic growth, but also especially susceptible to external shocks. After the announcement of the junk credit rating, Korea was not able to borrow money from abroad and its bonds became completely worthless overnight. The exchange rate and CP soared and the stock price plummeted.

Since then, the government recognized the seriousness of the domestic situation and tried to revive the economy by opening the bond market to foreign countries and relieving restrictions on acquisitions or mergers of companies by foreigners. This led Moody's to revise Korea's credit rating upward about three months after the junk crisis. After years of effort, Korea was able to pay back the IMF loan early in 2001. With this as momentum, Korea showcased the reformed CRAs regulations in 2001. In addition, under the influence of the Sarbanes-Oxley Act in the U.S., the Korean government made

---

<sup>87</sup> OECD/World Bank Institute, *Korea and the knowledge-based economy* (2000), at 117, <http://browse.oecdbookshop.org/oecd/pdfs/product/9200061e.pdf>.

initiatives to add several regulations related to the CRAs by the Financial Supervisory Service.

As of August 2013, the domestic credit rating market is comprised of the Korea Ratings Corporation (“Korea Ratings”), Korea Investors Service, National Information & Credit Evaluation Inc. (“NICE Information Credit”), and Seoul Credit Rating & Information Inc. (“Seoul Ratings”). These CRAs cooperate with foreign agencies, such as Moody’s and Fitch. Currently, these four CRAs occupy about 98% of the whole market.<sup>88</sup>

Korea Investors Service founded in 1985 started with 50 billion won and was the first CRA in Korea. It began to work with corporate bonds for the first time among the CRAs. It was incorporated as a subsidiary of Moody’s in 1998. Their greatest shareholder is Moody’s Investors Service<sup>89</sup> and another great shareholder is NICE INFRA Co. which Moody’s controls with 50% + 1 share.

Korea Ratings was founded in 1983 with a capital of 24.3 billion won and is a subsidiary of Fitch.<sup>90</sup> They are a credit rating and consulting agency. They do research on credit assessment, special assessment, and risk management solution business. Credit

---

<sup>88</sup> See Financial Supervisory Service of South Korea, 2008 *Nyun shinyongpyunggaui shinyoungpyunggasiljeok boonseok* [The present status of Korean CRAs in 2008] (May 13, 2009) (S. Kor.), [http://www.fss.or.kr/fss/kr/promo/bodobbbs\\_view.jsp?seqno=13571&no=34&s\\_title=%BD%C5%BF%EB%C6%F2%B0%A1&s\\_kind=content&page=5](http://www.fss.or.kr/fss/kr/promo/bodobbbs_view.jsp?seqno=13571&no=34&s_title=%BD%C5%BF%EB%C6%F2%B0%A1&s_kind=content&page=5).

<sup>89</sup> DAS, SUBHAMOY, PERSPECTIVES ON FINANCIAL SERVICES 350 (2009).

<sup>90</sup> KAWAI, MASAHIRO ET AL., IMPLICATIONS OF THE GLOBAL FINANCIAL CRISIS FOR FINANCIAL REFORM AND REGULATION IN ASIA 245 (2012).

ratings account for 60.8%, business valuation assessment 25.7%, and the information business comprise 13.5 % of their sales.<sup>91</sup>

Built in 1985, NICE Information Credit is the predecessor of the Korea Investors Service and became separate entities in 1998. In 2000, they established a strategic alliance with R&I,<sup>92</sup> which is one of leading Japanese CRAs. They perform credit checks, credit investigation business, and debt collection.

Lastly, Seoul Ratings has been participating in the market since 1992.<sup>93</sup> Their sales are lower compared to the three CRAs.

Regarding market share in 2011, Korea Investors, NICE Information Credit, and Korea Ratings each have 33.7 %, 33.4 %, and 32.5% respectively.<sup>94</sup> In addition, the total sales of credit ratings have increased slightly compared to the previous year as it is approaching 834 billion won.<sup>95</sup> The table indicates the Financial Supervisory Service of South Korea, 2011e total sales of 2011 in the field of credit rating in companies'

---

<sup>91</sup> *Financial Disclosure Report*, KOREARATINGS.COM (Sept. 2012), <http://www.korearatings.com/kr.jsp> . As of January 14, 2013, Fitch's percentage of shareholding is approximately 73.55%.

<sup>92</sup> The R&I is the largest CRA in Japan, which was founded after the merger of JBRI and NIS in 1998.

<sup>93</sup> See Seoul Credit Rating & Information Inc., <http://www.scri.co.kr/eng/index.jsp> .

<sup>94</sup> Financial Supervisory Service of South Korea, 2011 *Shinyongpyungga hoisau shinyoungpyungga shiljeok boonseok* [Performance analysis of CRAs in 2011] (Apr. 16, 2012) (S. Kor.), [http://www.fss.or.kr/fss/kr/promo/bodobbbs\\_view.jsp?seqno=15850&no=41&s\\_title=%BD%C5%BF%EB%C6%F2%B0%A1&s\\_kind=title&page=1](http://www.fss.or.kr/fss/kr/promo/bodobbbs_view.jsp?seqno=15850&no=41&s_title=%BD%C5%BF%EB%C6%F2%B0%A1&s_kind=title&page=1) .

<sup>95</sup> *Id.*

business.<sup>96</sup> The total sale of 2011 in the field of credit ratings in CRAs was 834 billion won, which was an increase of 5.7% compared to the 78.9 billion won last year.<sup>97</sup> To increase the issue of corporate bonds from 113 trillion won in 2010 to 120 trillion won in 2011 was the main reason for the growth of the sales.<sup>98</sup> Those three CRAs share the market, each maintaining about 30% in the credit ratings market.<sup>99</sup> Among the three CRAs, Korea Investors Service has been leading. Seoul is far behind occupying 0.4% of the total.<sup>100</sup> As the U.S. CRAs dominate the global CRA market, these three Korean CRAs govern the Korean CRA market.

As shown above, most of the Korean CRAs are dominated by foreign agencies. That leaves Korean market vulnerable to their whims as the market is essentially controlled by these foreign agencies.

Why do Korean CRAs rely on the U.S. rating agencies? Looking at percentage of ownership, the Korean CRAs seem to be Korean companies, but they have in all actuality fallen into foreign companies' hands. If Korean CRAs were capable of performing rating

---

<sup>96</sup> *Id.*

<sup>97</sup> *Id.*

<sup>98</sup> *Id.*

<sup>99</sup> *Id.*

<sup>100</sup> *Id.*



services, why did they need foreign CRAs? The reasons are lack of methodology, reputation, and capital.

The Korean CRAs are far from being able to operate solely on basis of their reputation. Compared to the U.S. CRAs which were created a century ago, the Korean CRAs were established just two decades ago and the scale of their systems are comparatively smaller. It means that the U.S. CRAs have built their reputations for longer period of time than the Korean CRAs, and have had a head start in building trust. As mentioned in Chapter 3 regarding their reputation, the Korean CRAs have less public confidence since they have shorter histories. Unlike the U.S., Korea was not proactive in doing business which the domestic CRAs in the section of structured finance, nor did they try to develop their own criteria with their own advanced methodology. These are the reasons why the Korean CRAs haven't had the success enjoyed by that of the Japanese CRAs.

Korean CRAs needed the capital as well as the skills of the foreign CRAs. In the case of Korea Ratings, it entered into a contract for receiving supporting capital from Fitch Ratings in 2000. In the same year, Financial Supervisory Commission officially approved its credit rating business and it was listed on KOSDAQ the following year. It couldn't be possible without the Fitch's capital.

Another example is Korea Investors Service. It joined hands with Moody's in 1998 and it was finally incorporated into Moody's in 2001. It is notable that Korean CRAs were difficult to build up without infusion of foreign capital.

Recently, the Korean CRAs have produced overvalued credit ratings. In particular, construction companies and savings banks brought chain of bankruptcies. The capital market has been hit hard by these woes.

Numerous construction companies filed for bankruptcy and many savings banks are being liquidated by the government each year. According to a report released on September 13, 2012, Financial Services Commission ordered suspension of businesses on 20 debt-saddled savings banks (asset size to approximately 38%) due to poor management and liquidated the businesses three times stage by stage for one year.<sup>101</sup> During the first half of 2011, Samhwa, Busan, Daejeon, Central Busan, Jeonju, Bohai, Domin, Gyungeun bank, and during the second half of the year, Jeil 1, Jeil 2, Prime, Daeyoung, Ace, Bulebird, Tomato Savings, and Solomon, Hankook, Mirae, and Hanjoo

---

<sup>101</sup> Financial Services Commission of South Korea, *Jeochook-eunhaenggunjungyungyoungel wuihan chooga jaedogaeseon bangsan* [Additional plan for improving system for the sound management of saving banks] (Sept. 13, 2012) (S. Kor.), [http://www.fsc.go.kr/info/ntc\\_news\\_view.jsp?bbsid=BBS0030&page=4&sch1=content&sword=지축은행&r\\_url=&menu=7210100&no=28820](http://www.fsc.go.kr/info/ntc_news_view.jsp?bbsid=BBS0030&page=4&sch1=content&sword=지축은행&r_url=&menu=7210100&no=28820).

were ordered to suspend their businesses in May 2012.<sup>102</sup> As a result, in recent years, many companies including savings banks were closed down and went bankrupt.

Seemingly, high-grade packaging companies have increased the actual Korean economy that was in the slow lane. The situations of the corporations that are in desperate need of high credit rating are as follows: When the credit rating goes down, it becomes that much harder to expand their business and apply for a loan as needed from a bank. Since the expansion of the business becomes harder, it is highly unlikely that they will increase revenue. Finally, the cases used to be connected to a worsening business. Therefore, the issuers are unconditionally desperate for the rise of the credit ratings so that this can be used for their external image.

Korean CRAs face similar types of problems to the U.S. and this has a great influence on the Korean economic system that is relatively small. By integrating Korea's special circumstances and the U.S. experience, it is time to consider resolution.

---

<sup>102</sup> Financial Services Commission of South Korea, *Jae 309 Gookhwe jeongmoo wuiwonhwe upmoohyunhwang* [The 309th Extra session of the National Assembly: present condition of National Policy Committee] 36 (July 26, 2012) (S. Kor.), [http://www.fsc.go.kr/info/ntc\\_news\\_view.jsp?bbsid=BBS0030&page=4&sch1=content&sword=지축은행&r\\_url=&menu=7210100&no=28755](http://www.fsc.go.kr/info/ntc_news_view.jsp?bbsid=BBS0030&page=4&sch1=content&sword=지축은행&r_url=&menu=7210100&no=28755).

#### 4. THE FAILURE OF CRAS

The biggest common cause of failure of CRAs in both the U.S. and Korea is that CRAs continued poor performances which did not adequately predict the risk of the finance products. The Enron crisis of 2001 and the mortgage crisis of 2008 caused the current U.S. economic recession. The CRAs which continued to provide incorrect credit ratings through the past years are criticized by investors who believed the credit ratings and took a huge loss. The U.S. CRAs also lost public confidence in Korea by showing poor performances and providing impartial credit ratings. Korean

CRAs have also provided overrated credit ratings to the domestic companies. Even though some companies were reeling from bankruptcy crisis, the CRAs seemingly weren't aware of the situation. Preposterously, they kept maintaining these companies as investment grades until the companies filed for court receivership. Shortly after they heard the news, the CRAs dropped the grades as default. In addition, the CRAs of both countries were criticized for conflicts of interest, lack of competition, and immunity from negligence. Currently, several cases that recognized the responsibility of CRAs have come out from courts and the both governments also have been operating a strong reform of CRAs.

## A. U.S.

### 1) Systemic Failure of CRAs Exposed by the U.S. Economic Recession

Since 2000, the U.S. maintained low interest rates under the leadership of the central bank and direction of people. Because of the policy, in U.S. many people started to buy houses taking loans from financial institutions. Investment banks issued new securities with the loan securitization and then started to sell these to investors. Aimed at these mortgage-based products, other structured products were created and sold again and again. In the process, the U.S. CRAs were criticized for receiving overvalued credit ratings regarding mortgage-based products and derivative products.

By experiencing crisis and difficulties in the structured finance market, the U.S. has drawn up measures regarding the CRAs which produced inaccurate credit ratings. Losses due to the subprime crisis have been focused on the structured finance products which were based on the sub-prime mortgage-backed securities. The structured products have advantages of fast profits, but investment risk also increases. In 2007, about KRW 4.2 trillion of structured financial products were in the securities market.<sup>103</sup> The most well-known of these products are CDOs.<sup>104</sup> The troubled products were RMBS backed by CDOs. CDOs are relatively vulnerable and volatile because of their peculiar

---

<sup>103</sup> See Blundell-Wignall, Adrian, *Structured Products: Implications for Financial Markets*, 2007 OECD J. FIN. MARKET TRENDS no. 1, at 27, <http://www.oecd.org/finance/financial-markets/39654605.pdf> ; To see past year information, see also Sabarwal, Tarun, *Common Structures of Asset-Backed Securities and Their Risks*, 4 CORP. OWNERSHIP & CONTROL 258, 259 (2006).

<sup>104</sup> It is called securitization which is the packaging of a collection of assets into fixed income securities.

characteristics. According to the Bank of International Settlements, they define CDOs as: 1) [p]ooling assets; 2) trenching of liabilities that are backed by the asset pool, and 3) de-linking of the credit risk of the collateral asset pool from the credit risk of the originator, usually through use of a finite-lived, standalone special purpose vehicle.<sup>105</sup>

The more these tranches are mixed, the more complicated products come through repetitive transactions, and the more the products stand to make money or lose money. That means that these financial products are likely to be volatile and vulnerable. The huge financial investors have been fascinated by this fact. CRAs have made money by appraising products such as CDOs including traditional securities since the products were created.

Enron signaled the decline of the U.S. economy. Enron was one of leading corporations in U.S., employing over 22,000 people and creating \$1.3 billion in revenue the year before it went bankrupt in 2001.<sup>106</sup> Enron scandal should have served as a warning to the U.S. when it became evident that there were systemic fraud in the company's accounting and management. The Enron scandal proved to be a prelude to collapse of the bubble economy, and had a dramatic effect on the dissolution of major

---

<sup>105</sup> Committee on the Global Financial System of Bank for International Settlements, *The role of ratings in structured finance: issues and implications*, <http://www.bis.org/publ/cgfs23.pdf>.

<sup>106</sup> “[F]ortune named Enron America's Most Innovative Company for six consecutive years.”, *see* ZHAO, YUAN, CORPORATE GOVERNANCE AND DIRECTORS' INDEPENDENCE 131 (2011). Furthermore, their revenue of 2000 was \$100,789 million, more than double that of the previous year, *see* DUCHAC, JONATHAN ET AL., FINANCIAL ACCOUNTING: AN INTEGRATED STATEMENTS APPROACH 48 (2006).

accounting firms and a series of powerful corporations. The Enron case has been treated as the worst financial scandal by damaging the reputation of the U.S. In 2006, BBC news wrote an acerbic review of the Enron scandal that stated “the Enron case was the biggest in a series of scandals that damaged the reputation of America.”<sup>107</sup>

Although the U.S. administrative and legislative branches struggled to create the Sarbanes-Oxley Act of 2002, the economy went steadily downhill. Since then, several large banks and corporations have collapsed and consequently, U.S. housing prices fell. The sub-prime RMBS crisis plunged the U.S. economy into the largest recession since the Great Depression, a recession it has yet to fully recover from. Many scholars have commented that too many investors poured too much capital into the housing market because they trusted the visible economic situation at the time, which looked positively glowing.

In 2001, even though Enron’s credit was rapidly deteriorating, the CRAs kept it at investment grade.<sup>108</sup> Following Enron’s filing for bankruptcy,<sup>109</sup> the Senate Committee on Governmental Affairs launched a broad investigation into the Enron collapse. The

---

<sup>107</sup> See DÜMKE, RICCARDA, CORPORATE REPUTATION AND ITS IMPORTANCE FOR BUSINESS SUCCESS: A EUROPEAN PERSPECTIVE AND ITS IMPLICATION FOR PUBLIC RELATIONS CONSULTANCIES 2-3 (2002).

<sup>108</sup> Yim, *Recommendations for Developing*, *supra* note 6, at 19-21 (stating the inaccurate credit ratings of Enron).

<sup>109</sup> Hill, *Regulating Rating Agencies*, *supra* note 34 at 46 (“[C]learly, four days before Enron declared bankruptcy, its debt was actually junk. The furor over Enron, WorldCom, and other recent debacles has led to calls for regulatory changes in a number of industries.”).

Senate Committee held a hearing entitled “Rating the Raters: Enron and the CRAs” to verify the performances of CRAs in the Enron scandal.<sup>110</sup> To investors, the behavior of CRAs was in itself, irresponsible, negligent and characterized by non-duty of care.<sup>111</sup> Nevertheless, Moody's earnings have skyrocketed between 2002 to 2006.<sup>112</sup>

Another example is the turmoil of RMBS. From 2006 to 2007, abuses of RMBS whose ratings were exaggerated led the U.S. to its current financial crisis. While investors were enthusiastic about RMBS and the housing market, were there any signs of default of RMBS?

In March 2006, according to data released by the National Delinquency Survey and Mortgage Bankers Association concerning the fourth quarter of 2005, the delinquency rate for mortgage loans on one-to-four-unit residential properties was up from 4.38 % over the fourth quarter of 2004 and 4.44 % over the third quarter of 2005.<sup>113</sup> On December 13, 2006, NDS declared that the delinquency rate for mortgage loans on

---

<sup>110</sup> See *Rating the Raters: Enron and the Credit Rating Agencies: Hearing Before S. Comm. on Gov't Affairs*, 107th Cong. (2002) [hereinafter *Senate, Enron Hearing*].

<sup>111</sup> SEC, *2008 Summary Report*, *infra* note 118, at 12 (“[O]ne analyst expressed concern that her firm’s model did not capture half of the deal’s risk... let’s hope we are all wealthy and retired by the time this house of cards falters”); Yim, *Recommendations for Developing*, *supra* note 6, at 21-22 (criticizing the reckless and irresponsible performance of CRAs at the Enron scandal).

<sup>112</sup> LEWIS, MICHAEL, PANIC: THE STORY OF MODERN FINANCIAL INSANITY 325 (2009).

<sup>113</sup> Mortgage Bankers Association, National Delinquency Survey Q208 (2008), at 10, [http://www.vermontmba.org/files/Q208\\_NDS.pdf](http://www.vermontmba.org/files/Q208_NDS.pdf).



one-to-four-unit residential properties had increased 28 basis points from the second quarter, and up 23 basis points from a year earlier.<sup>114</sup>

Given the above data from 2002 to 2006, did CRAs, operates as professional investigators of securities and economic materials, not know the signs of subprime mortgage turmoil? The 2002 data indicates that there was a considerably more complicated and much larger financial market. Why did they idle at that point? By simply following the data, one can plainly see that CRAs performed poorly and their negligence is obvious.<sup>115</sup>

One of main contributors to the U.S. mortgage crisis is that too many investors were encouraged to buy RMBS that were given over-rated positives by the major CRAs<sup>116</sup> with credit loans.<sup>117</sup> Some commentators have claimed negligence. Because credit ratings were inaccurately high, investors were encouraged to invest large amounts

---

<sup>114</sup> *Id.*

<sup>115</sup> Krinsman, Allan, *Subprime Mortgage Meltdown: How did it Happen and How will it End?*, 13 J. STRUCTURED FIN. 5 (2007) (stating that since the end of 2006, over 30 subprime originators have gone bankrupt or gone out of business).

<sup>116</sup> See Hill, *Regulating Rating Agencies*, *supra* note 34.

<sup>117</sup> From the collapse of Century Financial U.S. Subprime crisis, In March, 2008, Bear Stearns was undertaken by JPMorgan, and in September, Lehman Brothers went bankrupt. The financial crisis resulting from a decline in housing prices made U.S. house prices slump, and all U.S. financial areas fell into decline. The crisis had a global impact. See, e.g., FRANKS, SANDY & NUNNALLY, SARA, BARBARIANS OF WEALTH: PROTECTING YOURSELF FROM TODAY'S FINANCIAL ATILAS 252 (2010); Hunt, John, *One Cheer for the Rating Agencies: How the Mark-to-Market Accounting Debate Highlights the Case for Rating-Dependent Regulation*, 60 S. CAR. L. 749 (2009) [hereinafter Hunt, *One Cheer Rating Agencies*]; Particularly, for detailed information of the collapse of Bear Stearns and other financial scandals such as the Madoff scandal, see also Black, *Protecting The Retail Investor*, *infra* note 118, at 14-19.

of capital into the U.S. housing market, buying RMBS and CDO based on MBSs.<sup>118</sup> Such excessive investments fueled the housing bubble, and further led to the current U.S. economic recession. During this turmoil, the lack of sophistication and the reckless behavior of the CRAs were exposed.<sup>119</sup>

As public opinions grew that U.S. CRAs were liable for the crisis, the U.S. has been spurred on to impose liability on the CRAs and reform the industry.<sup>120</sup> In structured finance, where CRAs devote a large amount of their business, arrangers aim to meet the CRAs' standard by mixing a pool of underlying assets so that they may receive desired

---

<sup>118</sup> My discussion of the subprime-mortgage securities is considerably indebted to Murdock, Charles, *The Financial Reform Act: Will it Succeed in Reversing the Causes of the Subprime Crisis and Prevent Future Crises?* (Loy. U. Chi. L., Res. Paper, 2010); Proposed Rules for Nationally Recognized Statistical Rating Organizations, 73 Fed. Reg. 36212 (June 19, 2008) (to be codified at 17 C.F.R. pts. 240, 249b) (“[B]eginning in the middle of 2006, home values leveled off and led to a corresponding increase in delinquencies. This marked increase in subprime loan delinquencies ... the influence ... extended the overall economy.”); Hunt, John, *CRAs and the 'Worldwide Credit Crisis': The Limits of Reputation, the Insufficiency of Reform, and a Proposal for Improvement*, 2009 COLUM. BUS. L. REV. 605 (Sept. 5, 2008) [hereinafter Hunt, *Worldwide Credit Crisis*]; Black, Barbara, *Protecting The Retail Investor In An Age Of Financial Uncertainty*, 34 DAYTON L. REV. 61, 61-65 (2009) (explaining how the U.S. economy has fallen during the 2000s) [hereinafter Black, *Protecting The Retail Investor*]; SEC, *Summary Report of Issues Identified In the Commission Staff's examinations of Select Credit Rating Agencies* (July 2008) [hereinafter SEC, 2008 *Summary Report*], <http://www.sec.gov/news/studies/2008/craexamination070808.pdf> (highlighting that delinquency for subprime mortgage loans in the U.S. dramatically increased, creating turmoil in the markets for RMBS backed by such loans and CDOs. The CRAs suspected the accuracy of their performances of the ratings) ; Lee, Wonsam, *Shinyong pyunggaui hoisaui minsa chekim* [Civil Liability of CRAs], 23 Corp. L. J. 59, 60 (2009) (S. Kor.) [hereinafter Lee, *Civil Liability*].

<sup>119</sup> See e.g., Coffee, John, *Ratings Reform: The Good, The Bad, and The Ugly*, 1 HARV. BUS. L. REV. 231 (2011) [hereinafter Coffee, *Ratings Reform*]; Black, *Protecting the Retail Investor*, *supra* note 118, at 4 (stating the past U.S. economic turmoil).

<sup>120</sup> See BAKER, KENT & NOFSINGE, JOHN, *SOCIALLY RESPONSIBLE FINANCE AND INVESTING* 210 (2012); *Enhancing Investor Protection and the Regulation of Securities Market: Hearing Before the S. Comm. on Banking, House and Urban Affairs*, 111th Cong. 78 (2009); *Approaches to Improving Credit Rating Agency Regulation: Hearing Before the Subcomm. on Capital Mkts., Ins. & Gov't Sponsored Enters. of the H. Comm. on Fin. Servs.*, 111th Cong. 116 (2009).

rating results.<sup>121</sup> This approach keeps ratings artificially high and CRAs still claim that they are not involved in structuring assets and recommending any sales.

## 2) Poor performance of U.S. CRAs on Korea's credit Outlook

Korea's sovereign credit ratings of the U.S. CRAs were devalued. The Big Three produced credit ratings, which were difficult to agree.

The first example is Moody's. In January of 2009, the foreign currency long-term senior debt ratings of eight banks such as Hana Bank, IBK, KEXIM, Kookmin Bank, KDB, NACF, Shinhan Bank and Woori Bank were lowered to A2 by Moody's. The next month, they raised all those banks' credit ratings slightly all at once. This eyebrow raising action happened since Moody's applied different methodologies when these banks were appraised. Moody's became aware that they've had a bug in the program used to rate complex debt securities in 2006 and finally rated them as Aaa even though they deserved much lower grades. They tried to correct this problem and carried out the methodology changes in 2007. It is strange to note that this company still remains as global recession-proof agency.

The second example is Korean sovereign credit ratings assessed by Fitch are the second example. During the financial crisis in 1998, Fitch excessively moved Korea's

---

<sup>121</sup> ELSON, ANTHONY, GOVERNING GLOBAL FINANCE: THE EVOLUTION AND REFORM OF THE INTERNATIONAL FINANCIAL ARCHITECTURE 139 (2012).

sovereign credit ratings in a short period of time. For example, Korea's credit rating was junk by Fitch, but it suddenly recovered to Positive after 1 month .

On December 23, 1997, Fitch downgraded Korea's sovereign rating to B- which was the worst value in the Korean financial history and that credit rating was maintained for 1 month. The credit rating was much lower than that of Lebanon's which was evaluated as BB at that time.<sup>122</sup>

Even though the Korean government applied for relief through the IMF program, it shouldn't be compared with Lebanon's economy, considering international competitiveness and the scale of economy. Despite the fact that IMF funding solution that had emerged at the time, as soon as the credit rating result was announced, Korea's credit had fallen to the bottom. Then, on February 3, 1998, Fitch abruptly bumped up the rating to BB+ 1 month later, reflecting Korea's positive situation by the relief loan. There was a strong criticism of Fitch for failing the chief feature of the CRAs- the alarm function failed in Korea.

The third example also features Fitch. On November 10, 2008, Fitch downgraded Korea's credit outlook from "stable" to "negative". The following day, they also lowered the credit outlook of major Korean financial institutions to "negative".<sup>123</sup> The Korean

---

<sup>122</sup> *Id.*

<sup>123</sup> Olsen, Kelly, *Fitch lowers credit outlook on emerging economies*, FOXNEWS.COM (Nov. 10, 2008), [http://www.foxnews.com/printer\\_friendly\\_wires/2008Nov10/0,4675,ASEmergingEconomiesFitch,00.html](http://www.foxnews.com/printer_friendly_wires/2008Nov10/0,4675,ASEmergingEconomiesFitch,00.html).

government and Korean financial institutions refuted the outlook; however, by the following day the anxiety of the securities market had escalated. The outlook of Fitch had exacerbated the state of the Korean securities market. In simple terms, Fitch's outlook so far has been proven wrong. Since November, the Korea Composite Stock Price Index ("KOSPI") has increased fast over the last year.<sup>124</sup>

According to Korea Exchange, the KOSPI 2009 was increased by 700 points showing a significant growth for the year.<sup>125</sup> In addition, the Korean Securities Dealers Automated Quotations ("KOSDAQ") went through the roof in 2009 as well: It was below 300 at first, but it finally reached 1800.<sup>126</sup> It shows that Korean economy was maintaining momentum and Fitch did not reflect the economic stability in their rating process at that time.

The British media such as Financial Times and Economist and Fitch have expressed skepticism regarding the Korean economy over the years. There are many assumptions about their skepticism. One of them is that Korea's Strategy and Finance Minister complained to the British Finance Minister at the G20 Finance Ministers Meeting in London in March 2009. Meanwhile, there were concerns that the negative opinions of the Korean economy, exacerbated by the earlier complaints of Korean

---

<sup>124</sup> See Korea Exchange, [http://eng.krx.co.kr/ml/ml\\_3/ml\\_3\\_1/JHPENG01003\\_01.jsp](http://eng.krx.co.kr/ml/ml_3/ml_3_1/JHPENG01003_01.jsp).

<sup>125</sup> *Id.*

<sup>126</sup> *Id.*

financial authority caused HSBC to give up its undertaking with the Korean Foreign Exchange Bank. Korea needs to look at realities rationally and learn not to let emotions dictate their response. Korea has to realize that rational response is the best response.

In addition, Fitch stated that according to their own stress test, Korea's banks may lose 42 trillion won because of falling values of investments in securities, and released the report to the press.<sup>127</sup> The stress test is the way to diagnose the scale of the bank's insolvency and its capital, assuming key variables such as growth and currency exchange rates, inflation, and etc. In the article, it stated that these banks might need support for recapitalization fund and additional fund for losing value.<sup>128</sup> The Korean government sweated over dealing with Fitch's expectations and strongly refuted Fitch's assessments.

Fitch expected that these banks would suffer from lack of funds and their finance will be exacerbated. Fitch announced the expected rate of equity to asset ratios would be: Kookmin Bank (4.4%), Shinhan Bank (3.9%), Woori Bank (2.9%), Hana Bank (4.6%), Industrial Bank of Korea (5.5%), except Bank (5.1%), First Bank (4.5%), Busan Bank 4.3%, Daegu Bank (3.7%), Kyungnam Bank (3.5%), Jeonbuk Bank (3.0%), and Jeju Bank (3.8%).<sup>129</sup>

---

<sup>127</sup> Kim, Taegyu, *Korean Banks Will Lose W42 Tril. By 2010*, KOREA TIMES (Mar.13, 2009), [http://www.koreatimes.co.kr/www/news/biz/2009/03/123\\_41234.html](http://www.koreatimes.co.kr/www/news/biz/2009/03/123_41234.html).

<sup>128</sup> *Id.*

<sup>129</sup> *Id.*

However, according to the report from the Financial Services Commission and the Financial Supervisory Service, the equity asset of Korean banks would be stronger than the equity asset of the City bank(1.5), JPMorgan(3.8), Bank of America(2.8) in U.S., UBS(1.1), Standard Chartered (3.7) in Europe, and Tokyo-Mitsubishi UFJ (3.2) in Japan.<sup>130</sup>

The announcement of the results of the stress test by Fitch is fallible since it did not compare the Korean banks with foreign banks under the same conditions. In order to insure the fairness of Fitch's report, the Bank of Korea, as well as those of the U.S., Japan, and Europe should be compared to each other with the same variables. Furthermore they are unfair that they estimated losses for Korean banks only. Furthermore, it is doubtful whether the U.S. CRAs have produced partial and favorable credit ratings to a certain countries. Japan's sovereign credit ratings are the example. The CRAs have been far too lenient with Japan by producing inflated credit ratings. Japan's debt is rapidly increasing and their economy has been devastated.

A report released by OECD shows the gross debt of 11 countries in 2011 and the link with the gross domestic product and the gross debt of Japan. Japan has reached the highest ranking among those countries.<sup>131</sup> Greece and Italy are behind Japan. These two

---

<sup>130</sup> *Id.*

<sup>131</sup> OECD, *Medium and Long-term Scenarios for Global Growth and Imbalances*, OECD Economic Outlook, Vol. 2012/1 (2012), at 212, <http://www.oecd.org/berlin/50405107.pdf>.

countries have applied for the current financial relief to the IMF and faced the worst economic crisis, trying to manage and prevent national bankruptcy.<sup>132</sup> Furthermore, among those 11 countries, Japan has the highest percentage regarding average consolidation to stabilize debt with 8.9%.<sup>133</sup> On the other hand, in the case of Belgium, it has only 1.2%.<sup>134</sup> This shows how much the might of Japanese economy has been blown out of proportion.

Looking at the Atlantic magazine's data, Japan's GDP figures over the last 30 years, indicates a more serious situation.<sup>135</sup> As shown in the chart, Japan's GDP growth shows imbalance for many years. Japan's nominal GDP has suffered a large drop over last 30 years.<sup>136</sup> Since 1998, Japan has lost 10 trillion yen and has been stuck in the quagmire of recession. Japan's fiscal balance has continued to plunge since 1991 and the situation is significantly worse today than it was a decade ago.<sup>137</sup> Since 2008, Japan's economy has plunged and it has not recovered yet. Japan has a long way to go; to get

---

<sup>132</sup> *Id.*

<sup>133</sup> *Id.*

<sup>134</sup> *Id.*

<sup>135</sup> O'Brian, Matthew, *There is only thing that can save Japan now: Inflation*, THE ATLANTIC (Nov. 20, 2012), <http://www.theatlantic.com/business/archive/2012/11/there-is-only-one-thing-that-can-save-japan-now-inflation/265421/>.

<sup>136</sup> *Id.*

<sup>137</sup> *Id.*



back to the boom days of 1990's. This reflects how the current Japanese financial crisis is deepening and spreading.

Nonetheless, as of 2010, Japan's credit rating was higher than that of Korea's.<sup>138</sup> At the time, Moody's was maintaining Japan's credit rating as Aa2.<sup>139</sup> Then, Moody's made downward revision from Aa2 to Aa3 in 2011.<sup>140</sup>

On the contrary, Korea was appraised as A1 by Moody's over the years and has been cranked up a notch to Aa3 in August 2012.<sup>141</sup> As of 2013, Moody's has maintained Japan's credit rating as Aa3 since 2011.<sup>142</sup> Korea had made leap in economic growth from 2009 to 2010. The GDP growth turned around 6.2 % in 2010.<sup>143</sup> To issue a public

---

<sup>138</sup> Myung, Soongyoung, *Hankook Shinyongdeunggeup Ilbon Choowol* [Korea's credit rating overtook Japan's], MK ECONOMY (Sept. 10, 2012) (S. Kor.), [http://mbnmoney.mbn.co.kr/news/view?news\\_no=MM1000680246](http://mbnmoney.mbn.co.kr/news/view?news_no=MM1000680246).

<sup>139</sup> *Id.*

<sup>140</sup> *Rating Action: Moody's lowers Japan's government rating to Aa3; outlook stable*, MOODYS.COM (Aug. 24, 2011), [https://www.moodys.com/research/Moodys-lowers-Japans-government-rating-to-Aa3-outlook-stable--PR\\_224752](https://www.moodys.com/research/Moodys-lowers-Japans-government-rating-to-Aa3-outlook-stable--PR_224752).

<sup>141</sup> *Rating Action: Moody's upgrades Korea to Aa3; outlook stable*, MOODYS.COM (Aug. 27, 2012), [https://www.moodys.com/research/Moodys-upgrades-Korea-to-Aa3-outlook-stable--PR\\_253877](https://www.moodys.com/research/Moodys-upgrades-Korea-to-Aa3-outlook-stable--PR_253877).

<sup>142</sup> *Rating Action: Moody's assigns Aa3 to Japan Expressway Holding & Debt Repayment Agency's bonds*, MOODY'S COM (Aug. 21, 2013), [https://www.moodys.com/research/Moodys-assigns-Aa3-to-Japan-Expressway-Holding-Debt-Repayment-Agency's-PR\\_278767](https://www.moodys.com/research/Moodys-assigns-Aa3-to-Japan-Expressway-Holding-Debt-Repayment-Agency's-PR_278767).

<sup>143</sup> Lall, Subir & Karasulu, Meral, *Korea: Economic Prospects and Challenges after the Global Recession*, 27 KOREA'S ECONOMY 6, 12 (2011), available at [http://www.keia.org/sites/default/files/publications/30848\\_bergsten\\_sp.pdf](http://www.keia.org/sites/default/files/publications/30848_bergsten_sp.pdf).

statement about what had not yet happened and made an impact on Korea's credit ratings and economy is much to be deprecated. Finally, in September 2012, by raising Korea's credit rating from A+ to AA- by Fitch, Korea's sovereign credit rating surpassed Japan's for the first time.

Looking at the growth of Korea and Japan's economies, Korea's economic growth has far surpassed the Japan's from 1990 to 2012.<sup>144</sup> Despite Japan's economic stagnation and Korea's high economic growth rate, Japan has taken undeserved credit ratings by the image of economic and military power. On the other hand, Korea's has been undervalued for decades.

Only with the comparison of GDP growth, it may not be enough to declare that Korean sovereign ratings are undervalued and Japanese credit ratings are overvalued. However, Korea has more than \$3100 billion which is the biggest exchange reserve in the Korean history and the finances are also sound. Since Dodd-Frank act, CRAs tend to evaluate the sovereign credit ratings carefully. The recent rise in Korean sovereign ratings by Fitch and Moody's overtaking Japan's sovereign credit ratings can be strong evidence of the present Korean economy.

---

<sup>144</sup> Shin, Jaewoo et al., *Superpower dashi ggumgguneun Ilbon* [Japan wants to dream of Superpower...how well has Avenomics worked?] YONHAPNEWS (Mar. 28, 2013) (S. Kor.), <http://www.yonhapnews.co.kr/bulletin/2013/03/27/0200000000AKR20130327189500008.HTML>.

According to the recent report, Korea already overtook Japan regarding purchasing power parity-adjusted wages.<sup>145</sup> In addition, Korea's national debt ratio is around 30%. It shows a better coping crisis than Japan's debt ratio which is around 200%.<sup>146</sup> In addition, there is a research that Korea will overtake Japan in 2017 regarding GDP per person at purchasing power parity.<sup>147</sup>

Having overtaken Japan's sovereign ratings does not mean that Korea surpassed Japan's economic power. The main point is that CRAs lowered Japan's sovereign ratings belatedly even though Japan has been suffering from their unstable economic status and the highest public debt ratios among G20 countries. It is questionable for CRAs to conduct their actions timely. CRAs are aware that there have been significant problems on the national debt and the domestic economy for decades and the colossal debt was not created within a few years. It is undeniable that Japan's economy is a lack of substantiality and its sovereign ratings were quite overvalued. This could be an example of double standards and power games in international arena.

---

<sup>145</sup> Nah, Jihong, *Ile Shinyong Eucjeon Hankook... Jalduingeotdo Bujungjuk Moseupdo* [Korea: overtaking Japan... following Japan from the good to the bad], CHOSUN.COM (Sept. 8, 2012) (S. Kor.), [http://news.chosun.com/site/data/html\\_dir/2012/09/08/2012090800190.html](http://news.chosun.com/site/data/html_dir/2012/09/08/2012090800190.html).

<sup>146</sup> *Id.*

<sup>147</sup> *A game of leapfrog*, ECONOMIST.COM (Apr. 28, 2012), <http://www.economist.com/node/21553498>.

## B. Korea

### 1) Poor performances of Korean CRAs

Korean CRAs also have many problems. As U.S. CRAs have come under attack for issuing exorbitant inflation of credit ratings or issued lagging ratings without first measuring for exact financial situation of the companies; Korean CRAs also have a few.

Korea Line Corporation was appraised by Nice Information Credit and Korea Investors Service as BBB+ until applying for corporate rehabilitation proceeding in January 25, 2012. They suddenly lowered their grading to D after hearing the news that the company almost went bankrupt.<sup>148</sup> The credit rating of Chinhung International was also lowered after a corporate workout and the credit rating of Busan Savings Bank was also reduced, and was ordered suspension of business by the government shortly after receiving its investment grade.<sup>149</sup> Several medium-sized companies have now gone into receivership with debts of several million and some of them have already filed for bankruptcy. This situation was not a matter of one or two companies, but of many. It requires looking at the evidence of poor performances by CRAs through cases between Korean corporations and CRAs and finding solutions.

---

<sup>148</sup> *Rating review and history of Korea Line Corporation*, KISRATING.COM, [http://www.kisrating.com/eng/ratings/rsearch\\_business.asp?kiscd=720186](http://www.kisrating.com/eng/ratings/rsearch_business.asp?kiscd=720186).

<sup>149</sup> Choi, Myungyong, *Duitbook Shinyongphyungga Eje Gueman* [No need too late credit rating, Circulation Assessment is the only solution], MONEYTODAY (Feb. 22, 2011) (S. Kor.), <http://www.mt.co.kr/view/mtview.php?type=1&no=2011022214415039172&outlink=1>.

Woongjin Holdings is a key example. In the second half of 2012, the news that Woongjin Holdings which seemed to be was on a sound financial footing had applied for court receivership shocked the Korean financial market. The holding company commonly means a company with several subsidiaries, which has more than 100 billion dollars in total assets under the Monopoly Regulations and Fair Trade Law.<sup>150</sup> According to the law, the subsidiary's equity capitalization that holds the holding company should be more than 50% of the financial holding company's assets.<sup>151</sup> It is also known as a parent company. The parent company dominates the subsidiaries by controlling all of the shares of the subsidiary without relying on corporation to join a company. In other words, when a subsidiary is bankrupt, it is more likely for default risks to be put together since the holding company will not be able to pay interest. For these reasons, if bankruptcy occurs, since the creditors of the holding company lay claim to the remaining capital of the subsidiary and bonds of the parent company always have the risk of bankruptcy of the subsidiary, the securities of the parent company is likely to be a little lower than it should be evaluated.

---

<sup>150</sup> Gongjeonggeolaebeob [Monopoly Regulation and Fair Trade Act] Act. No.4198, Dec. 8, 1992, art. 2-4 (S. Kor.).

<sup>151</sup> *Id.* An entrepreneur (excluding the entrepreneur whose annual amount of sales or purchase in a particular business area is less than 4 billion won) whose market share in a particular business area falls under the following subparagraphs shall be presumed a market-dominating entrepreneur referred to in subparagraph 7 of art. 2.

In March of 2012, the news that Woongjin Group decided to sell shares of Woongjin Coway which was the group's flagship, propelled the stock prices of Woongjin Holdings upward.<sup>152</sup>

However, this was just a flash in the pan as their debt ratio was increasing. In September of the same year, Woongjin which seemingly had appeared to expand their business announced that they wouldn't be able to run the company and held up the white flag.<sup>153</sup> The court accepted the statutory management within two weeks and the current president Shin was chosen as the general manager for this receivership.<sup>154</sup> Their 30 years of success had quickly collapsed. Woongjin's downfall was due to the excessive expansion policy.<sup>155</sup> They ambitiously promoted several businesses, but this ambition proved to be an investment burden.<sup>156</sup> The income they earned from their own businesses was not enough to deal with snowballing debt and interest.<sup>157</sup> Even though the financial

---

<sup>152</sup> Park, Donghui et al., *Woongjin Coway Insoojeon Jaesamhoobo Geupboosang* [A third candidate emerges for takeover battle for Woongjin Coway], HANKYUNG.COM (July 12, 2012) (S. KOR.), <http://www.hankyung.com/news/app/newsview.php?aid=2012071219771&intype=1>.

<sup>153</sup> Kong, Kanga, *Deal Between Woongjin, MBK in Korea Collapses*, WALL ST. J. (Sept. 28, 2012), <http://online.wsj.com/news/articles/SB30000872396390443328404578022103309493538>.

<sup>154</sup> Yang, Hoseung et al., *Woongjin Holdings' commencement of reorganization proceedings and relevant bankruptcy law issues*, YOON & YANG LLC (Oct. 2012), <http://www.lexology.com/library/detail.aspx?g=b6a54da0-4654-4e28-8173-4a508c4c13e1>.

<sup>155</sup> Kim, Taejong, *Woongjin Group affiliate declared bankrupt*, THE KOREA TIMES (Sept. 26, 2012), [http://www.koreatimes.co.kr/www/news/biz/2012/09/123\\_120935.html](http://www.koreatimes.co.kr/www/news/biz/2012/09/123_120935.html).

<sup>156</sup> *Id.*

<sup>157</sup> *Id.*

structure of the Woongjin was deteriorating, early warnings by CRAs did not work properly to reduce the impact for the investors. CRAs that have great responsibilities in this situation did not give any signal to unwary investors.

For example, the Woongjin Holding's debt-to-equity ratio was 312% at the end of 2011.<sup>158</sup> In June, their debt ratio soared 374% and their financial situation was getting worse.<sup>159</sup> Nevertheless, Korea Ratings evaluated them as A-(investment grade).<sup>160</sup> As Woongjin Holdings filed for court receivership, Korea Ratings belatedly dropped their grade from A- (Investment) to D (default).<sup>161</sup>

On March 26, 2012, Korea Ratings evaluated the company as following: Korea Ratings rates Woongjin Holding's non-guaranteed bonds as A- and major factors are as follows:-Excellent credibility and good operating performance of the flagship subsidiary

-self-strengthen the foundation for a business

-after business diversification, the company is getting competent, but overall increased in business risk.

-due to the aggressive expansion policy, increased financial burden

---

<sup>158</sup> *Id.*

<sup>159</sup> Yim, Myunggyu, 2012nyun Jeungshigyohoon: Woongjin shinhwaui mollak [2012 stock market lesson: Woongjin the fall of Myth], EDAILY (Dec. 19, 2012) (S. Kor.), <http://www.edaily.co.kr/news/NewsRead.edy?newsid=01439926599760160&SCD=DB11&DCD=A10102>.

<sup>160</sup> *Id.*

<sup>161</sup> *Id.* See Seoul Central District Court [Dist. Ct.], 2012hwoi-hap185, Oct. 11, 2012 (S. Kor.).

-due to the heavy financial cost, poor cash flow exists.<sup>162</sup>

Afterwards, in September, Korea Ratings stated “[K]orea Ratings downgraded the company’s credit rating for the commercial paper as D as the company applied for corporate receivership to the Seoul Central District Court on September 26, 2012.”<sup>163</sup>

Following month, Woongjin Holdings fell into corporate rehabilitation proceedings, which dealt with assembly of related persons, reorganized the claim, and engaged in a period of investigation.<sup>164</sup> The phenomenon of Korea Ratings abruptly adjusted credit ratings of Woongjin Holdings in the second half of 2012.

In the case of non-unguaranteed bond of Woongjin Holdings, it had maintained a grade of A- from January 2010 until the second half of 2012.<sup>165</sup> Then, in the second half of the year 2012, the credit rating had been demoted to the default grade. Preposterously, there was no sign of a downward adjustment.<sup>166</sup>

---

<sup>162</sup> *Regular review of Woongjin Holdings’ non-guaranteed bonds and Commercial Paper*, KOREA RATINGS, <http://www.rating.co.kr/index.jsp> (type Korean “웅진 홀딩스[woongjin holdings]”; then follow “평가의견[review] of Mar. 26, 2012”).

<sup>163</sup> *Id.*

<sup>164</sup> *Id.*

<sup>165</sup> *Id.*

<sup>166</sup> *Id.*



The case of Woongjin Holdings of Commercial Paper is similar. From January 2010 until the second half of 2012, it maintained A2-grade without change.<sup>167</sup> In the second half of the year 2012, like unguaranteed bond, it had been demoted to the default grade after the news of legal management of Woongjin Holdings.<sup>168</sup>

Anxious investors likely seek answers regarding Korea Ratings' responsibility by not anticipating that Woongjin Holdings would file for receivership. A weak investigation and negligence would be the main reasons. In addition, the accounting firm that was responsible for the audit must be held accountable. If the firm had even tried to investigate Woongjin Holding's deteriorating financial condition, they would have known about Woongjin's downward spiral. As an accounting firm that is responsible for financial investigation, failing to figure out the atmosphere of the company cannot be accepted. If they had conducted strict scrutiny of the company's financial statement, they would have been able to determine the company's deteriorating situation. Shareholders of Woongjin Holdings may decide to file a suit against the firm for reason of negligence. Credit rating, literally, signifies a financial report to investors as to learn the financial soundness of the issuer. The current issuer's financial condition should be contained in the credit rating, but in actuality, it does not work that way.

---

<sup>167</sup> *Id.*

<sup>168</sup> *Id.*

Ssangyong Engineering & Construction Co. Ltd. a leading construction company which was a steady presence in Korea's construction history, is a fine example regarding this matter. On February 13, Korean influential media simultaneously announced that Ssangyong Engineering & Construction had entirely become capital impaired.<sup>169</sup> On February 22, 2012, Ssangyong Engineering & Construction announced to the media that they will pursue a debt workout program in an effort to improve its financial structure.<sup>170</sup> As a result of the failure of subsequent sale, Ssangyong which suffered a liquidity crisis was fully eroded, posting a net loss of 411.4 billion won last year.<sup>171</sup> The company having a big deficit for two years in a row eroded all the capital of 1,488 billion won.<sup>172</sup> The news that Ssangyong Engineering & Construction which was expanding businesses domestically and overseas was posting huge loss in capital shook the securities market.

When analyzing financial statements of Ssangyong Engineering & Construction, the signs were already there. As of January 1, 2010, the total liabilities reached 113.8 billion won, as of December 31, 2010, 117.7 billion won, and as of December 31, 2011;

---

<sup>169</sup> Ahn, Daegyul et al., *Jabonjamsik Ssangyong Gunsul* [Capital erosion Ssangyong Engineering & Construction], HANKYUNG (Feb. 13, 2013) (S. KOR.), <http://www.hankyung.com/news/app/newsview.php?aid=2013021464161>.

<sup>170</sup> *Ssangyong Engineering to file for debt workout this week*, YONHAPNEWS (Feb. 24, 2013), <http://english.yonhapnews.co.kr/news/2013/02/24/0200000000AEN20130224001700320.HTML>.

<sup>171</sup> *Id.*

<sup>172</sup> *Id.*

133, 8 billion won.<sup>173</sup> The financial report clearly shows that Ssangyong Engineering & Construction had been heavily in debt over many years and the size of the debt grew increasingly faster.

Looking at the credit ratings of the Ssangyong Engineering & Construction, Korea Investors Service gave a BBB + rating from 2008 until the first half of 2012 for senior insecure corporate bonds.<sup>174</sup> Then, in the second half of 2012, it fell to BB+ and in February 2013, it dropped to B-.<sup>175</sup> For commercial paper, until the first half of 2012, they received A3+ rating which is pretty high grade in the second half 2012, a B+, in February of 2013, it was finally relegated to B-.<sup>176</sup>

According to the summary, financial indicators presented by Korea Investors Service, Debt-to-equity ratio of Ssangyong Engineering & Construction already increased from 263.6% in 2010 to 477.5% in 2011, which is more than 1.5 times.<sup>177</sup> It shows that their financial condition began to get significantly worse.<sup>178</sup> Starting in 2011, their

---

<sup>173</sup> Ssangyong Engineering & Construction, *Separate Financial Statements of Ssangyong* (Dec. 31, 2011), at 4, <https://www.ssyenc.com/ivtR/file/eng/report/AuditorsReport2011.pdf>.

<sup>174</sup> Ssangyong Gunsul Yoyakjaemoojipyo [Rating history and Summary of Financial Statements of Ssangyong Engineering & Construction], KISRATING.COM, [http://www.kisrating.com/ratings/rsearch\\_business.asp?kiscd=500330](http://www.kisrating.com/ratings/rsearch_business.asp?kiscd=500330).

<sup>175</sup> *Id.*

<sup>176</sup> *Id.*

<sup>177</sup> *Id.*

<sup>178</sup> *Id.*

operating profit began to suffer a loss which amounted to 664 billion won.<sup>179</sup> This is a big contrast with 2010, when the operating profit was of 91.4 billion won.<sup>180</sup>

Despite these financial statements, Korea Investors Service did not adjust credit ratings regarding unsecured corporate bonds and commercial paper in the long or short term. There was no difference from 2010 to the first half of 2012. Since impaired capital falls under the purview of the grounds for the delisting of the stock market, Ssangyong is currently on the verge of delisting on the securities market and their trading has been stopped until the stocks are liquidated.

Another important example is GS Engineering and Construction Corporation which along with Ssangyong Engineering Construction is renowned in both the Korean and foreign market. At the end of August in 2009, GS Engineering and Construction Corporation won a \$ 1 billion valued contract for LNG liquefaction package in Iran and won a 22 billion won project for natural gas on September 16.<sup>181</sup> In response, the Korean Investors Service upgraded their credit rating of senior unsecured corporate bonds from

---

<sup>179</sup> *Id.*

<sup>180</sup> *Id.*

<sup>181</sup> *GS E&C Consortium, 2.2 Billion USD Project LOA Received(Ruwais 4th NGL Train Project)*, GS E&C (June 16, 2009) (S. Kor.), <http://www.gsconst.co.kr/en/Pr/PrNewsView.aspx?Lang=en&BoardCode=B007&CompositionNo=1321&GotoPage=8&SearchItem=&SearchWord>.

AA-to A + and commercial paper from A2 to A1 at the end of September in 2009.<sup>182</sup> GS's Debt-to-equity ratio remained unchanged. The debt-to-equity ratio that reached 171.2% in 2009 increased to 177.8% in 2010; however, it did not affect the credit rating and CRA raised the credit rating of GS Engineering and Construction Corporation reflecting the good news of the overseas orders.<sup>183</sup>

According to Ecredible, a corporate credit authentication services specialist, 295 construction companies went bankrupt since January 2010.<sup>184</sup> In the first half of 2010, a total of 60 companies went bankrupt and in the first half of 2011 another 61 companies went out of business.<sup>185</sup> Currently, those companies have chosen a workout plan that should rely on the banks and creditors, and in the end, they filed for court receivership.

In addition, due to self-interest and fighting among creditors, the debts negotiations get harder and harder. Eventually the damage falls on the investors. It was the role of CRAs to issue credit rating through full investigations of these the companies, so that investors could make informed decisions on whether to invest or not. Investors are

---

<sup>182</sup> *GS E&G Yoyakjaemoojipyo [Rating history and Summary of Financial Statements of GS E&C Consortium]*, KISRATING.COM (S. Kor.), [http://www.kisrating.com/ratings/rsearch\\_business.asp?kiscd=500143](http://www.kisrating.com/ratings/rsearch_business.asp?kiscd=500143).

<sup>183</sup> *Id.*

<sup>184</sup> Han, Hyungyong, *Yonchaeyool hwakdae Boodowuigi jeonmoongunsulsa nuleo* ['Bankruptcy crisis' Professional construction companies have increased], CNNEWS (June 21, 2012) (S. Kor.), <http://www.cnews.co.kr/uhtml/read.jsp?idxno=201206201030349950277>.

<sup>185</sup> *Id.*

not the only ones to take a loss, as smaller companies' working with these sinking ships also sustained great loss. As mid-sized construction companies faced financial difficulties, the smaller companies that were subcontracted by them began to crumble.

In such situation, the counter-argument of construction companies cannot be ignored. Once the credit rating lowers, the corporate bond market becomes stiff. Since there aren't many people and institutions who want to invest, they begin to suffer from financial difficulties. The pitiable circumstances of companies that are in desperate need of good or high credit ratings are imminent and understandable. Especially, in the case of the construction and shipbuilding industry which run businesses by borrowing money from creditors and banks even though their credit bubbles are overextended the CRAs knowingly acquiesce to demands for higher ratings. As a result, when many construction companies go bankrupt, their subcontractors are also toppled as a result of the domino effect. And eventually it devastates the industrial economy as a whole. The vicious cycle is systematically repeated, but they don't know how or where to loosen the knot. The government has a lot of on their plate, as they should think deliberately about what moves to make to repair this broken system.

The Bonds White Paper published by Tongyang Securities in 2012 analyzed the shoddy credit ratings of the construction industry in detail. According to the report, the construction industry was highly inconsistent with given creditworthiness and credit

ratings.<sup>186</sup> It pointed out that the profitability and the debt-to-equity ratio was much more likely to be worse than the actual credit rating.<sup>187</sup> The facts are that they do not receive payment of construction on time, and in the meantime the contingent liabilities grow, and that they did not fill the money vacuum are the main reasons why their management woes were exacerbated.<sup>188</sup> Thus, as the financial situations were worsening in the construction industry, in order to relieve their financial difficulties, the Financial Services Commission announced the exceptional funding support for the small and mid-sized construction companies.<sup>189</sup>

The government began to support the construction industry as one solution for the credit ratings and financial difficulties. From August 2012 to July 2013, the small and medium-sized construction corporations, including workout corporations<sup>190</sup> and construction companies in the public sector were applicable to the support plan. Korea

---

<sup>186</sup> *Tongyong Chaegwon Baekseo: 2012 nyungan Jeonmang [Bonds White Paper: 2012 Annual Forecast]*, TONGYANG SECURITIES (Nov. 2011), <http://file.myasset.com/sitemanager/upload/2011/1104/141635/2011110414163501.pdf>.

<sup>187</sup> *Id.*

<sup>188</sup> *Id.*

<sup>189</sup> See *supra* note 102.

<sup>190</sup> *Id.*

Credit Guarantee Fund is about to support the credit security limit up to 300 billion won, close to 85%, per company.<sup>191</sup>

The construction industry is held up as an example, but this case is in correspondence to Korea's industrial economy. Issuers desperately want their bonds to be evaluated as high credits rating and CRAs are hesitant to drastically adjust their credit ratings in order to meet the high expectations of clients who are these companies. Like Xerox copies, there are many corporations that receive the same credit ratings from the three Korean CRAs. Those CRAs upgrade and downgrade the credit rating on the same day as if they planned it in unison.

The current Korean CRAs still lack integrity in issuing ratings, and this is unfortunate as they are an important source of information in the industry for the issuing companies and investors. The fundamental principle of the credit rating is uncomplicated. The perspective of investors, armed with the grade, issued by CRAs, try to make informed investment decisions; whereas in the position of the issuing companies, through being evaluated by the CRAs and resulting grade, they can sell their stocks and collect money for their businesses. This business connection should be based on trustworthiness. If this trust is manipulated by any unsavory external factor, the grade itself becomes meaningless. The Korean CRA industry has been encroached by the foreign CRAs in a

---

<sup>191</sup> *Id.*



very short time, and if they are to survive, they would have to re-earn the trust of the jittery investors. The collapse of the credit rating industry will have repercussions for the whole industry as it happened in the U.S.

## 2) Credit bubbles

According to a report released by the Korea Ratings, high-grade corporate bonds which hold credit ratings of AAA and AA have currently reached a total of 45% as of 2012.<sup>192</sup> The percentage of the A grade companies rose more than 3% to 79.7%. On the other hand, the percentage of below BBB decreased from 20.3% to 23.5%.<sup>193</sup> Interestingly, a grade over an A comprises approximately 78% of the entire corporate bonds, which tracks the majority of the corporate bonds that are in good condition. This means that Korean CRAs have produced overly rated credit results for their clients, the issuers.

The credit bubbles are serious problems in Korea as much as in the U.S. The CRAs have been affected greatly by the structural problem that is wielded by the corporations that pay high their service fees. The higher each subsidiary credit rating is,

---

<sup>192</sup> Yang, Seungyong, *Issuereport KR Credit Seminar: 2012 choigun donghyanggwa jeonmang* [Issue Report, KR Credit Seminar: Recent trends and outlook in credit ratings 2012], KOREA RATINGS (Jan. 19, 2012) (S. Kor), [http://www.rating.co.kr/paging/Q\\_research\\_001?biz\\_op\\_code=Q&usr\\_rpt\\_cd=3](http://www.rating.co.kr/paging/Q_research_001?biz_op_code=Q&usr_rpt_cd=3) (Type Korean: 2012 년 1 월 KR Credit Seminar).

<sup>193</sup> *Id.*

the credit rating of the holding company is bound to inflate their credit rating above than what is actual.

An example of credit rating bubble is Hyundai Rotem. Most of the daily newspapers covered the news of overestimated credit rating of Hyundai Rotem, a subsidiary of Hyundai Automotive Group in September 2012.<sup>194</sup> Korea Investors Service raised the existing credit rating of A (positive) to A+ (stable) on Hyundai Rotem.<sup>195</sup> Regarding this raised credit rating of Rotem, according to Hyukjae Lee, a credit analyst at then IBK Investment Securities he accused the existing credit rating of Hyundai Rotem to be overly rated;<sup>196</sup> criticizing bubbles of the credit rating report. In addition, he pointed out that even though the debt and repayment burden actually increase, to upgrade their credit rating is unreasonable, given Rotem's prioritizing of ostensible expansion of the business.<sup>197</sup> As another example, corporate bonds of Woongjin Holdings that went up on the verge of applying for the statutory management were rated BBB+ by Nice

---

<sup>194</sup> Kim, Moonho, *Shinpyungsa Hyundaicha Yonbi Gwajang Pyungga* [Foreign CRAs said Hyundai Motor Company's credit ratings are overly rated], FINANCIAL NEWS (S. Kor.), Nov. 13, 2012, at 11, [http://www.fnnews.com/view?ra=Sent0301m\\_View&corp=fnnews&arcid=201211120100101650005677&cDateYear=2012&cDateMonth=11&cDateDay=12](http://www.fnnews.com/view?ra=Sent0301m_View&corp=fnnews&arcid=201211120100101650005677&cDateYear=2012&cDateMonth=11&cDateDay=12)

<sup>195</sup> *Credit Ratings of Hyundai Rotem*, KOREA INVESTORS SERVICE, [http://www.kisrating.com/eng/ratings/rsearch\\_business.asp?kiscd=119613](http://www.kisrating.com/eng/ratings/rsearch_business.asp?kiscd=119613).

<sup>196</sup> Kim, Jiyoung, *Shinyongsa Deunggeupun Gupoom* [CRAs that have lost their trustworthiness "credit bubbles"], ETODAY (Dec. 12, 2012) (S. Kor.), <http://m.etoday.co.kr/view.php?idxno=639863&mn=1>.

<sup>197</sup> *Id.*

Information Credit and A- by Korea Ratings. It is hard not to wonder whether these were really the correct credit ratings.

According to the report released by Tongyang Securities, it shows how serious the inflation of the credit rating in Korea has been from 2007 to 2011.<sup>198</sup> Companies that received AA grades, significantly increased from 39 in 2007 to 80 in 2011.<sup>199</sup> For three and a half years, AA-rated corporations more than doubled. The number of companies that were graded BBB decreased from 107 in 2007 to 66 in 2011<sup>200</sup> and the companies that received a rating of BB or less decreased by about 1.5 times more than in 2008.<sup>201</sup> As shown in the data above, the number of superior rating such as AA grade greatly increased year after year; in contrast, the low grades less than BBB decreased dramatically each year.

Overall, the credit ratings of Korean corporations seem to have moved upward. Doubts have been raised whether these companies truly deserve the AA grade they continue to receive year after year, and whether their finances have been strong year after year; or whether there are shady deals among these companies and the CRAs resulting in undeserved high ratings. As much as AA ratings increase and bond ratings below BBB

---

<sup>198</sup> See *supra* note 186

<sup>199</sup> *Id.*

<sup>200</sup> *Id.*

<sup>201</sup> *Id.*

decrease every year, the Korean economy still should have shown growth, but that's not the real story.

As many targeted corporations receive investment grades of AA and above, what they show externally are companies of sound financial footing. But do they really belong in the tier of higher investment grades? Leading domestic corporations readily conceal their tremendous financial difficulties, and seemingly reassure investors by receiving undeserved high credit ratings. Looking at these factors, it is plain to see how these companies that were given good credit ratings, and ultimately filing for chain-reaction bankruptcies affected the economy. It is very clear how Korean economy has been negatively influenced by the credit bubbles over past few years.

### 3) Examination through annual default rate

Through the default rates, investors or third parties are able to find out what the probability of the company's bankruptcy is. Default rate means the numerical indicating whether the bankruptcy occurs for a period of time in some places. This default can be a barometer to detect how much investment risks the companies have. The covenant which establish obligations for the protection of investors and prohibited acts between investors and the company must be reflected on the future credit rating. Among the companies that were being rated by CRAs, the default rates indicate the relationship between the credit ratings and the company's default status. Lower level is less default. Looking at the

average cumulative default rates, higher credit ratings, and lower default rates indicates the correlation between default rates and credit ratings.

As seen in the status of annual default rate from the Financial Supervisory Service, for the most recent 10 years, the annual default rates status show a decline. Especially in 2004 and it has risen continuously since 2008.<sup>202</sup> In 2011, the annual default rate was lowered to 1.01 and recovered to the level before the financial crisis of 2008. Except in 2006, 2008, and 2011, the investment grade has been maintained at 0.00 continuously.<sup>203</sup> But in 2012, as the default rate of investment grade became 0.41%, the situation was deteriorating again.<sup>204</sup> On the other hand, speculative grade which recorded 15.11 in 2004 rose sharply, but it showed a decline until 2007.<sup>205</sup> Again, since 2008, the default rate started to rise significantly and recorded 12.96 in 2010, which is an all-time high. In 2012, the default rate of speculative-grade was 15.66%, which was the highest level.<sup>206</sup>

The default rate of 10 years' worth of bonds of Korea's three major CRAs presented at the Financial Supervisory Service is a large data. According to the statistics,

---

<sup>202</sup> Financial Supervisory Service of South Korea, *2012nyundo Shinyongphyungga hoisau shinyongpyungga Shiljeok Boonsuk* [Performance analysis of CRAs in 2012] (Apr. 29, 2013) (S. Kor.), [http://www.fss.or.kr/fss/kr/promo/bodobbs\\_view.jsp?seqno=16726&no=44&s\\_title=%BD%C5%BF%EB%C6%F2&s\\_kind=title&page=1..](http://www.fss.or.kr/fss/kr/promo/bodobbs_view.jsp?seqno=16726&no=44&s_title=%BD%C5%BF%EB%C6%F2&s_kind=title&page=1..)

<sup>203</sup> *Id.*

<sup>204</sup> *Id.*

<sup>205</sup> *Id.*

<sup>206</sup> *Id.*

the cumulative default rate of the three CRAs shows the similar flow to each other. Especially, NICE Information Credit has shown the lowest default rates for the 10 years among the three CRAs.<sup>207</sup> This agency started as the lowest rate the first year and kept the lowest rate for over 10 years.<sup>208</sup> From the 7<sup>th</sup> year, and each successive year, this gap has gotten wider.<sup>209</sup> Whereas, the Korea Investors Service exceeded the average default rate, it has been gradually increasing the default rate gap with NICE Information Credit. Judging by the statistics, NICE Information Credit seems to be running the most stable CRA in Korea currently.

---

<sup>207</sup> *Id.*

<sup>208</sup> *Id.*

<sup>209</sup> *Id.*

## 5. REGULATION OF CRAS

For the past 10 years, the U.S. and Korea have seen drastic reforms for CRAs. In case of the U.S., Based on Sarbanes-Oxley Act in 2002, Credit Rating Agency Reform Act of 2006, and other proposed rules, through Dodd-Frank Act, the regulations of CRAs got detailed and strengthened. Especially, the Dodd-Frank Act requires deleting credit ratings from its rules. Because of the Act, the CRAs industry is entering a new phase. Following the U.S. flow, Korea reformed CRAs regulations in 2001 and 2009. The 2009 reform aimed to tighten the regulations of CRAs. In 2013, Korea again reformed the CRAs regulations by unifying CRAs regulations in Capital Markets Act. All CRAs regulations were transferred to Capital Markets Act and the regulations on duty, disclosure, and consumer protection were strengthened.

### A. U.S.

#### 1) Initiatives of the CRA Reform Act

The SEC and the legislative branch have reviewed a number of issues regarding CRAs over the past few years. While investigating the role of CRAs, the SEC issued a report to seek public comments in 1994.<sup>210</sup> With the public comments and the report, the

---

<sup>210</sup> See SEC, Rating Agencies and the Use of Credit Ratings Under the Federal Securities Laws, 68 Fed. Reg. 35258 (June 12, 2003).

SEC proposed to amend the Net Capital Rule to define the term “NRSRO” under the securities Exchange Act of 1934.<sup>211</sup> The Rule proposal was issued in 1997.<sup>212</sup>

After a series of big corporations went bankrupt, in January 2002, the Senate Committee on Governmental Affairs issued a report that examined the failures of CRAs and concluded that CRAs failed to perform high quality ratings, and instead showed lack of diligence.<sup>213</sup> The report went on to provide recommendations, one of which was the enactment of a new act.<sup>214</sup> It contains the failures of CRAs and recommends improvements for the CRAs.<sup>215</sup>

Consequently, the U.S. enacted the Sarbanes-Oxley Act (“SOX”) of 2002,<sup>216</sup> by mandating a study of the role and function of CRAs in the securities market pursuant to Section 702 of SOX.<sup>217</sup> The SOX also provides performance measures to improve

---

<sup>211</sup> Hill, *Regulating Rating Agencies*, *supra* note 34 at 56 (explaining the past regulatory initiatives).

<sup>212</sup> See Capital Requirements for Brokers or Dealers under the Securities Exchange Act of 1934, 62 Fed. Reg. 68018 (Dec. 30, 1997).

<sup>213</sup> See Hunt, *Worldwide Credit Crisis*, *supra* note 118, at 618.

<sup>214</sup> *Id.*

<sup>215</sup> *Id.*

<sup>216</sup> SARBANES OXLEY ACT OF 2002, PUB. L. NO. 107-204, § 702(B), 116 STAT.745 (2002); SEC, *Role and Function Report*, *supra* note 6, at 25-27; See also Yim, *Recommendations for Developing*, *supra* note 6, at 24-25 (stating the background of the Act).

<sup>217</sup> See generally Burnie, David et al., *How SOX Affects Investing through Credit Rating Agencies*, 15 Corp. L. & Acct. & Fin. J. 49, 50 (2004) (stressing the role and function of CRAs and criticizing the conflicts of interest); White, *For Better or For Worse*, *supra* note 44; SEC, *Role and Function Report*, *supra* note 6.



information flow from CRAs to the market, remove barriers to entry into the credit rating business,<sup>218</sup> and preclude conflicts of interest faced by CRAs.<sup>219</sup> On January 3, 2003, The SEC issued an additional report entitled “Enron’s Credit Rating: Enron’s Bankers’ Contacts with Moody’s and Government Officials”.<sup>220</sup>

In this report, the Senate Committee pointed out the lapse in Moody’s performances in the Enron’s collapse. Afterward, the SEC published a concept release entitled “Rating Agencies and the Use of Credit Ratings under the Federal Securities Law” in June 2003.<sup>221</sup> This concept release is far-reaching in its review of NRSROs

---

<sup>218</sup> Owing to the fact that NRSRO certification of CRAs was a complex process, Moody’s and S&P were able to maintain their dominant position. Thus, authentication of NRSRO was recognized as a barrier to entry into the industry. That was a regulatory license to CRAs. See, e.g., Partnoy, *Paradox credit ratings*, *supra* note 24, at 10-13; Lee, *Implication*, *supra* note 6, at 384 ; Partnoy, *Siskel and Ebert*, *supra* note 34 at 682 (“[O]nce regulation is passed...rating agencies begin to sell not only information but also the valuable property rights associated with compliance with that regulation”); SEC, *Role and Function Report*, *supra* note 6, at 36-40.

<sup>219</sup> S&P still maintains their position: “[I]n the world of commerce when money changes hands there is always a potential for conflict. It is our firm belief that a) no business model is immune from the potential for conflicts of interest; and b) despite its potential for conflicts, the issuer-pay model—with conflicts properly managed—is the best available model because it enables the provision of ratings simultaneously to all investors free of charge.” See *S&P Commitment: Quality and Independence*, STANDARDANDPOORS.COM, <http://docs.noodls.com/viewDoc.asp?filename=50914%5CEXT%5C200908040059005329083041.pdf>.

<sup>220</sup> STAFF OF S. COMM. ON GOVERNMENTAL AFFAIRS, 107TH CONG., ENRON’S CREDIT RATING: ENRON’S BANKERS’ CONTACTS WITH MOODY’S AND GOVERNMENT OFFICIALS (Comm. Print 2003).

<sup>221</sup> See *supra* note 210.

pursuant to Section 702(b) of the SOX.<sup>222</sup> While the SEC was struggling, the International Organization of Securities Commissions (“IOSCO”) enacted the *Code of Conduct Fundamentals for CRAs* (“Code of Conduct”) in 2004 to improve investor protection, fairness, efficiency and transparency of the securities markets, and reduce systemic risk.<sup>223</sup> The code of conduct provides for quality and integrity of the rating process, independence, avoidance of conflicts of interest, and responsibilities to the investing public and issuers.<sup>224</sup>

Subsequently, in 2005, the CRA Duopoly Relief Act was proposed in Congress and was enacted in 2006.<sup>225</sup> In July 2006, this bill was passed in the House of Representatives by roll call vote, but did not become law because of the absence of the President’s signature.<sup>226</sup>

---

<sup>222</sup> Hill, Claire, *Rating Agencies Behaving Badly: The Case of Enron*, 35 CONN. L. REV. 1145, 1154 (2003), (“Sarbanes-Oxley has been one legacy of Enron, More legislation is actively being considered.”) [hereinafter Hill, *Behaving Badly*].

<sup>223</sup> See, e.g., Technical Committee of the International Organization of Securities Commission (IOSCO), *Code of Conduct Fundamentals for Credit Rating Agencies* (Dec. 2004), <http://www.eesc.europa.eu/self-and-coregulation/documents/codes/private/065-private-act.pdf> ; Lee, *Korean legislation*, *supra* note 6, at 384-385 (explaining Code of Conduct created by IOSCO).

<sup>224</sup> *Id.*

<sup>225</sup> *The Credit Rating Agency Duopoly Relief Act: Hearing on H.R. 2990 Before the H. Comm. On Fin. Servs.*, 109th Cong. (2005).

<sup>226</sup> *Id.*

## 2) CRAs Reform Act of 2006

On September 29, 2006, with the signature of President Bush, Congress enacted the CRA Reform Act of 2006.<sup>227</sup> The SEC voted to adopt rules related to NRSROs on June 18, 2007<sup>228</sup> and the rule took effect on June 26, 2007.<sup>229</sup> The CRAs Reform Act of 2006 was legislated in the wake of the collapse of several well-rated corporations such as Enron, and was designed to regulate the CRA industry in order to prevent similar investment debacles in the future.<sup>230</sup>

To reduce the barriers to the NRSRO, the Act created a new section, Section 15E of the Securities Exchange Act of 1934, providing for SEC registration of NRSROs if specific requirements are met.<sup>231</sup> The act suggested guidelines by which the CRA is

---

<sup>227</sup> See generally SEC, *2008 Summary Report*, *supra* note 118, at 4 (noting that under the new rules, NRSROs are required to make certain public disclosures, certain records, and financial reports to the SEC, establish procedures to manage the handling of material non-public information and manage conflicts of interest. The rules additionally prohibit an NRSRO from having certain conflicts of interest); FRIED, JOSEPH, WHO REALLY DROVE THE ECONOMY INTO THE DITCH? 294 (2012).

<sup>228</sup> Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 72 Fed. Reg. 33564 (June 18, 2007).

<sup>229</sup> SEC, *Annual Report on NRSRO 2008*, *supra* note 57, at 1-2 (noting the introduction of the CRA Reform Act of 2006).

<sup>230</sup> See, e.g., MOBIUS, MARK, BONDS: AN INTRODUCTION TO THE CORE CONCEPTS (2012). KNORR, KARIN ET AL., THE OXFORD HANDBOOK OF THE SOCIOLOGY OF FINANCE (2013). ENGEL, KATHLEEN & MCCOY, PATRICIA, THE SUBPRIME VIRUS: RECKLESS CREDIT, REGULATORY FAILURE, AND NEXT STEP (2011).

<sup>231</sup> *Id.*

eligible for the application of NRSROs.<sup>232</sup> It also provides authority for SEC to implement financial reporting and oversight rules with respect to registered NRSROs.<sup>233</sup> The Act aims to improve the quality of ratings in the interest of investors, and in the public interest, by fostering accountability, transparency and competition.<sup>234</sup>

The Act also amended Section 17 of the Exchange Act. The SEC proposed the amendment of paragraph (a) (2) of Rule 17g-2<sup>235</sup> to require NRSRO to make a record documenting the rationale.<sup>236</sup> Rule 17g-3 requires an NRSRO to furnish the Commission with reports on an annual basis.<sup>237</sup>

---

<sup>232</sup> Securities Exchange Act of 1934, Definitions and application, Nationally recognized statistical rating organization, 15 U.S.C. § 78c(a)(62) (2010).

: “(A) [h]as been in the business as a CRA for at least the 3 consecutive years immediately preceding the date of its application for registration under [Section 15E of the Exchange Act]; (B) issues credit rating ratings certified by qualified institutional buyers, in accordance with Section 15E(a)(1)(B)(ix) [of the Exchange Act], with respect to – (i) financial institutions, brokers, or dealers; (ii) insurance companies; (iii) corporate issuers; (iv) issuers of asset-backed securities (as that term is defined in Section 1101(c) of part 229 of Title 17, Code of Federal Regulations, as in effect on the date of enactment of this paragraph); (v) issuers of government securities, municipal securities, or securities issued by a foreign government; or (vi) a combination of one or more categories of obligors described in any of the clauses (i) through (v); and (C) is registered under Section 15E [of the Exchange Act].”

<sup>233</sup> *Id*; see also White, *For Better or For Worse*, *supra* note 44, at 9-11 (introducing the Reform Act of 2006).

<sup>234</sup> See Hill, *Regulating Rating Agencies*, *supra* note 34 at 63 (stating that the regulatory regime of rating agencies discourages competition); Black, *Protecting The Retail Investor*, *supra* note 118, at 12.

<sup>235</sup> See *supra* note 78.

<sup>236</sup> See Lee, *Korean Legislation*, *supra* note 6, at 397-398.

<sup>237</sup> See *supra* note 80.

To enact the independent reform, which considered only credit rating, is critical. Because this act was made in a situation where critique of the U.S. credit rating had not reached its peak, it was timely and pertinent. Furthermore, the Act dealt with problems of the Big Three and NRSRO first. With this as a momentum, the number of NRSRO has increased to 10 as of 2013.<sup>238</sup> The act's aim which was to reduce a barrier to enter NRSRO was achieved. This experience led to enact Dodd-Frank Act successfully.

### 3) Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

On July 21, 2010, Barack Obama signed into law a new act entitled the “Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”).”<sup>239</sup> The Act was implemented with the intent to promote the financial stability of the U.S. by improving accountability and transparency in the financial system.<sup>240</sup> Specifically, Barney Frank in the House and Chris Dodd, a chairman in the Senate Banking Committee initiated the law that was initially proposed on December 2, 2009.<sup>241</sup>

---

<sup>238</sup> SEC, *Registered NRSROs*, <http://www.sec.gov/about/offices/ocr.shtml>.

<sup>239</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

<sup>240</sup> *Id.* See also Boyack, Andrea, *Lessons in Price Stability from the U.S. Real Estate Market Collapse*, 4 MICH. ST. L. REV. 925, 967 (2010) (stating that this Act focuses on “monitoring systemic risks posed by institutions that may be too big to fail.”).

<sup>241</sup> IPB USA, U.S. COMMODITY FUTURES TRADING COMMISSION 230 (2009).

The Wall Street Journal appraised this bill saying “[C]ongress approved a rewrite of every financial rules touching every corner of finance...in the biggest expansion of government power over banking and markets since the Depression.”<sup>242</sup> As the Wall Street Journal mentioned, the law is supposed to be able to change many financial regulations established in the U.S. since the Depression, and would affect all federal financial regulatory agencies.

The Act which covers more than 800 pages, had an important influence in the global financial markets, not just the U.S. Since Dodd-Frank Act was enacted, overall regulations and oversight were much powerful in the U.S. capital market as well as CRAs market.

Sections 931 through 939H of the Act stipulates the regulations of CRAs titled “Improvements to the Regulation of Credit Rating Agencies.” The strengthened regulations of the CRAs were created in the Act by reducing conflict of interest that weakened CRAs during the current U.S. economic recession. Indeed, the Act was a tremendous opportunity to change of the recognition of CRAs. However, there is a limit in that the reform was focused only on NRSRO, not all CRAs.

---

<sup>242</sup> Paletta, Damian et al., *Law Remakes U.S. Financial Landscape*, WALL ST. J (July 16, 2010) (introducing the new law, Dodd-Frank bill, the most influential law to every U.S. financial area at this time), <http://online.wsj.com/news/articles/SB10001424052748704682604575369030061839958>.

First, the legislation creates a new requirement for NRSROs to conduct a one-year look-back review when any NRSRO employee goes to work for an obligor of the securities market instrument subject to a rating by that NRSRO. It requires NRSRO to build on the internal control system and submit annual control reports to the SEC. This is to encourage competition for CRAs. However, this is a purely formal regulation of NRSRO. Creating a special club which is NRSRO and being controlled differently from non-NRSRO CRAs meant the priority for NRSRO. Because of that, issuers and investors, of course, prefer NRSRO CRAs. There is unintended consequence that this could encourage oligopoly of NRSRO.

Second, the Rule 436(g) under the Securities Act of 1933 has no force or effect under the Dodd-Frank Act.<sup>243</sup> The previous provision protected NRSRO from liability if they knowingly make false or misleading statements in connection with securities registration statements in order to deceive investors. When CRAs did not conduct diligent and reasonable investigation, now investors are able to file a lawsuit against CARs asking for professional responsibility.

---

<sup>243</sup> The SEC adopted the rule 436(g) in 1982 for exempting NRSROs from liability under section 11 of securities act and expanded the rule exemption to include assigned by NRSROs to money market funds in 1986. The SEC sought comment on whether Rule 436(g) under the Securities Act of 1933 should be rescinded. *See* Concept Release on Possible Rescission of Rule 436(g) under the securities Act of 1933, 74 Fed. Reg. 55162 (Oct. 27, 2009). Section 11 of the Securities Act impose civil liability for material misstatements or omissions in the registration statement of their clients for public offerings; *See* Deats, Caleb M., *Talk that Isn't Cheap: Does the First Amendment Protect Credit Rating Agencies' Faulty Methodologies from Regulation?*, 110 COLUM. L. REV. 1818, 1835-1836 (2010) (describing the liability of gatekeepers under U.S. federal securities laws, especially, section 11 of the Securities Act).

Furthermore, under Dodd-Frank Act, the SEC removed Regulation FD of the exemption for NRSROs and CRAs implementing Section 939B of the act in October, 2010.<sup>244</sup> By being deprived of the exemption clause, the CRAs are hard to plead the first amendment as their excuses.

In fact, the U.S. government recently filed a lawsuit against the S& P. On February 4, 2013, the U.S. Department of Justice filed a civil lawsuit against the S&P.<sup>245</sup> This lawsuit is the first case for asking accountability of the CRA from the government. The S&P was blamed in part, swindling investors out of a lot of money in RMBS and CDOs during the mortgage crisis. The government argued that the S&P formulated the credit rating of some CDOs that triggered the global financial crisis, ignored the objective standard of rating for the benefit of the agency and finally lied to investors with the overestimated grades.

Many financial institutions have suffered much loss and bankruptcies and this lead to a financial crisis in mammoth proportions. The gargantuan fiscal deficits became a long-term menace in the U.S. The problem is that the U.S. economy is under a large budget deficit that is getting bigger; the government seemed to sue one of the global

---

<sup>244</sup> COPELAND, CURTIS, CONG. RESEARCH SERV. R41472, RULEMAKING REQUIREMENTS AND AUTHORITIES IN THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT 15 (2010).

<sup>245</sup> U.S. Department of Justice, *Department of Justice Sues S&P for Fraud in Rating Mortgage-Backed Securities in the Years Leading up to the Financial Crisis* (Feb. 5, 2013), <http://www.justice.gov/opa/pr/2013/February/13-ag-156.html>.



CRA over pre-crisis credit ratings. Unfortunately, it's the taxpayers who are left to cover this loss. The development of the lawsuit is being watched with keen interest. Furthermore, this lawsuit will make an impact on future Korean courts' decisions. This will be an emblematic precedent for the CRAs.

Third, Section 939A requires each federal agency to remove any reference or requirement of reliance on credit ratings and look for a substitute for credit ratings.<sup>246</sup> The Act aimed to reduce rate-dependent clauses in the financial regulations. Indeed, many regulations stated that banks and pensions only invest in debt instruments rated a certain minimum grade.<sup>247</sup>

The spirit of the law is to reduce over-reliance on ratings in order to encourage investors to conduct their own analysis. It would obviously be impossible for non-rating experts to analyze the complicated financial products relying on their own analyses. As of November 2013, pursuant to Section 939A of Dodd-Frank Act, SEC has deleted references to credit ratings from its rules and looked for a substitute for credit ratings by

---

<sup>246</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 939A(a), 124 Stat. 1376, 1887 (2010) (to be codified at 15 U.S.C. § 78o-7).

<sup>247</sup> This amendment was proposed by Sens. Maria Cantwell(D-Wash) and George LeMieux (R-Fla.). The Cantwell-Lemieux amendment was approved by the Senate 61 to 38. *See, e.g.,* Senator Cantwell, *LeMieux-Cantwell Amendment Stops Over-Reliance on CRAs* (May 13, 2010), <http://cantwell.senate.gov/news/record.cfm?id=324942>; Listokin, *If you misrate, supra* note 6, at 103-104 (suggesting that the regulatory role of CRAs should be eliminated).

requesting for comment from public.<sup>248</sup> The SEC is planning to delete all credit ratings from its rule this year.<sup>249</sup> If adopted, It will bring great changes to the CRAs market.

Although having deleted the clauses that required credit ratings seems to be a last resort to resolve the problems of the CRAs, it actually isn't. Even though there will be no requirement to use the credit ratings, and given assumption in the future, that there would a powerful substitute for the credit ratings; still, presently, there would be no choice but for investors to use credit ratings to know the soundness of securities. If the SEC finds a substitute for credit rating, it will take time to be established firmly in the financial market. The substitute might be great cost to start up and it could cause economic dislocation.

Moreover, compliance officers would no longer be able to work on ratings, methodologies, or sales.<sup>250</sup> These are for preventing conflicts of interest. By stating obligations of CRAs employees specifically, the Act is emphasizing accuracy and transparency of credit ratings.

---

<sup>248</sup> See Removal of Certain References to Credit Ratings under the Securities Exchange Act of 1934, 76 Fed. Reg. 26550 (May 6, 2011); SEC, *SEC Announces Agenda for Credit Ratings Roundtable* (Apr. 2013), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171514902#.UtEiwfRDvIs>.

<sup>249</sup> Gallagher, Daniel, Commissioner of SEC, *A renewed focus on SEC priorities: AICPA/SIFMA Financial Management Society Conference on the Securities Industry* (Oct. 25, 2013), [http://www.sec.gov/News/Speech/Detail/Speech/1370540102737#.UtY5D\\_RDvIs](http://www.sec.gov/News/Speech/Detail/Speech/1370540102737#.UtY5D_RDvIs).

<sup>250</sup> See IPB USA, *supra* note 241, at 242.

Another feature of the law is that the SEC earned a powerful authority to oversee CRAs and NRSRO. The Act creates Office of Credit Ratings within the SEC to assign an agency to a financial product.<sup>251</sup> This Act showed how much it focused on credit rating's importance. The SEC has had broader authority and responsibility since the Act was enacted. SEC can deregister CRAs which provide unsound credit ratings. Given greater authority, the SEC also granted a lot of duties to oversight NRSRO and seeks a solution for improvement of the overall CRAs market. Granting SEC power and installing Office of Credit Ratings in SEC show that the Act declared the importance of CRAs internally and externally. It would be a very efficient way to supervise and regulate CRAs in the specialized division. This was a good example for Korea's situation where dual departments such as Financial Supervisory Service and the Financial Services Commission both regulate and govern CRAs.

Lastly, even though the Act took care of overall CRAs, it did not provide solutions regarding substantial conflict of interest associated with issuer-pays model and monopoly of the U.S. major CRAs. In section 939A, the Act removes any reference to credit ratings. However, it does not mean that the Act bans the use of credit rating. Even if a substitute for credit rating comes out, it is highly problematical how fast the alternative will be used by people or how long the substitute will go through trial and

---

<sup>251</sup> In fact, this content was proposed by Senate. See Brady, Dennis & Ylan, Mui, *Senate passes amendment on debit and credit card swipe fees*, WASH. POST.(May 14, 2010), <http://www.washingtonpost.com/wp-dyn/content/article/2010/05/13/AR2010051303571.html>.

error to work out the kinks to take place of the traditional rating system. It might intensify the confusion. Obviously, the Act gave a big wave to the financial market, but the problems of CRAs have not changed much even though it has been almost three years now since the enactment.

In spite of the regulations, the major U.S. CRAs are still expanding businesses and their revenues are growing. Because other CRAs cannot compete with the Big Three, the problem of competition is also at standstill. Furthermore, issuer pays model is still widely used in the CRAs market. Given the pay model, it is hard to guess how much CRAs have improved their ratings' transparency and accuracy.

#### B. Korea

In the case of Korea, the significance of credit was not considered seriously, however, after Korea's credit ratings decreased dramatically because of the IMF program, the word 'credit ratings' became the buzzword in Korea.<sup>252</sup> Since the CRA business started in 1985, the Korea CRAs market has accomplished tremendous growth over the past 30 years. Numbers of regulations associated with credit ratings have been made in securities laws as the stock market expanded.

---

<sup>252</sup> IMF INDEPENDENT EVALUATION OFFICE, THE IMF AND RECENT CAPITAL ACCOUNT CRISES: INDONESIA, KOREA, BRAZIL 26-28 (2003).

Securities	Related Regulations	Description
Commercial paper	<p>1) Enforcement Decree of the Financial Investment Services and Capital Markets Act</p> <ul style="list-style-type: none"> <li>• Art. 183</li> <li>• Art. 328</li> </ul> <p>2) Regulations for the Financial Investment Industry</p> <ul style="list-style-type: none"> <li>• Art. 5-29</li> </ul>	<p>*Art. 183 (Over-the-counter Transactions of Commercial Paper): The commercial papers shall be assessed by not less than two credit-rating agencies</p> <p>* Art.328 (Handling of Clean Bills): Credit ratings shall be assigned by more than two credit-rating agencies.</p> <p>* Art. 5-29(Credit assessment methods): commercial paper shall be assessed by a multiple credit rating based on the modified financial statements.</p>
Corporate bonds	<p>1) Regulations on the Securities Underwriting Business (Financial Investment Association)</p> <ul style="list-style-type: none"> <li>• Art. 11</li> <li>• Art. 7-17</li> </ul> <p>2) Enforcement Decree of the Financial Investment Services and Capital Markets Act</p> <ul style="list-style-type: none"> <li>• Art. 300-2</li> </ul>	<p>* Art.11 (Acquisition of unguaranteed bond): the bond should be evaluated by two or more persons who received permission to work on credit ratings of the bonds.</p> <p>*Art.7-17: The credit rating evaluated by a CRA should be top-grade or be within the top grade of the second sub-grade.</p> <p>* Art. 300-2 (Special Cases concerning Private Equity Funds for Corporate Financial Stability, etc.): A company which receives non-investment ratings with respect to corporate bonds from more than two CRAs.</p>
Asset-backed securities	<p>1) Regulation on Supervision of Asset Securitization Business.</p> <ul style="list-style-type: none"> <li>• Art. 2-1</li> </ul> <p>2) Enforcement Decree of the Financial Investment Services and Capital Markets Act</p> <ul style="list-style-type: none"> <li>• Art. 40</li> <li>• Art. 80</li> </ul>	<p>* Art. 2-1(Recognized standards of asset holders): A Corporation should receive an investment-grade rating from the CRAs.</p> <p>* Art. 40 (Grounds for Restriction on Transactions with Major Share- holders): a major shareholder is assessed by two or more credit rating companies to non-investment grade.</p>

	<ul style="list-style-type: none"> <li>• Art. 328</li> <li>• Art. 338</li> </ul>	<p>* Art. 80 (Exceptions to Restriction on Limits of Asset Management): Where the person receives investment grade ratings or higher from a CRA 2.</p> <p>* Art. 328(Dealing with Unsecured Bills): It shall be one that has been subjected to credit assessment by two or more credit rating companies.</p> <p>* Art. 338(Restriction on Transactions with Major Shareholders): the major shareholder is rated non-investment grade by two or more credit rating companies.</p>
	<p>3) Provisions of the Financial Investment Industry</p> <ul style="list-style-type: none"> <li>• Art. 3-8 (2)</li> <li>• Article 4-40</li> <li>• Article 5-18</li> <li>• Article 8-7 (2)</li> </ul>	<p>* Art. 3-8 (2): In order to distinguish between 'normal' classified assets, assets that credit rating BBB- or A3- companies guarantee value 1/200</p> <p>* Art. 4-40: The securities is limited as bonds that deposit institutions can buy and that receive more than A grade credit rating from a CRA.</p> <p>* Art. 5-18: Securities for being an object of conditional sale securities must receive an investment-grade (more than BBB) from CRAs.</p> <p>* Art. 8-7 (2): The standards of the soundness of the securities can be classified according to the credit ratings from domestic and international CRAs.</p>

Table 1: Examples of Korean rate-dependent regulations  
(Source: Statues of The Republic of Korea, for each regulation,  
As found on the statutes)<sup>253</sup>

<sup>253</sup> Statues of The Republic of Korea, [http://elaw.klri.re.kr/eng\\_service/main.do](http://elaw.klri.re.kr/eng_service/main.do).

For ease of reference, only the relevant extracts of the regulations are included. As seen below, regulations regarding credit ratings are numerous. To reduce conflicts of interest, a diverse set of practical rules should be regulated and discussed in depth. A strategy for maintaining a distance between CRAs and their clients should be considered.

CRAs walk on eggshells and rate their clients highly since doing otherwise means loss of business. Then, when the companies have severe financial issues, they cut the grades precipitously. As the structural ills are serious in the CRAs industry, it's hard to charge off all the responsibility to them. Since their clients are holding dominant positions, the conflict of interest remains as the main problem solving the structural ills.

As of now, the CRAs have little choice but to rely on their fees that come from their clients, and evaluation subjects. This dominant-subordinate relationship spoils the expectation of fairness in the whole industry. As soon as the words “downgrade” are mentioned, everyone on both sides get defensive. Following the global flow on the CRAs and the U.S. recent reforms, Korea reformed the credit rating regulations in 2001 and 2009 aiming at strengthening the CRAs liability.

The Use Act that provided provisions for credit ratings at that time was revised on a large scale. Under the revision, the internal control standard was created, which was a breakthrough to control CRAs. Furthermore, it contains strict regulations governing credit ratings. For example, the assessment division was separated from sales division. Conflict of interest and unfair conduct were prohibited under the law. Furthermore, the

objects of credit ratings were expended. The reform also tightened up the responsibility on CRAs.

Since this reform had been implemented before Dodd-Frank Act was created in 2010, the government and congress must have considered the reform agenda of the U.S. Department of the Treasury that would be mostly parts of the Dodd-Frank Act.<sup>254</sup>

Shortly after the Use Act was revised in Korea, Dodd-Frank Act was enacted in the U.S. Under the influence of the Dodd-Frank Act, Korea has made an effort to legislate more feasible and concrete regulations of credit ratings.

Following the flow of the Dodd-Frank Act, the Financial Services Commission carried out a new instruction model for the CRAs since 2012. Before making new model, the government prepared their Task Force team for credit rating market advancement and then announced their plan through a process of public hearings and comments.<sup>255</sup> The new criterion indicated that when evaluating corporate credit ratings, the default rates should be listed.<sup>256</sup> In order to prevent shopping for company's credit rating, releasing of anticipated credit ratings before the issuance of corporate bonds by CRAs is completely

---

<sup>254</sup> U.S. Department of the Treasury, *Fact Sheet: Administration's Regulatory Reform Agenda Moves Forward Credit Rating Agency Reform Legislation Sent to Capitol Hill* (July 21, 2009), <http://www.treasury.gov/press-center/press-releases/Pages/tg223.aspx>.

<sup>255</sup> Kim, Hohye, *Shinyongphyngga Jedo Gesun* [A sketch of the improvement of CRAs], THEBELL.CO.KR (Dec. 20, 2011) (S. Kor.), [http://www.thebell.co.kr/front/free/contents/article\\_view.asp?key=201112300100047670002700](http://www.thebell.co.kr/front/free/contents/article_view.asp?key=201112300100047670002700).

<sup>256</sup> *Id.*



prohibited.<sup>257</sup> The Task Force team which consisted of combined Financial Service Commission, Financial Supervisory Service, and the industry released the plan of advanced credit rating market and finalized the example criteria on disclosure of credit ratings business.<sup>258</sup>

In late 2012, Financial Supervisory Service announced to adopt the new guideline of CRAs that Dodd-Frank Act dealt with. According to the new guideline, the Financial Supervisory Service which blocked, the so-called credit rating shopping, is a prescriptive power since February, 2013.<sup>259</sup> The rating shopping means that the issuers have had prior contacts with the CRAs and choose one of them to strongly request a good credit rating. In addition, the conduct that verbally informs the expected future credit rating is prohibited.<sup>260</sup>

When the structured finance products are appraised, CRAs should describe details of current evaluation ratings, issuer of financial status, the relevant underlying asset, and

---

<sup>257</sup> *Id.*

<sup>258</sup> Financial Supervisory Service of South Korea, *Shinyongpyunggui gongshideung Mobeomgyu-joon Jaejung shiheng* [Enactment and implementation of example criteria on disclosure of credit ratings business] (Nov. 27, 2012) (S. Kor.), [http://www.fss.or.kr/fss/kr/promo/bodobbs\\_view.jsp?seqno=16377&no=1&s\\_title=%BD%C5%BF%EB%C6%F2%B0%A1%B5%EE%B1%DE&s\\_kind=title&page=1](http://www.fss.or.kr/fss/kr/promo/bodobbs_view.jsp?seqno=16377&no=1&s_title=%BD%C5%BF%EB%C6%F2%B0%A1%B5%EE%B1%DE&s_kind=title&page=1).

<sup>259</sup> *Id.*

<sup>260</sup> *Id.*

a structured history in the evaluation report.<sup>261</sup> In order that the rated companies prevent or misrepresent the important materials, the company representative has to review the related materials and submit them to the rating agencies.<sup>262</sup> If the rated company does not submit significant materials such as the CEO certification, the CRAs can terminate the contract made with the company.<sup>263</sup> It aims to improve the quality of credit rating materials by establishing practices with the expectation that the rated companies will submit the exact contents of the material in a timely manner.

Lastly, the Financial Supervisory Service instructs CRAs to update their credit ratings and the evaluation reports on their webpage or the Korea Financial Investment Association webpage in regards to credit ratings for commercial paper, corporate bonds, and asset-backed securities under the capital market law.<sup>264</sup> It should include definitions of individual credit rating, 1 year default rate or three years cumulative default rates, workout, and economic default rate including debt restructuring.

Originally, the Financial Supervisory Service aimed the independence of evaluation would be secured by the attempts to wipe out undue influence on rate requests

---

<sup>261</sup> *Id.*

<sup>262</sup> *Id.*

<sup>263</sup> *Id.*

<sup>264</sup> *Id.*

through improved regulations on unreasonable practices like rating shopping. The expectation was an improvement in the quality of long-term credit rating.

However this government's guideline has been criticized as a pure political spin as they overlooked the structural problems of the distorted financial market. The reason why the independence of the credit rating is not assured by people is the evaluation fee system. It is a paradoxical situation that rated companies are the main source of income to pay the evaluation fee for the CRAs. The Financial Supervisory Service mentioned the self-credit rating as an alternative measure last year, but no one has started discussions about it. With this reform, Korea did not add the contents such as deleting credit ratings from its rules or installing an office in the SEC. Because the SEC struggles with finding a substitute that Dodd-Frank Act requires and verifying the problems, Korea must keep tabs on the U.S. move. If the U.S. finds a substitute and the substitute could be deployed on a commercial scale, Korea is likely to initiate additional reforms in the future.

The regulations of credit ratings underwent important changes. The Korea credit rating industry was running by Use and Protection of Credit Information Act, Enforcement Decree of the Use and Protection of Credit Information Act, Enforcement Rule of the Use and Protection of Credit Information Act, and Financial Investment Services and Capital Markets Act. Meanwhile, Use Credit Act contained regulations of CRAs and overall use of credit ratings run by Capital Market Act.

Through a drastic amendment of Capital Markets Act in 2013, original regulations of CRAs business have transferred to Capital Markets Act.<sup>265</sup> Having moved the regulations of CRAs business to Capital Markets Act is considered a drastic reform for CRAs as much as the past two reforms. This surprise move shows that the government is very aware of the importance of the CRAs. Therefore, regulations of credit information remains in Use Credit Act and the parts of CRAs belonged to Capital Markets Act since August, 2013.

As well as other companies, CRAs should have been regulated under Capital Markets Act. Due to the divided legal system, the CRAs market was unsteady in efficiency. Through this revision, CRAs business became parts of the Capital Markets Law which is the largest financial law to oversee the whole capital market and finally, a unified legal system.

Article 9 provides a definition of credit ratings.<sup>266</sup> In article 337(5)-2, unauthorized CRAs are prohibited in order to facilitate sound investments and to protect investors.<sup>267</sup> This shows the importance of CRAs. The use of similar names in credit ratings is strictly forbidden under article 333(7).<sup>268</sup> Moreover, the compliance officer

---

<sup>265</sup> See *supra* note 3.

<sup>266</sup> Capital Markets Act art. 9 (S. Kor.).

<sup>267</sup> Capital Markets Act art. 337(5)-2 (S. Kor.).

<sup>268</sup> Capital Markets Act art. 333(7) (S. Kor.).

system started to operate. Article 333(8) and 333(15) state the obligations of employees in CRAs and administrative sanctions if violated.<sup>269</sup> The introduction of the compliance officer system seems to follow the U.S.

Article 335(9) is also worthy of attention, which specifies faith obligation of employees in CRAs.<sup>270</sup> To state an active moral obligation of CRAs to prevent conflict of interest represent much to a current CRA market where issuer pays model are widely used. This clause can play a big role when a plaintiff holds CRAs responsible for professional liability, director's duty of care, and director's duty of loyalty. Moreover, by amending disclosure obligations, regulations of CRAs have been reinforced under article 335(12).<sup>271</sup> When changing methodology of credit rating and credit ratings, CRAs must submit all the relevant information to the Financial Services Commission and Korea Exchange. Finally, as referred in article 335(15), legal actions against the violations of regulations have been strengthened.<sup>272</sup>

---

<sup>269</sup> Capital Markets Act art. 333(8) and 333(15) (S. Kor.).

<sup>270</sup> Capital Markets Act art. 335(9) (S. Kor.).

<sup>271</sup> Capital Markets Act art. 335(12) (S. Kor.).

<sup>272</sup> Capital Markets Act art. 335(15) (S. Kor.).

### C. International

International organizations such as IOSCO, G20, and the Financial Stability Board have released provisions to regulate the CRAs. Especially, the IOSCO, which is an international body which deals with regulations and supervisions of cross-border securities transactions, is significant. Releasing the code of conduct of CRAs in 2004, IOSCO noted problematic issues on CRAs much earlier than the U.S. financial reform. In 2008, IOSCO warned of CRA's crisis and suggested recommendations to improve CRA's performance through certain code of conduct thereby strengthening their processes and procedures to protect the integrity of the ratings process. According to a report, IOSCO modified CRA code of conduct to enhance transparency, competition, and responsibilities of the CRAs.<sup>273</sup>

In recent years, IOSCO's pace has been very active and released a few reports in 2012. Through a consultation report, it suggests installing an organization for management exemplifying different perspectives of the multiple supervisors. This "college of regulation" report covers CRAs internationally and CRA registration system between the continents.

---

<sup>273</sup> Technical Committee of the International Organization of Securities Commission (IOSCO), *The role of Credit Rating Agencies in Structured Finance Market: Final Report* (May 2008), <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD270.pdf>.

The G20 is also concerned about the credit ratings industry. In November, 2008, the G20 discussed the regulations regarding credit ratings. In a meeting in 2009, they agreed to strengthen the regulation in 2010 and discussed ways to reduce reliance on credit ratings. In 2013, the leaders released the declaration regarding the reduction of reliance on credit rating and enhancement in transparency of the CRAs.<sup>274</sup>

In February 2012, the Financial Stability Board, another big international organization suggested roadmap regarding the problem of relying on CRA credit ratings and proposals.<sup>275</sup> According to the current Financial Stability Board's timeline that is soon to be released, the international financial conferences organizations are planning to issuing precautions to reduce credit rating dependence by the end of 2013 and offer an alternative to replace the CRA credit rating reference.<sup>276</sup>

Likewise, many international organizations are focused on discussing ways to reduce the reliance on credit ratings and strengthening responsibilities of the CRAs. However, if the influential international bodies are all trying to reduce or cut out the credit ratings, unintentional impact on the Korean capital market as well as the international markets are expected. Since appropriate alternatives have not been created,

---

<sup>274</sup> *Russia G20: G20 Leaders' Declaration*, G20.ORG (Sept. 2013), [https://www.g20.org/sites/default/files/g20\\_resources/library/Saint\\_Petersburg\\_Declaration\\_ENG.pdf](https://www.g20.org/sites/default/files/g20_resources/library/Saint_Petersburg_Declaration_ENG.pdf).

<sup>275</sup> Financial Stability Board, *Roadmap and Workshop for Reducing Reliance on CRA Ratings* (Nov. 5, 2012), [https://www.financialstabilityboard.org/publications/r\\_121105b.pdf](https://www.financialstabilityboard.org/publications/r_121105b.pdf).

<sup>276</sup> *Id.*

the reality is that investors have no choice but to use credit ratings even though there will be no requirements to use credit ratings from its rules.

Korean conditions couldn't be better. According to the flow of the international community, if the government limits the use credit ratings or tries to control the operations of CRAs in the domestic market, which is vulnerable to external influences, investors will fall into complete and utter confusion. If alternatives were to come out, no one knows how soon they would be used in the near future and achieve recognition.

For stability of the whole world CRAs market, as well as Korea's, it is reasonable to create collective institutions that govern CRA industries to improve the problem of credit ratings. As a matter of fact, several international organizations have proposed similar agreements and guidelines which are exhausting and time-consuming. In order to collect the opinions of other organizations and create overall guidelines of regulations on credit rating, establishing a special office in G20 to represent the international organizations can be an efficient way.



## 6. FAILURE OF REGULATION

Throughout CRAs reforms it was useful for both the U.S. and Korean CRAs to bring about changes in markets and regulations. However, deep-seated CRAs problems such as conflict of interest, lack of competition, immunity of negligence, and inaccuracy etc. remain unsolved in spite of the drastic reforms. One of factors that the U.S. failed is that the U.S. suffers from a shortage of manpower in SEC to respond to changes in myriad of regulations. Korea has a history of emulating the U.S. CRA regulations by accepting most of its rules. The biggest problem for Korea is that the current regulations do not sit in accord with Korea's reality. In contrast to the U.S. Korea needs a policy to increase the demand for credit ratings and regulations to support it. Once there is high demand for credit ratings, the domestic CRAs market will be invigorated. If there is not enough demand, the regulations are useless. A common situation in both countries is that the ideal law is not enough to meet the expectations of reality

### A. Problematic Issues of Both Countries

#### 1) Conflict of Interest

How have the CRAs been able to make such huge profits? Where do the tremendous incomes of CRAs come from? Mr. John Diaz, a manager director at Moody's, gave testimony before the U.S. Senate Committee on Governmental Affairs, stating that Moody's derives over eighty-five percent of their annual revenue from issuers

whom they rate.<sup>277</sup> The most debatable concern in the CRA industry is about this questionable revenue model.

The basic business model of the large CRAs converted to an issuer-pays model from the subscriber-pays model, whereby the legal entity that wants to issue the securities pays the CRA to rate their securities. The CRAs' revenue model has been criticized for having fundamental conflicts of interest. As the issuers are the main clients of CRAs, it would be hard for CRAs to be impartial concerning inflated ratings. This is the source of much of the criticism concerning poor performances and flawed rating results.

Over the past three years, the Congress and SEC have been producing diverse releases and regulations focusing on developing the transparency of CRAs. They evaluated a number of controversial issues, but they have not dealt with the revenue model issue because this issue is directly related to the revenues of the CRAs. Before the 1970s, the subscribers (investors)-pays model dominated the issuer-pays model in the CRAs market. Perhaps the most important impetus behind this change was technological development. As photocopying technology developed, the information provided by the CRA was likely to be carried from one subscriber to other entities, the entities that did not pay for the information.<sup>278</sup> The issuers in this financed products market are the real

---

<sup>277</sup> See *Supra* note 110.

<sup>278</sup> CROCKETT, ANDREW ET AL., CONFLICTS OF INTEREST IN THE FINANCIAL SERVICES INDUSTRY: WHAT SHOULD WE DO ABOUT THEM 45 (2003).

conceivers of the financed securities and the arrangers of the transacted securities.<sup>279</sup> CRAs get paid from both sides depending on the transactions.

It is natural for the CRAs to prefer this model because their clients are not individual investors, but wealthy financial investors, which create and develop the financed structures like CDOs. This model cannot be transparent considering that the issuers are clients of the CRAs. The CRAs assess the securities which need to be transacted in the financial market and get paid literally by the issuers.

During the 1970s, as the revenue model shifted from the “user-pays” model to the issuer-pays model for services,<sup>280</sup> the issuer-pays model intensified the conflicts of interest with issuers, prompting issuers and their underwriters to shop for ratings and refuse to pay for ratings they deemed too low.<sup>281</sup> With the issuer-pays model, CRAs undercut their incentives to monitor themselves. They undermined their reputations by ignoring the defaults-for their revenue by issuers.<sup>282</sup>

---

<sup>279</sup> *Id.*

<sup>280</sup> Professor Partnoy strongly criticizes conflicts of interest. CRAs continue to be paid directly by issuers, they give unsolicited ratings that at least potentially pressure issuers to pay them fees. Based on the relationship between issuers and CRAs, one questions how the rating would be fair and correct; *See* Partnoy, *How and Why CRAs*, *supra* note 10.

<sup>281</sup> *See* Lynch, *Current Regulatory Environment*, *supra* note 57, at 30.

<sup>282</sup> *See* Partnoy, *Siskel and Ebert*, *supra* note 34 at 635 (stressing that reputational capital view has limitations in concerning of inaccuracy in credit spread estimation and the market participants’ expectation of obtaining more favorable ratings).

Now that they are entrenched in the issuer-pays model, it is unlikely CRAs will return to the subscribers-pays model for several reasons. First, considering the financed products market that is too complicated to be accessed by ordinary people, issuers including the creators of the complex products and the arrangers of the transactions need to appraise the securities before transacting the securities. The important thing to remember at this point is that the value of the transactions are enormous and the means that the securities appraised by the CRAs are a very high price.

For example, according to the Moody's 2010 annual report, Moody's generated almost \$290 million of their revenue from transactions of structured finance, in which the investment banks pay for the assessing securities.<sup>283</sup> Deals of structured finance account for the largest portion of their revenues. To analyze structured finance requires focus on the objects to be issued. Compared to the corporate and government issues that judge the entity's overall capacity to meet its financial obligation, the structured finance needs more time and effort to be analyzed. Several debt securities of individual financial assets are pooled into a structured vehicle and turned into complex securities.

Ordinary people, such as individual investors, cannot afford to appraise those securities by paying stupendous amounts of money like huge gigantic financial

---

<sup>283</sup> Moody's, *Moody's 2010 Annual Report* (Feb. 25, 2011), at 2-4, [http://files.shareholder.com/downloads/MOOD/0x0x549102/63FE2998-B052-4E99-B69F-60165C7944E2/MOODY\\_S\\_2011AR\\_FINAL.PDF](http://files.shareholder.com/downloads/MOOD/0x0x549102/63FE2998-B052-4E99-B69F-60165C7944E2/MOODY_S_2011AR_FINAL.PDF).

institutions would do. On CRAs' websites, information about appraised securities is made public, but those results are paid for by issuers.

Another reason is the operating expenses of CRAs itself. As the securities market gets more complicated and makes more money, the CRAs have hired more employees to deal with and analyze those products. In the days of the subscriber- model, the CRAs were able to manage their businesses through the investors-pays because the work was relatively simple compared to now. However, to handle modern complex products, the CRAs needed more specialists, lawyers and staff. Because the CRAs never seem to manage their business with the subscriber-model, they do not want to change their current business model.

As pointed out above, most of credit rating fees come from issuers. However, CRAs issue unsolicited ratings without billing from the issuers. Sovereign ratings could be the example. In this case, since issuers would not pay for the sovereign ratings, criticism on issuer pays model does not seem to be enough.

However, there are practical reasons why CRAs issue unsolicited ratings behind it. The unsolicited ratings are still strongly related to issuer pays theory, according to the recent research.<sup>284</sup> By issuing unsolicited ratings, CRAs would be more likely to earn

---

<sup>284</sup> Fulghieri, Paolo et al., *The Economics of Solicited and Unsolicited Credit Ratings*, 27 REV. FIN. STUD. 484, 518 (2014).

benefits from issuers.<sup>285</sup> First, since unsolicited ratings would be, on average, lower than solicited ratings, issuing unfavorable unsolicited ratings make issuers to be reluctant to pay for the ratings and relatively enhance the value of the solicited ratings.<sup>286</sup> Second, since all favorable ratings are relatively solicited, issuers pay for its ratings.<sup>287</sup> Consequently, CRAs would likely to earn more money by issuing unsolicited ratings.<sup>288</sup> Unsolicited ratings like some of sovereign ratings seem to unrelated to issuers pays model, but, in reality, this service would help to earn more money from issuers.

Regarding the issuer-pay model, the criticism of the NRSROs, and the immunity reality, the CRAs have been criticized severely, but they still adhere to their opinion that their business will decrease when their reputation is depreciated. The opinion seems to be applied everywhere, but the prosperity of the CRAs was not created by their reputation alone. Also reputation cannot solve all those severe problems of the CRAs industry.<sup>289</sup>

The key point is this: If CRAs perform poorly by issuing low-quality ratings and keep producing incorrect rating results, the issuers and investors would rely less on CRAs,

---

<sup>285</sup> *Id.*

<sup>286</sup> *Id.*

<sup>287</sup> *Id.*

<sup>288</sup> *Id.*

<sup>289</sup> See e.g., Partnoy, *Siskel and Ebert*, *supra* note 34, at 633-635 (criticizing the CRAs' assertion that they live or die based on their reputed capital); Hunt, *Worldwide Credit Crisis*, *supra* note 118, at 620-621. (explaining the reputational capital view).

and their reputations would decrease. Their place in the market would be overtaken by other more reputable CRAs. Once their reputations should go down, they would suffer financially, and their revenue would fall. When considering that Moody's and S&P have earned their reputations over 100 years, this defense seems correct.

However, there are number of factors that challenge their assertion that they are highly reputable. First, the subprime mortgage crisis shows that CRAs failed to provide reliable and accurate analyses of securities.<sup>290</sup>

In spite of the fact, they could maintain their prosperity because of the rating-dependent regulations. This is the reason why the Dodd-Frank Act is trying to eliminate mandatory regulations related to the rating results.<sup>291</sup> The reason seems to stem from the fact that their clients are issuers; in other words, there are obvious conflicts of interest. CRAs need to increase their revenues, and the issuers need high ratings to be able to sell their issuance more profitably.<sup>292</sup> This relationship created lax diligence by accepting errors, and the rating agencies must have been pressed by issuers who pay considerably

---

<sup>290</sup> See HOSSAIN, AKHAND, CENTRAL BANKING AND MONETARY POLICY IN THE ASIA-PACIFIC 229 (2009).

<sup>291</sup> The former SEC chairman, Christopher Cox mentioned that there are at least 44 of forms and rules relied on credit ratings. See SEC, *Statement on Proposal to Increase Investor Protection by Reducing Reliance on Credit Ratings by Christopher Cox* (June 2008), [http://www.sec.gov/news/speech/2008/spch062508cc\\_credit.htm](http://www.sec.gov/news/speech/2008/spch062508cc_credit.htm).

<sup>292</sup> Yim, *Recommendations for Developing*, *supra* note 6, at 49-52.

high fees.<sup>293</sup> In the subprime crisis, these limitations finally surfaced and developed into the current economic turmoil.

In the hearing before U.S. House of Representative, Mr. Gellert, Chairman and Chief Executive Officer of Rapid Ratings International Inc. mentioned that “We have absolutely no contact with issuers at all.”<sup>294</sup> The participants in the hearing considered that “it is a standard practice in the industry.”<sup>295</sup>

To sum it up, in order to protect CRAs’ reputation, CRAs need to perform with adequate analytical skill, financial materials, appropriate levels of due diligence, and circumspect behavior.<sup>296</sup> CRAs should be held responsible for their significant roles in leading this economic turmoil.

## 2) Lack of Competition

It is obvious that Credit Reform Act of 2006 marked a new era in the CRAs regulatory framework. The Act defined the NRSRO, including the credit rating, lowered the barrier for the entry of NRSROs, and the CRAs added many monitoring regulations. One of the remarkable reforms was to lower the bars for applying to the NRSROs for the

---

<sup>293</sup> Partnoy, *Siskel and Ebert*, *supra* note 34 at 652-653.

<sup>294</sup> *Oversight of the Credit Rating Agencies Post-Dodd-Frank: Hearing Before the Subcomm. on Oversight and Investigations of the H. Comm. on Fin. Servs.* 112th Cong. (2011).

<sup>295</sup> *Id.*

<sup>296</sup> *See SEC, Role and Function Report*, *supra* note 6, at 6.



non-Big Three. It created a new section 15E of the Securities Exchange Act of 1934, providing for SEC registration of NRSROs if specific requirements are met.

The spirit of the law was to break up the oligopoly. Obviously, it was true that it was hard for the non-Big Three to enter the NRSROs club because of the high requirements. After the Act, as of March 1, 2011, ten CRAs had been registered.<sup>297</sup> The SEC expects that approximately 30 CRAs will be registered as NRSRO.<sup>298</sup> This is a seemingly remarkable success when compared to the past when only three CRAs were in the NRSROs. It looks better than when the only major CRAs existed in the NRSROs.

However, what impact on the CRAs market is more important than the number of CRAs registered in NRSROs. In reality, even though there are ten CRAs currently in the club, no one denies that the major CRAs still control the securities market. Considering the dominance of the three major CRAs in the credit rating industry, there are few differences between the before and after the reform.

Another question is whether the increase in quantity of CRAs has had a strong influence in the accuracy of the credit rating. In other words, the law aimed to open the NRSROs so the CRAs would compete together. Through competition, the law tried to

---

<sup>297</sup> For the list of NRSRO-CRAs, *see supra* chapter 3.A.

<sup>298</sup> *See Hill, Regulating Rating Agencies, supra* note 34 at 86 (arguing that increase the number of NRSROS would be a desirable proposal).

promote accurate rating results for investors. Despite their efforts, the dominance of the three CRAs still exists in the global market.

What about accuracy? Is there any correlation between competition and accuracy over a few years? Recently, there is a different opinion on increasing competition. Professor Becker and Professor Milbourn examined how increased competition affects the credit ratings market.<sup>299</sup> According to their research, when the competition increased, the quality of ratings were lower from the incumbents.<sup>300</sup> In those studies, they say that “[i]ncreased competition from Fitch coincides with lower quality ratings from the incumbents: rating levels went up, the correlation between ratings and market-implied yields fell, and the ability of ratings to predict default deteriorated.”<sup>301</sup>

Professor Hunt concludes that “[C]ompetition and a well-functioning reputation mechanism go together.”<sup>302</sup> Common sense dictates that increasing the number of NRSRO-CRAs would help promote competition among CRAs. However, in order to improve the CRAs industry, his experiential examination left the task to scholars and

---

<sup>299</sup> Becker, Bo & Milbourn, Todd, *How did increased competition affect credit ratings?* (NBER, Working Paper No. 16404, 2010).

<sup>300</sup> *Id.* at 22.

<sup>301</sup> *Id.*

<sup>302</sup> Hunt, *Worldwide Credit Crisis*, *supra* note 118, at 627(explaining the significance of competition-enhancing efforts).

regulators to consider not only increasing competition among CRAs, but also improving the quality of incumbents.<sup>303</sup>

According to the article, because of “the substantial economic magnitude”, the competition does not always work in rating quality.<sup>304</sup> It will be very helpful when Korea creates new laws regarding the Korean CRAs if the legislators consider the result interesting. Because Korean CRAs have not developed enough, promoting competition among CRAs might cause confusion or temptation to mimic the U.S. system if done without careful consideration.

The last issue is that there are no regulations establishing the substantive or procedural requirements for an entity to become an NRSRO. The SEC provides only the NRSRO recognition criteria,<sup>305</sup> which are:

(1) “[T]he organizational structure of the rating organization; (2) the rating organization’s financial resources...(3) the size and quality of the rating organization’s staff...(4) the rating organization’s independence from the companies it rates; (5) the rating organization’s rating procedures...; and (6) whether the rating organization has

---

<sup>303</sup> *Id.* at 25 (explaining that increased competition did not affect to improve the quality of ratings).

<sup>304</sup> See Becker & Milbourn, *Increased Competition affect credit ratings*, *supra* note 299.

<sup>305</sup> See SEC, *Role and Function Report*, *supra* note 6.

internal procedures to prevent the misuse of nonpublic information and...those procedures are followed.”<sup>306</sup>

The SEC verifies the application of an NRSRO and they decide whether the CRA is qualified based on their criteria. The qualification should have been described very thoroughly and enacted as part of the law. As it is, applying NRSRO is unclear as to whether CRAs are qualified or not and what the standard is. Raising barriers to entry trying to improve quality would decrease competition, and potentially favor large incumbents.

The spirit of the law that boosts competition through the application has been impeded by the SEC’s subjective opinions. In addition, in regards to the power of the NRSRO, the current status is not helpful for the small CRAs, but credible CRAs. It should be part of the law as long as the NRSRO is in securities law, in order to promote the spirit of law, which is to enfeeble to oligopoly of the major CRAs.

The NRSROs were formed as a means for applying rate-dependent regulations. The scale, revenue, facilities, and affordability of credit ratings have differentiated NRSROs from non-NRSROs. It means that NRSROs strive to be distinguished among CRAs.

---

<sup>306</sup> *Id.*

With that concept, legislators were able to keep making new regulations easily corresponding to the status. In fact, the concept of NRSRO was created to produce more reliable rating results compared to ratings by non-NRSROs.

As discussed in Chapter Three, the Dodd-Frank Act tries to eliminate many regulatory requirements stipulating that banks and pensions only invest in debt instruments rated at a certain minimum grade. It is the beginning of removing rate-dependent regulations. If this is true, why do we need to keep the NRSROs? It is doubtful whether the NRSROs concept should still exist. If the law begins to remove rate-dependent regulations under the financial law, then the necessity of NRSRO is eliminated. The Act is inconsistent with respect to the reform of NRSRO application and the rate-dependent regulations. The Act strives to increase the number of CRAs in the NRSRO club and eliminate rate-dependent regulations. If the rate-dependent regulations are all removed, then NRSRO-CRAs have no benefit. Since the law will eliminate rate-dependent regulations, the NRSRO concept and benefits will fade.

In short, a certain NRSRO-CRA, which is not in the major CRAs, could make money using the remaining rate-dependent regulations. However, in the long term, the benefit will decrease. The legislators must consider the consistency in one act. By getting rid of the regulations, the NRSRO concept will be abolished. Since the NRSRO concept was created to be related to the regulations, there is no reason to remain in the NRSRO club.

### 3) Immunity of Negligence of CRAs

The prosperity of CRAs have been able to maintain steam from the Regulation FD exemption<sup>307</sup> and the rule 436(g) for exempting NRSROs from liability implemented under section 11 of Securities Act of 1933. While the legislative branch and the administration were struggling with making new regulations in order to control CRAs, the courts have been producing forbearance rulings over years because of these regulations above. Most of CRAs have been immune from their wrong credit rating and the enormous impact on the financial market, but the Dodd-Frank Act removed both regulations, and the CRAs might be at risk.

However, the CRAs have been protected under another significant shield, the First Amendment.<sup>308</sup> The CRAs have argued that their credit ratings are to be treated as opinions<sup>309</sup>, as freedom of speech, which should be guaranteed and protected under the Constitution. Even though the legislative branch made productive regulations, the courts

---

<sup>307</sup> Through the Regulation Fair Disclosure (“Regulation FD”), NRSRO has been given an exemption when they share material non-public information with issuers without conducting complex disclosure requirements.

<sup>308</sup> “[C]ongress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the government for a redress of grievances.” *See* U.S. CONST. amend. I.

<sup>309</sup> S&P explains as following: “[R]atings should not be viewed as assurances of credit quality or exact measures of the likelihood of default. Rather, ratings denote a relative level of credit risk that reflects a rating agency’s carefully considered and analytically informed opinion as to the creditworthiness of an issuer or the credit quality of a particular debt issue.” *See What Credit Ratings Are & Are Not*, STANDARDANDPOORS.COM, <http://www.standardandpoors.com/aboutcreditratings/>.

have granted the CRAs this right. The CRAs have defended claims brought by investors and issuers who believed credit ratings have been wrongfully assigned, by asserting that their ratings qualify as publications of a sort under the First Amendment.

Many of courts have ruled that the CRAs are not liable for negligent misrepresentations unless its mistaken advice reaches the level of reckless disregard for the truth. Even though the rulings were for the CRAs, the efforts of plaintiffs in securities lawsuits have been continuing for decades, until the latest surprising judgments came out regarding the First Amendment.

In *County of Orange v. McGraw-Hill Cos.*, County of Orange, which bankrupted in 1994, filed a lawsuit against the S&P in 1996. County of Orange alleged that the S&P performed wrongfully when producing excessively high ratings of them in 1993.<sup>310</sup> Based on the results, County of Orange invested eagerly until finally bankrupting in 1994. The plaintiffs sought the recovery of its losses against the S&P. The S&P strongly refuted, claiming that their credit ratings were their opinions on the securities, which are protected under the First Amendment, not financial advice to the plaintiff. The court ruled that the S&P's ratings were opinions on an issue of public concern.<sup>311</sup> Finally, County of Orange dismissed its \$2 billion suits agreeing to a settlement of \$140,000, roughly 0.0007% of

---

<sup>310</sup> *County of Orange v. McGraw-Hill Companies, Inc.*, 245 B.R. 151, 154 (C.D. Cal 1999).

<sup>311</sup> *Id.*

the claimed damages. This case was but one case of threat to the CRAs' immunity, but there were limits regarding to the burden of proof on plaintiffs to convince the court.<sup>312</sup>

Another two cases show similar rulings concerning the First Amendment. In *Jefferson County Sch. Dist. No. R-1 v. Moody's Investor's service, Inc.* and *Quinn v. McGraw-Hill companies*, each court ruled that the rating result was not investment advice and liable for defamation for its unsolicited publication regarding the plaintiff's bond issuance because the opinion was of public concern, not false, and should be protected by the First Amendment.<sup>313</sup>

In the U.S., CRAs have had the indulgence of the First Amendment's guarantee of freedom of the press.<sup>314</sup> Professor White in Economics at the New York University Stern School of Business says "By wrapping themselves in the First Amendment, they ask to be treated like newspapers."<sup>315</sup> Based on this theory, if a CRA maliciously gives a false opinion that is different from the facts, the plaintiffs can have a case. The problem of

---

<sup>312</sup> See *Compuware Corp. v. Moody's Inv. Servs., Inc.*, 499 F.3d 520 (6<sup>th</sup> Cir. 2007).

<sup>313</sup> See *Quinn v. McGraw-Hill Companies*, 168 F.3d 331 (7<sup>th</sup> Cir. 1999); *Jefferson County School District No. R-1 v. Moody's Investor's Services, Inc.*, 175 F.3d 848 (10<sup>th</sup> Cir. 1999).

<sup>314</sup> See Arthur, *Control and Responsibility*, *supra* note 8.

<sup>315</sup> White, Lawrence, *Financial Regulation and the Current Crisis: A Guide for the Antitrust Community* n.11 (NYU, Working Paper No. EC-09-11, 2009).



burden of proof is formidable, as shown in *County of Orange v. McGraw-Hill Cos.*<sup>316</sup> Because of the Reform Act and the increasing liability, CRAs have only recently changed from being a traditional section of the media.<sup>317</sup> Because of this, a different court ruling was anticipated.

On September 2, 2009, an astonishing ruling was delivered in *Abu Dhabi Commercial Bank v. Morgan Stanley & Co. Inc.*<sup>318</sup> The court stated: “[I]t is well-established that under typical circumstances, the First Amendment protects rating agencies, subject to an “actual malice” exception, from liability arising out of their issuance of ratings and reports because their ratings are considered matters of public concern. However, where a rating agency has disseminated their ratings to a select group of investors rather than to the public at large, the rating agency is not afforded the same protection. Thus, the Rating Agencies’ First Amendment argument is rejected.”<sup>319</sup> In this

---

<sup>316</sup> In most cases, the CRAs have been shielded from liability absent a showing of willful misconduct. Professor Partnoy argues that they have avoided their liability under the First Amendment asserting that their opinion is a publication like any other publication, and not unique in any way. *See also* Partnoy, *Paradox credit ratings*, *supra* note 24, at 20.

<sup>317</sup> For detailed arguments of imposing accountability of CRAs, *see* Manns, Jeffrey, *Rating Risk after the Subprime Mortgage Crisis: A User Fee Approach for Rating Agency Accountability*, 87 N. C. L. Rev. 1011 (2009).

<sup>318</sup> *See Abu Dhabi Commercial Bank v. Morgan Stanley & Co. Inc.*, 651 F. Supp. 2d 155, 172 (S.D.N.Y. 2009).

<sup>319</sup> *Id.* at 176-177.

case, U.S. District Judge Shira Scheindlin ruled that the CRAs that were associated with a limited number of investors do not deserve the same free speech protection.<sup>320</sup>

In 2010, another ruling threatened CRAs. In *California Public Employees' Retirement Systems v. Moody's Corp.*, the court stated: "[T]he right to free speech allows us to give our opinions on things of public concern. The issuance of these SIV ratings is not, however, an issue of public concern. Rather, it is an economic activity designed for a limited target for the purpose of making money. That is not something that should be afforded First Amendment protection and the Defendants are not akin to members of the financial press."<sup>321</sup>

The court made a distinction between things of public concern and economic profit. This court interpreted the matter of First Amendment broader. Even though the rulings are small, the numbers are growing. It is obvious that rulings favorable to the plaintiffs threatened CRAs. Through these rulings, it has been revealed that CRAs are not merely journalistic, but essentially have part in the securitization. Now it becomes visible that courts are recognizing the authentic meaning of CRA ratings.

---

<sup>320</sup> Koppel, Nathan et al., *Judge Limits Credit Firms' 1st-Amendment Defense*, WALL ST. J.(Sept. 7, 2009) ("[T]he case involved a suit filed by institutional investors against the two firms in 2008, claiming the two ratings services issued misleading "investment grade" ratings to a \$5.86 billion structured investment vehicle, once known as Cheyne Finance, that collapsed in 2007. The suit is seeking class-action status on behalf of investors who had losses from the liquidation of notes issued by Cheyne SIV between October 2004 and October 2007."), <http://online.wsj.com/news/articles/SB125201681110884761>.

<sup>321</sup> *California Pub. Employees' Ret. Sys. v. Moody's Corp.*, No. 09-490241 (S.F. Super. Ct. order filed June 1, 2010), available at <http://www.callawyer.com/clstory.cfm?eid=915589&ref=updates>.

These rulings are expected to spur more lawsuits and influence the financial market in the U.S. Apparently; CRAs cannot insist that their credit ratings are akin to a publication or media. As more securities become complex, large, and challenging to be appraised, more investors require use rating results and rely on them. In addition, as long as the regulations require investors and issuers to use the ratings, the CRAs are not to be free from liability.

#### B. U.S.

The Dodd-Frank Act aims to reign in CRAs, but it is flawed. This legislation must be effective in controlling the capital markets and protect investors. If its act can be well-run in reality, the U.S. capital market would be much improved. However, implementation of the Dodd-Frank Act in the real world may provide too much bureaucracy for success.

According to a data from the U.S. House on Financial Services in 2012, the government lawmakers have written 185 of 400 rules.<sup>322</sup> The 185 rules are more than 5,000 pages.<sup>323</sup> In regards to credit ratings in the Act, SEC is making almost all the rules. Regarding the SEC's affordability, much concern is being voiced about the excessive demands of the act. In fact, the Dodd-Frank Act has proved to be an inefficient policy,

---

<sup>322</sup> *Financial Services Committee Unveils "Dodd-Frank Burden Tracker"*, Press Release of the H. Comm. on Fin. Servs. (Apr. 17, 2012), <http://financialservices.house.gov/news/documentsingle.aspx?DocumentID=291036>.

<sup>323</sup> *Id.*

requiring tremendous amounts of work and staff. The legislators must have believed that this policy would be reasonable to in reining in the CRAs, but they overlooked the SEC's affordability.

In 2010, SEC established the new office, Office of Credit Ratings("OCR") to obligate the Dodd-Frank Act. The OCR deals with monitoring NRSROs and issuing an annual public report of the examination. The amount of work tasked to the OCR is as follows: (1) Analyze whether the NRSRO conducts business in accordance with its policies, procedures, and methodologies; (2) Manage of conflicts of interest; (3) Ethics policies; (4) Internal supervisory controls; (5) Governance; (6) Compliance officer activities; (7) Complaints; and (8) Policies governing post-employment activities of former NRSRO staff.<sup>324</sup>

According to one recent report, the SEC recognizes that they have failed to keep up with financial market expansion. Through the financial crisis has proven to government officials and legislators that financial products are extremely complex and it is difficult to keep up with the rapid pace of change and growth.<sup>325</sup> Until 2004, the SEC

---

<sup>324</sup> SEC, *Examinations by the Securities and Exchange Commission's office of compliance inspections and examinations* (Feb. 2011), at 12, <http://www.sec.gov/about/offices/ocie/ocieoverview.pdf>.

<sup>325</sup> *Regulatory perspectives on the Obama administration's financial regulatory reform proposals: Hearing before the Comm. on Capital Servs. of the H. Comm. on Fin. Servs.*, 111th Cong. (2009) (testimony of SEC Chair Mary Schapiro).

and the trading volume were both affordable, but the balance dramatically dropped more than 200%.

Another example displays the worst face of the SEC. The amount of work has increased 261% compared to five years ago and the number of employees has increased only 15%. Since 2005, imbalance between the amount of work and the number of employees is got worse.<sup>326</sup> As of 2008, growing work regarding credit rating has already surpassed the ability of the staff's affordability. This shows that the SEC has created numerous law reforms and new legislation, but the management of the legislation and the CRAs cannot keep pace with the work load.

From 2003 to 2009, there had been little changes in the SEC exam staff which was about 20%, but the adviser assets ratio was twice as of 2009.<sup>327</sup> In addition, the work were responsible for increased 100% in 6 years.<sup>328</sup> The SEC has made a lot of rules on CRA oversight, but can hardly keep up under the current structure.

The SEC acknowledges the difficulties in keeping the balance between work and the growth of the securities industry. Both the SEC and the legislative branch share responsibility in poorly managing CRAs. Under this situation, just increasing the volume

---

<sup>326</sup> SEC, *Appendix: SEC Staff Levels Have Not Kept Pace with Industry Growth* (2009), <http://www.sec.gov/news/testimony/2009/ts060209mls-app.pdf>.

<sup>327</sup> *Id.*

<sup>328</sup> *Id.*

of workers does not make sense. It is doubtful that the SEC would have thorough oversight.

The recent report shows that 300 rules were issued in recent years.<sup>329</sup> According to the rulemaking deadline, some of them have already been issued in the 3 month and 6 month deadlines; the rest will be eliminated.<sup>330</sup> The 97 rules must be issued soon.<sup>331</sup> Furthermore, according to the act, the SEC is obligated to assign an agency to a financial product. The act aims to boost competition among the CRAs to produce more accurate and diligent performance in order to be assigned depending on the past performances. It is doubtful whether the SEC can verify the past performance of all CRAs and then assign an unbiased agency, in view of its staff and organization limits.

This is too excessive of a government intervention. Furthermore, some even have raised concerns that this is a disadvantage to small CRAs and non-CRAs. As DBRS rose to the forefront regarding appraising Re Remics,<sup>332</sup> non-Big Three CRAs usually created their own areas of expertise and managed their own business. The major CRAs can afford to deal with many kinds of complex securities with their larger staff, but smaller CRAs

---

<sup>329</sup> See Copeland, *supra* note 244, at 12.

<sup>330</sup> *Id.*

<sup>331</sup> *Id.*

<sup>332</sup> Philyaw, Jason, *S&P 'Incorrectly Analyzed' Re-Remic Mortgage Bonds*, HOUSINGWIRE.COM (Dec. 16, 2010), <http://www.housingwire.com/articles/sp-'incorrectly-analyzed'-re-remic-mortgage-bonds> (mentioning that S&P rated the second-most Re Remics issued in the first half of this year).

will find it difficult to keep up. Without the SEC's honest and thorough verification on the past performance of CRAs, the securities market might be headed for greater turmoil than was seen in the latest economic recession. If the SEC struggles to find a substitute for credit ratings and unrealistic deadlines under the Dodd-Frank Act then investors and eventually the government will once again find themselves facing the chaos.

Dodd-Frank Act also fails to relieve the tremendous burden and cost for small business and the small private sectors. Larger companies or sizable businesses are well equipped to respond to the changes internally, but smaller companies are less agile. For example, after the SEC brings a substitute for credit ratings, when small sized local bank needs their issued bonds to be assessed to sell to the investors, it would be cost prohibitive to switch to new evaluation system. After all, the bank wouldn't be able to expand the business or afford to maintain the business in the end. The Act did not consider the small private sectors at all and needs to reconsider the matter.

The last limit on this act is that it does not approach the most important issue; the issuer-pays model. The act only intensifies the pressure on CRAs by regulating diverse regulations. However, it does not include any issue regarding the revenue matters. The Act will create tensions and affect morale, and to top it off, it will not solve the fundamental problems. Sudden legal reforms cannot lead issuers and investors to use unknown smaller CRAs. The established reputations of the Big Three remain an

important asset to investors. In the end, in order to sell securities to investors there is no choice but for credit ratings performed by CRAs.

For these reasons, law reform should be continued regarding the payment method. Issuers have been put in an awkward position regarding receiving credit ratings from CRAs, but the payment method is a vicious circle where issuers pay their dues and the CRAs operate their companies with those dues. The mutual dependence has not been removed by the law. Because of the structure of securities market, the law cannot block the issuer pays model. Though the lawmakers have established strict criteria about the relationship between the CRA and the issuer, the CRAs can't be the objective when the issuers who are their patrons. The lawmakers have taken a more open approach to stimulate competition among the CRAs, but doubts lingered on its effectiveness. Over the years, through extensive law reforms, almost all regulations have been modified. However, regarding the payment methods which is the biggest thorn in regards to regulating the CRAs, the lawmakers have not touched it yet.

### C. Korea

After several attempts at reforms in CRA, people are skeptical with regards to the development of Korean CRAs. For the last 30 years, Korean CRAs have failed to achieve major accomplishments and continue to be dominated by established and more experienced foreign CRAs.



Korea always tries to emulate U.S. CRA regulations. The government's desire is that Korean CRAs will succeed like the U.S. CRAs once Korea adopts the advanced regulations is unrealistic. The current CRAs regulations are far from fixing the real problem facing the Korea CRAs. Demand for Korean CRAs is relatively low, so over regulating will not work. They have no merit in particular methodologies or their own criteria of particular evaluation like the U.S. The Korean regulations are mostly regulation and supervision. It is easy to see why the current reform is not on the right track.

The legislation of the U.S. aims to restrict CRAs. Further, it is abolishing credit ratings. Given the Korean economic situation, abolishing credit ratings like U.S. is premature. It is also difficult to go toward restriction because the size of the market and the demand are not enough. There are differences between Korean CRAs market and the U.S.<sup>333</sup>

Evaluations area of the credit ratings shows the differences. In fact, for example of Korea Investors Service, they target corporate bonds and ABS.<sup>334</sup> Whereas, the foreign CRAs such as S&P assess various securities such as sovereign, mutual funds, pension

---

<sup>333</sup> See 7. Recommendation

<sup>334</sup> *Understanding Credit Ratings*, KISRATING.COM, <http://www.kisrating.com/eng/business/creditrating.asp>.

funds, bank soundness, bank solvency and preferred stock etc.<sup>335</sup> There is not sufficient capacity for Korean CRAs to cope with assessing sovereign bank solvency since it needs many analysts and analysis of the vast amount of information. In the way just indicated, the evaluation area is limited, therefore, the demand for credit ratings are relatively low. As demand falls, the credit ratings have little market. Its methodology and the funding continue to tread water. If the market demand grows, undoubtedly, there is the potential for the methodology and the regulations to be improved.

Given the situation in Korea, there needs to be legislation that aims to revitalize the CRAs industry by increasing the demand for credit rating. With the government's policy to boost the demand and proposed regulations, the Korean CRAs industry should be expanded internally and externally. The government's long-term policy to support the CRAs plans to extend their businesses abroad would be one of the alternatives.

The U.S. had to carry out a policy to control their CRAs industry due to the excessive demand of credit ratings and the CRAs' monopoly by cutting credit ratings from its rules and looking for a substitute. Korea, on the contrary, has relatively little demand for credit ratings and has much smaller economy. If regulation is the main point for the CRAs industry, the domestic CRAs cannot expand.

---

<sup>335</sup> *Ratings Criteria*, STANDARDANDPOORS.COM,  
<http://www.standardandpoors.com/ratings/criteria/en/us?filtername=Table>.

First, Korea should make provisions to the investment community to utilize credit ratings, which in turn will encourage investors to use credit ratings. Once the demand grows, the market will expand, methodologies are likely to be developed, and capital should increase. If the credit rating is unmarketable, the Korean CRAs industry will continue running in place going nowhere. After demand is raised to sufficient level, Korean government should create its own regulatory regime to fit Korean situation after reviewing of the experiences of the U.S. Without this plan, the current regulations are impractical.

Korean CRAs industry is mainly concentrated among the conglomerates. Since majority of Korean companies are small-medium sized firms, the policy to boost credit ratings for these companies would be a great boost in creating demand. If better credit rating could be applied to the small-medium sized industry properly, it would lead to revitalization of the securities market as well as CRAs market. In expanding the ratings demand by small-medium sized corporations, and establishing CRAs to cater to their needs; this can spell good news for the ailing industries and key to going the distance.

#### D. Alternative Proposals and the limits

Lawmakers and scholars have recommended various alternatives to credit ratings. There are several that have been proposed as alternatives: public market data such as

credit spread, credit default swaps (“CDS”) spread, and stress test models which are produced by various consulting and risk management companies.

As a substitute, credit spread can be one of viable options. Professor Partnoy criticized the reality of CRAs which now recognized as regulatory license and pointed out the contradiction of the credit rating through reputation capital view in his article.<sup>336</sup> He already announced the argument for using credit spreads instead of credit rating long time ago.<sup>337</sup> That was a revolutionary idea since discussion of alternatives for credit rating was not actively discussed yet for that period.

Credit spreads means the risk premium on corporate bonds. In other words, it is a difference between corporate bond yields and Treasury bond yields. If credit spreads decrease, corporate bond yields get closer to Treasury bond yields. It can be seen as a signal that the economy is recovering. Due to this economy recovery, by lowering default risk, fund-raising expense decreases and a demand for corporate bonds increases, and the bond prices eventually rise.

On the other hand, if credit spreads increase, people tend to consider this period as a recession and prefer stable bonds. During this period, bond prices drop and businesses are less active. Professor Partnoy stated that all the information in the credit rating is in

---

<sup>336</sup> Partnoy, *Siskel and Ebert*, *supra* note 34, at 706-709.

<sup>337</sup> *Id.*

the credit spread. By measuring the credit spread periodically, it would be useful to watch the liquidity of the capital markets.<sup>338</sup>

Another potential substitute is CDS spreads. Recent research highlighted some of the advantages of CDS including: the transactions between buyers and sellers would be stable. Through regular payment of premiums, CDS spreads transactions have a long history of trade, and it would be easy to measure risk and price.<sup>339</sup> Since CDS spreads is effective to discover risk as quickly as equity prices, it could be a promising alternative for credit rating.<sup>340</sup>

However, this raises doubts about whether securities produced by all financial institutions could be analyzed this way due to the nature of CDS spreads.<sup>341</sup> There are limitations that more empirical studies are required about CDS spreads and with those associated. Practically speaking, since the CRAs should be producing the credit ratings considering all the pertinent situations about the institution regarding the securities, there

---

<sup>338</sup> Partnoy, *Siskel and Ebert*, *supra* note 34, at 708.

<sup>339</sup> Partnoy, Frank et al., *Credit Default Swap Spreads as Viable Substitutes for Credit Ratings*, 158 U. PA. L. REV. 2085 (2010).

<sup>340</sup> *Id.*

<sup>341</sup> *Id.*

should be a lot of discussion to compensate for defects in narrow methodology of CDS spreads.<sup>342</sup>

These are a small sampling of the studies, as there's a limit discussing the replacement of the credit ratings that have been used for more than a century. Currently, several consulting and risk management companies have developed their own stress test models to find alternative. Another up-and-coming method besides CDS spreads is its own stress test on risk assessment that is produced by the Invictus Group.<sup>343</sup>

Capital Assessment Model ("ICAM") is a fairly typical case among those stress test models. The company has developed its own ICAM and implemented a stress test for FDIC-insured U.S. banks quarterly.<sup>344</sup> With its methodology labeled, LoanLayering Way, they analyze public loan balance data about banks and demonstrate the credit risk.<sup>345</sup> The CEO of the company mentioned that 2 major CRAs were very interested in their ICAM.<sup>346</sup> Additionally, he pointed out that the current method of risk assessment about

---

<sup>342</sup> *Id.*

<sup>343</sup> See *What is the ICAM?*, INVICTUSGRP.COM, <http://www.invictusgrp.com/about/icam.php>.

<sup>344</sup> *Id.*

<sup>345</sup> *Id.*

<sup>346</sup> Voss, Jason, *The Post Ratings Agency World: An Interview with Invictus Group's Kamal Mustafa*, CFA INSTITUTE BLOGS (Mar.9, 2012), <http://blogs.cfainstitute.org/investor/2012/03/09/the-post-ratings-agency-world-an-interview-with-invictus-groups-kamal-mustafa/>.

bank loans covers up “single moment in time,” whereas ICAM produce more accurate credit risks considering loan maturity structure.<sup>347</sup>

However, the shortcoming of the above alternatives cannot be overlooked. As a part of reducing reliance on credit rating, regulators are deleting the reference of credit ratings from the regulations. There is certain limit to credit spreads as an alternative to credit ratings. When credit spreads decrease, it can appear as a turnaround for the economy. Therefore, the investment ratio increases for that period. In addition, when credit spreads increase, people tend to invest in relatively stable blue chip companies. When stock prices rise, due to plunging stock prices of convertible bonds, the transition is difficult. Because the consequent risk of default leads to sharply falling bond prices, this situation can send wrong signals as expansion of the economic downturn and leave investors confused.

In the long run, as a rapid alternative to the chaos cases, the CDS and stress test models are expected to receive wider attention than the credit spread. These methods are likely being magnified as alternatives since they analyze the banks’ credit risks through public bank loan data and the systematic analysis would not merely be a prediction of the current point in time but cover future credit risks.

---

<sup>347</sup> *Id.*

CDS spreads might be able to determine the current flow; however, it is far too limited for issuers and investors to determine the risk of the future with its traditional methods. Also, the endemic problems related to lack of competition and conflicts of interest are still ongoing. CDS spreads are numerical values which are calculated by collecting economic information. The Big Three already have an edge over all of the competitors since three CRAs employ many more securities analysts. Therefore, CDS is insufficient to resolve the problem of lack of competition.

Stress models are also unsatisfactory as a substitute for credit ratings. As various forms of stress models will be come out from different agencies, it would create competition among agencies and ease the problem of lack of competition. Nevertheless, as with credit ratings, the stress models would also be a task that investors ask the agencies to get the results. This alone would be inadequate substitute for credit ratings to resolve conflict of interest. Only a handful of models would be survived through fierce competition and it would take long time before it can be used as a substitute for credit rating.



## 7. RECOMMENDATIONS

Korea needs its own policy of supplementation in view of present domestic conditions. First, the government should propose an Adequate Policy for small and medium-sized corporations. Considering Korea's financial market where more than 90% are small to medium-sized corporations CRAs which focuses on in smaller corporations must be made to flourish under the government's support. Second, policies to encourage overseas expansion of Korean CRAs are required. If these policies succeed, this will bring many benefits such as income growth and Korean CRA market promotion. Without the support of the government, penetrating foreign market would be very difficult. Third, CRAs should devise and develop their own criteria strengthening competitiveness. As DBRS rather than S&P and Moody's comes immediately to mind regarding Re-Remics, the Korean CRAs need to develop a strong methodology for certain finance products, in order not to fall behind the competition. This would support overseas expansion and help Korean CRAs penetrate foreign markets. Fourth, in addition to government support Korean law makers should try and build a liability system on as well. CRAs that produce credit ratings which are now considered as public goods rather than just their opinions should high standards of responsibility and professionalism under the strong liability regulations regarding providing credit ratings to the public. Finally, like Office of Credit Ratings in SEC, an exclusive division of CRAs should be established within Financial

Supervisory Service. This will be able to better assist the Korean CRA industry and manage CRAs efficiently and professionally.

#### A. Adequate Policy for Small and Medium-sized Corporations

Korea is a country with a particular credit rating history as the government pursued the introduction of the CRAs. Through the 1970s, Korea reached the position of developing countries through government-led economic development. Furthermore, for the financial sector in the mid-1980s, many financial laws came from the U.S. due in part by the effort of the Korean government. There is an enormous amount of work to be done by the government to encourage healthy competition among the Korean CRAs. The government's role is extremely critical for the Korean CRAs industry. It seems to be paradoxical, but only by using the carrot and the stick approach, could Korean credit rating industry be able to compete with the advanced financial foundations needed to surge ahead.

More than anything else, nurturing of professional CRAs for small and medium-sized corporations and small and medium-sized CRAs are the point of the problem. Judging by their financial scale, it is hard for small-medium sized companies to ask for ratings from major domestic CRAs or a global CRA such as Moody's and S&P, because of burden of tremendous fees. In Korea, the power is concentrated on the three domestic CRAs; Korea Ratings, Korea Investors Service, and Nice Information Credit.

Why should we need to consider the small and medium sized companies at this stage? It is because small and medium sized companies are the backbones of the Korean economy. According to “The Current Status Index for Small and Medium Sized Companies 2012” which was published by Korea Federation of Small and Medium Business, there are 3,122,332 companies which accounted for 99.9 % of the entire enterprise of Korea and 12,262,535 workers who account for 86.8% of the employed population.<sup>348</sup> These smaller sized companies are indeed very important; to the extent they may hold the key to controlling Korea’s economic destiny.

Between 2000 to 2010, Korean small and medium-sized businesses have increased to 414,527, creating 3,581,841 new jobs.<sup>349</sup> Therefore, compared to large corporations where employment declined due to restructuring, the role of the small and medium-sized corporations continue to grow as a means of new employment. However, the proportion of the value-added production of small and medium corporations is not less than the majority of the total. These small-medium companies are in poor conditions with skill shortage and face financial difficulties in different ways. In particular, per capita the productivity of their value added was 1/3 smaller than that of larger

---

<sup>348</sup> Korea Federation of Small and Medium Business, *Daegiup-Joongsogiupgan gyukcha Youjeon* [Gap between large companies and small and medium business] (Jan. 21, 2013) (S. Kor.), <http://www.kbiz.or.kr/bbs/bbs.jsp?utype=H&site=www.kbiz.or.kr&ch=info/notice/news&boardid=B200901091745484965470> (follow “No. 2431” hyperlink).

<sup>349</sup> *Id.*

companies.<sup>350</sup> The gap between large and small businesses has been greatly expanded since 2005.<sup>351</sup> In manufacturing, per capita annual salary gap is expanding between small and large corporations.<sup>352</sup> By 2010 the annual per capita salary for small and medium-sized business was 46.9%, of the large companies.<sup>353</sup>

Since the mid-2000s, when Korea started to promote the development of small and medium-sized corporations with a system government policy, the National Commission for Corporate Partnership, which was launched at the end of 2010, is trying to solve the problem of the social conflicts among large and small corporations. For the accumulation of systematic information on small and medium corporations and corporate credit information infrastructure, the government established Korea Enterprise Data (“KED”) in 2005.

KED which was founded in February 2005 was the nation’s only professional public institution.<sup>354</sup> It aimed at the accumulation of systematic information on small and medium-sized corporations and corporate credit information infrastructure. KED was a public corporation created by large amount of capital investment from both national

---

<sup>350</sup> *Id.*

<sup>351</sup> *Id.*

<sup>352</sup> *Id.*

<sup>353</sup> *Id.*

<sup>354</sup> *About KED*, KEDKOREA.COM, <http://www.kedkorea.com/en/ENINT01R1.do>.

agencies and private financial institutions. The government created this organization in order to focus on the development of small and medium-sized credit rating industries.

However, in 2012 it became under privatization through the expansion of the private bank shareholders' equity.<sup>355</sup> In the current environment where small and medium-sized CRAs are hard to grow spontaneously in Korea without the government's support, the privatization is absurd. There have been many harsh criticisms on its privatization. Eventually, KED will fall as low as to become a profit CRA not for small and medium-sized companies.

Since KED is already being operated as a subsidiary of the Credit Guarantee Fund there is a limit collecting and accumulating credit information for small and medium-sized corporations.<sup>356</sup> Privatization of the CRA would accelerate the securities market where the conglomerates are pivotal. Since KED has already been privatized, a new government-led, smaller business friendly CRA should be established to replace KED, so that the small and medium-sized corporations and the Korean industry will be able to be developed together.

Since Korean economic activities are mainly focusing on large companies due to the recession fears of small businesses, Korean economy is unstable as small and

---

<sup>355</sup> *Id.*

<sup>356</sup> *See supra* note 354.

medium-sized corporations have been operating within the social structure that is unfriendly to their size specific needs, and cannot compete with huge conglomerate in many aspects.

According to the statistics of Association for Small and Medium Industry, business profit rate of small and medium corporations are lower than large companies, but the burden of financial costs is still higher than those of the large companies. Furthermore, the annual salary of workers per capita of small and medium corporations in 2010 does not even reach half of the large companies.<sup>357</sup>

The benefits to the economy in sheer scale, the large corporations are important. But, when the market size is limited like in case of Korea, it could be more efficient to form small and medium corporations. Under such notion, the economic policy should be made reflecting that perspective. The government will need to expand the support for establishment of CRAs which can deal with financial status of small and medium corporations with professionalism. These policies will eventually promote the credit rating industry, and furthermore, will be a solution to get out from under dark looming cloud of national downturn by developing small and medium sized corporations.

Different procedures such as the recovery rate and default rate should be used and totaled to evaluate the performance of CRAs. Korea does not have adequate statistical

---

<sup>357</sup> *Id.*

data for use in building CRAs. For this reason, a useful long-term policy to accumulate a body of national data to be used for reviewing the CRAs would be important.

#### B. Encourage Overseas Expansion

Thorough verification, the government's plan that can support the overseas expansion of Korean CRAs is required. Since Korean CRAs have entered into a technical and financial partnership with Moody's and Fitch, brand awareness and the methodology of credit rating do not seem to be behind when compared with other international CRAs. However, regarding a scale, compared to the leading global CRAs, Korea still lags behind the U.S. and other advanced countries in staffing and intelligence capabilities. These and any shortcoming should be identified and supplemented. Since many Korean companies have already entered the world stage showing presence in almost every country, the Korean CRAs have been performing with conglomerates' credit rating business, and don't seem to have difficulty with Korean CRAs extending their businesses abroad. However, when evaluating the sovereign credit rating or foreign global companies' credit rating, it is imperative to get enough evaluation models and assessment personnel to step up into international arena.

Japan is an example that can be a big stimulus to Korean CRAs. In Japan, the three international CRAs: S&P, Moody's, and Fitch, and two domestic CRAs: R&I and JCR are competing. JCR was registered as a NRSRO with the SEC as of September 24,

2007.<sup>358</sup> JCR partially withdrew from NRSRO registration, specifically with respect to ABS on December 2, 2010; however, JCR maintains in its registration.<sup>359</sup> The JCR, one of Japan's domestic agencies, but is now playing in the global market.

Japan opened their credit rating market in 1996. Even though foreign CRAs are increasing their business in Japan, JCR is in a different league from CRAs in Korea,<sup>360</sup> as it already went up to the world stage. According to the release titled "List of credit rating agencies registered in accordance with Regulation (EC)" published by European Securities and Markets Authority ("ESMA"), JCR was the only Asian CRA which was certified under the EU Regulations.<sup>361</sup> JCR described the certification as: "[C]ertification enables the use of credit ratings, which are issued by CRAs outside the EU, in the EU for regulatory purposes. CRAs inside the EU should be subject to registration for the similar endorsement."<sup>362</sup>

---

<sup>358</sup> SEC, *Seven Credit Rating Agencies Register with SEC as Nationally Recognized Statistical Rating Organizations* (Sept. 24, 2007), <http://www.sec.gov/news/press/2007/2007-199.htm>.

<sup>359</sup> SEC, *Annual Report on Nationally Recognized Statistical Rating Organizations as Required by Section 6 of the CRA Reform Act of 2006*, n.15 (Mar. 2012), <http://www.sec.gov/divisions/marketreg/ratingagency/nrsroannrep1212.pdf>.

<sup>360</sup> UJIE, JANICHI, *JAPANESE FINANCIAL MARKETS* 235 (2d ed. 2002).

<sup>361</sup> European Securities and Markets Authority, *List of registered and certified CRA's* (June 3, 2013), [http://ec.europa.eu/internal\\_market/rating-agencies/index\\_en.htm](http://ec.europa.eu/internal_market/rating-agencies/index_en.htm).

<sup>362</sup> *JCR regulatory affairs*, JCR.CO.JP, <http://www.jcr.co.jp/english/company/regulatoryaffairs.html>.



In addition, JCR has gained world recognition by approving External Credit Assessment Institutions (“ECAI”) under the Basel II agreement of the Basel Committee on Banking Supervision.<sup>363</sup> This shows that JCR is the only Asian credit rating agency whose credibility of their credit rating has been recognized worldwide. It was officially recognize by France in June 2007, Belgium in August 2007, Luxembourg in April 2008<sup>364</sup>, Germany in May 2008<sup>365</sup>, and Hong Kong in December 2011.<sup>366</sup>

Korea has been inspired by Japan’s successful debut overseas in CRAs industry and is in the beginning stage of preparation. In 2011, Nice Information Credit already made headway into the overseas market.<sup>367</sup> The same year in April, the agency held the “2011 Consumer Credit Risk Management Seminar”. Leading financial institutions and

---

<sup>363</sup> SOPHASTIENPHONG, KIATCHAI & KULATHUNGA, ANOMA , GETTING FINANCE IN SOUTH ASIA 2009: INDICATORS AND ANALYSIS OF THE COMMERCIAL BANKING SECTOR 96 (2008).

<sup>364</sup> *JCR was recognized as an eligible ECAI by Luxembourg Government*, JCR.co.jp (June 4, 2008), <http://www.jcr.co.jp/reportqa/pdfen/08d0050e.pdf?PHPSESSID=672efff0ba43a69153c6894d9fe663c3>.

<sup>365</sup> *JCR was recognized as an eligible ECAI by Germany*, JCR.co.jp (May 29, 2008), <http://www.jcr.co.jp/reportqa/pdfen/08d0258e.pdf>.

<sup>366</sup> *JCR Recognized as an Eligible ECAI by Hong Kong*, JCR.co.jp (Dec. 22, 2011), <http://www.jcr.co.jp/reportqa/pdfen/2011122210e.pdf?PHPSESSID=1ab19f729dd6965bb38fa45534faecdc>.

<sup>367</sup> NICE Information Credit, *Indonesia Eseo CB Seminar Gechoi* [NICE Group conducted CB seminar in Indonesia] (Apr. 27, 2011) (S. Kor.), [http://www.nice.co.kr/nb0113.nice?b01\\_seq=658](http://www.nice.co.kr/nb0113.nice?b01_seq=658).

officials in Indonesia were in attendance and showed a high level of interest.<sup>368</sup> They are expanding their business skill into Indonesia, specifically in consumer credit rating.<sup>369</sup>

C. Encourage CRAs to devise and develop their own criteria strengthening competitiveness

DBRS is the best example of domestic going international. It is Canada's domestic CRA. DBRS is also one of NRSRO CRAs. It can't compete with Moody's, S&P, and Fitch, but with regards to Re-Remics, a real estate mortgage investment vehicle, DBRS competes well with the major CRAs. In 2010 report from the International Monetary Fund, DBRS rate very large volumes of Re-Remics worldwide.<sup>370</sup> It competes on even level with S&P, but interestingly, Moody's and Fitch are behind DBRS in this vehicle.<sup>371</sup>

It shows how DBRS made notable growth and was recognized for their expertise in the global credit rating market. DBRS entered the world's four major CRAs about assessing U.S. RMBS. It only registered 3% in 2007, but showed its influence when it

---

<sup>368</sup> *Id.*

<sup>369</sup> *Id.*

<sup>370</sup> Kiff, John, *Uses and Abuses of Sovereign Credit Ratings*, IMF (Oct. 19, 2010), at 46, [http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/H1-UsesandAbusesof\(Sovereign\)Ratings.pdf](http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/H1-UsesandAbusesof(Sovereign)Ratings.pdf).

<sup>371</sup> *Id.*

shot up to 63% in 2010.<sup>372</sup> This is an alarming figure, as it overtakes S&P, the world's leading CRA. According to the table, Fitch and Moody's were not nearly as involved in 2010 with this appraisal.<sup>373</sup>

This seems to have been a decisive factor in which DBRS and S&P were able to monopolize the market of the mortgage backed securities. The S&P was involved in evaluating mortgage-backed securities, but the figure decreased in 2008 to 84%, and finally lost the lead to DBRS in 2010 showing a ratio of 62%.<sup>374</sup>

According to an IMF report, it was another prominent move of DBRS in the world market.<sup>375</sup> The report analyzes the worlds' three major CRAs and DBRS about assessing Re-Remics. In 2007, S&P, Moody's, and Fitch expectably monopolized the Re-Remics market and DBRS stayed a very small percentage at 6.8%.<sup>376</sup> Moody's, which was running hot, seemed to recede from the competition since 2009.<sup>377</sup> DBRS became solidified in the Re-Remics market beating S&P and Moody's in 2009. Looking at the

---

<sup>372</sup> Ishmael, Stacy-Marie, *DBRS, or the rating agency you've never heard of*, FTA LPHAVILLE IN FIN. TIMES (May 24, 2010), <http://ftalphaville.ft.com/2010/05/24/241181/dbrs-or-the-rating-agency-youve-never-heard-of/>.

<sup>373</sup> *Id.*

<sup>374</sup> *Id.*

<sup>375</sup> *See supra* note 370.

<sup>376</sup> *Id.*

<sup>377</sup> *Id.*

table, DBRS has been steadily increasing their share ratio for consecutive years, which differs from Moody's, S&P and Fitch.<sup>378</sup> In 2010, DBRS followed by S&P and Re-Remics found favor in world's eyes in regards Re-Remics. Even though this figure has not lead currently by 2013, this material can give significant insight to Korean credit rating industry which is gearing up to enter the world market.

First, it shows that a certain CRA which had no name recognition worldwide entered the international market and advanced the growth process over a few year period. Second, among numerous kinds of securities that can be graded, in particular, in the field of mortgage backed securities, DBRS printed ahead of the S&P and has climbed up to a leadership position in 2010 and is expanding their area to rate U.S. residential mortgage-backed securities. In order for Korean CRAs to secure success in the global market, it is important to secure areas where they are confident in a particular field of expertise and information strength. Korean CRAs must not miss significant niche markets that are growing rapidly.

As seen above, DBRS is not as powerful as Moody's and S&P, but they compete confident in their own criteria. They don't compete on reputation alone. It's interesting to note that DBRS is expanding to rate U.S. residential mortgage-backed securities.

---

<sup>378</sup> *Id.*

There is another example that has created a unique wavelength in the world market as much as DBRS. Dagong is a Chinese domestic CRA, established in 1994. While assessing their own credit ratings about different countries and companies, it began working in partnership with CRAs of U.S. and Russia in 2010. Breaking into the global credit rating market where three major U.S. CRAs, Moody's, S&P, and Fitch reigned supreme, they dared to change the credit rating market with their own unique system.

President Guan Jianzhong of Dagong explained that since the current global credit rating systems represent the position of the U.S., there were many problems they glossed over; and that's why Dagong saw a need for an independent international CRA.<sup>379</sup> Interestingly, according to the first sovereign credit rating report published in 2010, Dagong evaluated China's credit rating to AA+, which was higher than that of the U.S. which was AA.<sup>380</sup> The result garnered a lot of attention in the global credit rating market.

In addition, Dagong publicly denounced the current global CRAs, and accused them of having methodology problems and that their ability to predict was overestimated.<sup>381</sup> Furthermore, it pointed out that since the credit rating system is highly

---

<sup>379</sup> *Three Sponsors from China, the U.S.A. and Russia Sponsor the Establishment of a "Multilateral, independent, International CRA"*, EN.DAGONGCREDIT.COM (Oct. 25, 2012), [http://en.dagongcredit.com/content/details20\\_6709.html](http://en.dagongcredit.com/content/details20_6709.html).

<sup>380</sup> MAULDIN, JOHN ET AL., *ENDGAME: THE END OF THE DEBT SUPER CYCLE AND HOW IT CHANGES EVERYTHING* 199 (2011).

<sup>381</sup> *Id.*

reliant on the three major CRAs, every system is influenced by the U.S. dollars, that the world economy has moved up and down based on the flow, and the U.S. sovereign credit rating has been overestimated. They stressed that the new international credit rating system mode should be made up and be aimed to reform the global credit ratings market.<sup>382</sup>

Dagong announced downgrading the currency sovereign credit ratings of the U.S. from A+ to A with a negative outlook in 2012, giving reasons for continuous recession, fall down of GDP, pending fiscal cliff, and lack of solvency, especially of the growing debt.<sup>383</sup> On the contrary, they gave the sovereign credit rating of U.S. an A with a negative outlook as of February, 2013.<sup>384</sup> Dagong lowered credit rating of the U.S. for the reason of the growing debt. These reasons are nothing to sneeze at. After they assessed Korea, they graded it AA- with a stable outlook. Outwardly, the U.S. seems wealthy, but in reality the debts have conspicuously begin to accumulate.

According to the Federal Reserve Economic Data in 2013, the federal debt of U.S. has been soaring since the economic recession in 2007, and its speed has been

---

<sup>382</sup> *Id.*

<sup>383</sup> *Dagong Puts the U.S. of America's Credit Ratings on Negative Watch List*, EN.DAGONGCREDIT.COM (Dec. 25, 2012), [http://en.dagongcredit.com/content/details20\\_6873.html](http://en.dagongcredit.com/content/details20_6873.html) .

<sup>384</sup> *Sovereign ratings*, EN.DAGONGCREDIT.COM, [http://en.dagongcredit.com/ratingAnnouncement/countryList\\_3.html](http://en.dagongcredit.com/ratingAnnouncement/countryList_3.html).

gaining speed.<sup>385</sup> In the early 2000s, total public debt as percent of gross domestic product had remained 55 percent of GDP.<sup>386</sup> But the late 2000's it has increased to more than 100% of GDP.<sup>387</sup>

Furthermore, another report shows that the U.S. has the highest gross external debt among G7 governments.<sup>388</sup> The U.S. has been remaining more than 12 trillion dollars since 2006 and the debt has continued to increase, on the other hands, Canada has the lowest gross external debt among those countries, which has below 2 trillion dollars.<sup>389</sup>

According to another statistic, "World Economic Outlook October 2012" published by IMF in October 2012, The U.S.' debt was 67.2% of government fiscal balance in 2007 and it is currently 111.7% in 2013.<sup>390</sup> Unfortunately, it is forecasted to

---

<sup>385</sup> *Federal Debt: Total Public Debt as Percent of Gross Domestic Product (GFDEGDQ188S)*, Federal Reserve Bank of St. Louis (2013), <http://research.stlouisfed.org/fred2/series/GFDEGDQ188S>.

<sup>386</sup> *Id.*

<sup>387</sup> *Id.*

<sup>388</sup> *G7 Borrowing from Abroad*, 49 IMF Fin. & Dev.(1) 57 (June 2012), <https://www.imf.org/external/pubs/ft/fandd/2012/06/pdf/fd0612.pdf>.

<sup>389</sup> *Id.*

<sup>390</sup>

<sup>390</sup> IMF, *World Economic Outlook: Coping with High Debt and Sluggish Growth* (Oct. 2012), at 202, <http://www.imf.org/external/pubs/ft/weo/2012/02/pdf/text.pdf>.

reach 114% in 2017.<sup>391</sup> This is approximately double amount since the mortgage crisis in 2007. It shows how much the economy of the U.S. has been worsening and how fast the debt is increasingly year-by-year. Germany, for example, predicts that the rate of increase of the debt schedule is very slow in 2017<sup>392</sup> and Canada is expected to reduce the debt in 2017.<sup>393</sup> Euro area also has a stable balance unlike the U.S.

It shows that the U.S. is struggling with debt as is the case of Italy and Japan, where the recent economy has deteriorated rapidly. It means that the U.S. has slipped into recession in comparison to United Kingdom, France, the Euro Area, and Canada.

Thus, as gross debt of the U.S. is burgeoning very fast, the rating result of the U.S. performed by Dagong is not unfair and its conclusion to a large extent is sensible.<sup>394</sup> Compared to the fiscal revenue, with the speed of the debt increase for the U.S., it is predicted the ability to repay the debt will fall. Dagong seems to be on the dot with their prediction, considering the current situation.

As Dagong graded the U.S. as an A and China as AAA, there is a growing chorus of criticism that the Chinese government has hidden intentions with their credit ratings for political reasons. However, looking at the situation with an open mind, the

---

<sup>391</sup> *Id.*

<sup>392</sup> *Id.*

<sup>393</sup> *Id.*

<sup>394</sup> *Id.*



given rating suggests objective information. Even though the JCR joined the NRSRO as first Asian CRA and has been treated as the most advanced CRA in Asia, it never received attention with their credit rating results or methodologies as Dagong has. Dagong is not taking center stage in the global CRAs market as DBRS which produce its own special criteria. However, it is trying to influence to the international community by using a marketing strategy to publicize their name and by lowering the U.S. credit ratings, standing up to the most powerful country in the world.

Dagong needs to have a higher reputation, but it is true that many will admire their drive. This gives momentum and motivation for Korea's CRAs in getting ready to make their launch into the global market place.

As JCR, DBRS, and Dagong have worked with their unique survival method, Korean CRAs needs to develop their special areas of specialty. In other words, as DBRS has gained a reputation in the world stage assessing complicated securities such as Re-Remics, Korea should consider a friendly product; a certain industry that would be assessed by the specific CRAs. Korean CRAs are needed to develop specialty areas such as shipping, shipbuilding, ports, aviation, electronics, construction, etc that can be handled professionally by highly skilled and knowledgeable staff. The credit rating should be prioritized to the tremendous collection of information of issuers. Dealing with the information gathering and analysis of specific industries, this will serve as a springboard for international expansion in the future.

#### D. A radical overhaul of the liability system is necessary

In the U.S. investors who use and rely on the credit rating information believe the tort of liability would be applicable for the negligence or omission of information with regard to credit ratings. In reality, the court drew a strict line applying to the tort theory in *Gale v. Value Line Ltd.*<sup>395</sup> Stanley Gale, who was a lawyer and an investor, brought the lawsuit against Value Line whose publications he relied on when making investment decisions but subsequently suffered losses.<sup>396</sup> He brought forth the doctrine of Restatement of the Law of Torts 2d (1977) § 552 arguing that the company was negligent in supplying the necessary financial information.<sup>397</sup> However, the plaintiff failed to successfully argue this theory since this rule would be applied for “one who is paid for the information furnished and who supplies false information for the guidance of others

---

<sup>395</sup> *Gale v. Value Line, Inc.*, 640 F. Supp. 967, 969-972 (D.R.I. 1986).

<sup>396</sup> *Id.*

<sup>397</sup> RESTATEMENT (SECOND) OF TORTS §552 (1977):

“(1) [O]ne who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

(2) Except as stated in Subsection (3), the liability stated in Subsection (1) is limited to loss suffered (a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and (b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.”

in their business transactions.”<sup>398</sup> The court also responded that “there must be inherent in the circumstance obvious negligence”<sup>399</sup> such as “failing to exercise reasonable competence in obtaining or communicating the information.”<sup>400</sup> As previously mentioned, in *Jefferson County Sch. Dist. No. R-1 v. Moody’s Investor’s service, Inc.* and *Quinn v. McGraw-Hill companies*, each court ruled very strictly against the investors. As a result, this tort theory is not easily applicable for the investors who use the credit rating information.

The CRAs have been shielded by not only the First Amendment, but also by the Securities Act Rule 436. This rule was a safe harbor for CRAs, especially, NRSROs saying that NRSROs were not considered a part of a registration statement prepared or certified by an “expert”, within the meaning of Sections 7 and 11 of the Securities Act. This Rule explicitly provided that NRSRO be exempt from liability as an expert under Section 11.<sup>401</sup> Although civil liability based on Section 10(b) of 1934 applies, the matter of proving the malice is seriously difficult.

---

<sup>398</sup> *Id.*

<sup>399</sup> *Id.*

<sup>400</sup> *Id.*

<sup>401</sup> Husisian, *What Standard of Care*, *supra* note 9, at 427.

However, the Dodd-Frank repealed Rule 436(g) under the Securities Act of 1933<sup>402</sup>. It eliminated the exemption from the expert consent and liability provisions under the Securities Act for any credit ratings issued by a NRSRO.

The U.S. Court of Appeals for the 2<sup>nd</sup> Circuit considered that CRAs might be judged liable under Section 11 for expert liability as a result of changes in the recent Dodd-Frank Act.<sup>403</sup> In this case, the 2<sup>nd</sup> Circuit acknowledged the expert liability of CRAs by mentioning that “the issuance of a credit rating ostensibly falls within the “expert” category of potential liability under § 11.”<sup>404</sup> Even though the 2<sup>nd</sup> Circuit strictly drew the line regarding “underwriter liability”, it is of significance that the expert theory could be applied to the CRAs’ liability in future cases. Moreover, this change can be extended to the civil liability, which would be very hard for plaintiffs to prove the CRAs’ misrepresentation. It would be still hard but it is obvious that the responsibilities of appraising ratings weigh on CRAs.

---

<sup>402</sup> Former Rule 436(g) provided in pertinent part: “[N]otwithstanding the provisions of paragraph (a) and (b) of this section, the security rating assigned to a class of debt securities, a class of convertible debt securities or a class of preferred stock by a nationally recognized statistical rating organization, . . . , shall not be considered part of a registration statement prepared or certified by a person within the meaning of Sections 7 and 11 of the Act.” The 2<sup>nd</sup> Circuit mentioned that “Rule 436(g) was recently nullified by The Dodd-Frank Wall Street Reform and Consumer Protection Act.”

<sup>403</sup> See *In re Lehman Bros. Mortgage-Backed Securities Litig.*, 650 F.3d 167 (2d Cir. 2011).

<sup>404</sup> *Id.*

Since the Dodd-Frank Act section 932(a) has been created, which eliminated the safe harbor provisions of Private Securities Litigation Reform Act of 1995, civil remedies against CRAs has been made easier by making enforcement and penalty provisions of Exchange Act applicable to the agencies.<sup>405</sup> Prior to the alteration, the plaintiffs had to prove that the CRAs believed that they knowingly or recklessly made a material misstatement or omission.<sup>406</sup> This rule had given the plaintiffs a heavy pleading burden.<sup>407</sup> Section 933(b) lowers the standard by applying an action for money damages against CRAs.<sup>408</sup>

With the enactment of the 933(b)(2), it would be easier for the plaintiffs to file lawsuits against CRAs, but if CRAs successfully assert that they conducted a reasonable investigation of the materials in assessing the securities, the basis for any such lawsuits wouldn't be simple. Through the future rulings of the courts', the specific scope of what entails a reasonable investigation and the CRAs' faithfulness such standards would be

---

<sup>405</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub.L. No. 111-203, § 932(a), 124 Stat. 1376, 1879 (2010) (to be codified at 15 U.S.C. § 78o-7).

<sup>406</sup> See *Toukara v Fernicola*, 914 N.Y.S. 2d 161 (N.Y. App. Div. 2011)

<sup>407</sup> *Id.*

<sup>408</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub.L. No. 111-203, § 933(b)), 124 Stat. 1376, 1883-84 (2010) (to be codified at 15 U.S.C. § 78u-4(b)(2)).

identified. These changes in the U.S. will be exceedingly illuminating to redefine the liability regime of the Korean credit rating industry.

In addition, the new act is required to deal with matters of liability. Korea's legislations of liability on credit rating were scattered over Capital Markets Act, Use Credit Act, and Civil Code, etc. The fact that it was difficult to file a lawsuit against the CRA is one of several reasons it did not prompt social motivation regarding organization of these legislations. However, through the revision of the Capital Markets Act, it would be easier to utilize the Act.

Above all, the Capital Markets Act deals with CRAs liability. Article 125 of Capital Markets Act states that if the securities suffer a loss because of a false statement or a wrong information within important matters of the registration statement and the prospectus, the CRA that signed the description or accompanying documents as being truthful and accurate has a liability for damages to investors.<sup>409</sup> In addition, the article 162 of the Capital Markets Act states the liability for false description of the content by those "who specializes in credit rating".<sup>410</sup> Article 335 regulates legal actions against the violations committed by the CRAs.

---

<sup>409</sup> What "important matters" mean that average prudent investor should naturally know the reasonable matters before buying securities or considering all the circumstances, a reasonable investor potentially consider significant matters in deciding whether the acquisition of the securities, *see* Seoul District Court [Dist. Ct.], 2000Na32740, Nov. 23, 2000 (S. Kor.); *See* Capital Markets Act, art. 125 (S. Kor.).

<sup>410</sup> Capital Markets Act, art. 162 (S. Kor.).

In the credit rating industry, the Civil Code is also applicable. In accordance with Civil Code 750, CRAs shall be liable for damages if the damage occurred to their client due to the mistakes that occurred during the process of the credit rating evaluation.<sup>411</sup> In case of the U.S., the accounting profession has expanded in its potential liability to dependent parties.<sup>412</sup> The standard of care imposed on accountants is increasing, and has even affected other professionals.<sup>413</sup>

In case of the misrepresented appraisal, the Supreme Court granted compensation to clients who suffered damages through the misrepresented appraisals by the appraiser and the bona-fide third party based on Public Notice of Values and Appraisal of Lands, etc. and civil liability.<sup>414</sup> Even when there is a contract between a client and an expert providing professional service, imposing liability of contract between them is problematic. However, as credit ratings are intended to promote public interest, providing false information could be problematic not only to their clients but also to the third-party

---

<sup>411</sup> Minbeob [Civil Act], Act. No. 471, Feb. 22, 1958, art. 750 (S. Kor.) [hereinafter Civil Act].

<sup>412</sup> Husisian, *What Standard of Care*, *supra* note 9, at 414 (stating that many courts have expanded liabilities imposed on accountants.); *see also* Hunt, *Worldwide Credit Crisis*, *supra* note 118, at 664 (“[D]octors, lawyers, and accountants are required to meet minimum standards of care in providing services, even though they presumably are concerned with their reputations”).

<sup>413</sup> *Id.*

<sup>414</sup> *See, e.g.*, Supreme Court [S. Ct.], 82625 Da, Apr. 12, 1998 (S. Kor.); Supreme Court [S. Ct.], 56416 Da, May 25, 1999 (S. Kor.).

investors. After all, the opinion that was addressed and judged by experts is granted by a power of public confidence.

Furthermore, in regards to the appraisers system that is similar to the credit rating system, the Supreme Court admitted the liability of professional responsibility of the third-parties.<sup>415</sup> For example, a bond-issuing company filed a lawsuit against an accounting firm, alleging that the plaintiff's securities were unreasonably appraised contrary to the financial accounting standards and assessment. They accused the accounting firm of using a poorly planned methodology, which lacked rationality and objective justification even though they had known that their reviews would be provided to investors who would participate in the conspiracy of the shares of an unlisted corporation. The Supreme Court decided in favor of the plaintiff's and held the accounting firm responsible under the Capital Market Act, art. 125.

Credit ratings need public summons if the rating is regarding the listed securities under the Capital Markets Act. The credit rating has the power of public confidence, and as the effect reaches out to the investors who are the third party, the credit rating result comes under professional responsibility.

---

<sup>415</sup> See, e.g., Supreme Court [S. Ct.], 16007 Da, Jan. 28, 2010 (S. Kor.); Supreme Court [S. Ct.], 64627 Da, Oct. 10, 2009 (S. Kor.); Supreme Court [S. Ct.], 1646Daca, Nov. 10, 1987 (S. Kor.); Supreme Court [S. Ct.], 395Daca, Jan. 28, 1993 (S. Kor.).



In accordance with Civil Act 390, if a CRA breaches a contract, it shall bear the contractual liability.<sup>416</sup> However, in reality, when a CRA makes an evaluation contract, there is explicit disclaimer to limit the scope of their responsibilities in the contract. Considering these provisions and based on realistic scenario, a new law must be enacted. Thus, the clients are entitled to claim damages based on civil law regardless of liability for damages under the Capital Markets Act.

In regards to applying the professional responsibility on the CRA, the government and law makers must face the issue for the long haul. For experts such as doctors, lawyers, certified public accountants, and CRAs, almost without exception, there are provisions relating to the liability for damages in the law which govern their qualifications and their businesses.

Credit rating legislation should not be prejudicial to the enactment by attacking and overly tightening the CRAs. Since the investors who believed the investment grade and suffered a loss are likely to abuse the law by filing lawsuits against the CRAs, this could cause social agitation and clutter up the stock market. An exacting standard to prevent this is needed. The credit ratings provide the information about the credit risk of the securities in its methodology. Because believing and using the credit rating is

---

<sup>416</sup> Minbeob [Civil Act], art. 390 (S. Kor.).

investors' business, we can't compare these cases with the cases where the investors file lawsuits against the fund managers, who are hired to invest their money, and taking big losses because of the negligence and mistakes they made.

In *Budd v. Nixen*, Judge described the components in tort for professional responsibility following:

1) "[t]he duty of the professional to use such skill, prudence and diligence as other members of his profession commonly possess and exercise; 2) a breach of that duty; 3) a proximate causal connection between the negligent conduct and the resulting injury; and 4) actual loss or damage resulting from the professional's negligence."<sup>417</sup>

If the CRAs follow appropriate assessment procedures without prejudicial judgment, comply with the internal regulations, endeavor to produce credit ratings faithfully, and urge users not to rely solely on their results for the rational decision to invest, this guideline could be a strong deterrent against the investors contemplating filing frivolous lawsuits against the CRAs.<sup>418</sup>

In fact, all CRAs specify their cautionary note in their reports for the users. For example, in case of Nice Information Credit, they add the cautionary note as following:

"[S]ince credit rating and rating reports which provided by NICE Information Credit are comments about the repayment ability of future, it is evaluated and analyzed

---

<sup>417</sup> *Budd v. Nixen*, 491 P.2d 433 (Cal. 1971).

<sup>418</sup> *Id.*

based on the predictive information. These predicted results may vary with the actual information. In addition, NICE Information Credit does not express the operational risk in accordance with interest rate and exchange rate fluctuations due to internal procedures or systems, liquidity risk, the risk of market fluctuations. Moreover, credit rating is our unique opinion according to the appraisal standard of NICE Information Credit. Furthermore, it does not recommend buying and selling particular securities. As such, we emphasize that the information users should make a decision about investment through self-analysis and evaluation of the securities, the issuer, and guarantee agencies.”

Another crucial issue is to urge caution among investors regarding the business prospects of the issuers of securities, the possibility of recovery of principal and interest to users.<sup>419</sup> This doctrine is mentioned in detail in *In re Worlds of Wonder Sec. Litigation*.<sup>420</sup> In this doctrine, the Ninth Circuit affirmed the dismissal of the officers and directors, major shareholders, and underwriters of Worlds of Wonder, holding that the "bespeaks caution doctrine" applied.<sup>421</sup> The court held that the optimistic statements in a debenture prospectus were not false and misleading because the prospectus contained

---

<sup>419</sup> GREENE, EDWARD ET AL., U.S. REGULATION OF THE INTERNATIONAL SECURITIES AND DERIVATIVES MARKETS 15-17 (9TH ED. 2008).

<sup>420</sup> See *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407 (9th Cir. 1994).

cautionary language elsewhere in the document that adequately disclosed the risks involved.<sup>422</sup>

Arranging the liability legislation on credit rating the one, but not in order that investors bring their lawsuits against the CRAs, principles of definitive courts will be required. Moreover, to specify legislation regarding civil, tort, and professional liability is urgent.

#### E. Create Exclusive Division of CRAs in Financial Supervisory Service

The start of Dodd Frank Act was the momentum, and the SEC created a new department exclusively for the credit rating, called “Office of Credit Rating.”<sup>423</sup> This shows the government’s willingness to strengthen monitoring of the credit rating industry and inform the importance of the credit rating internally and externally. The Office of Credit Ratings implements law, submits an annual report to Congress, maintains a close relationship with Congress, and enhances regulation awareness.<sup>424</sup> In addition, they perform overall investigation regarding the NRSRO and create a public report for general investors in order to help the public understand the credit rating.<sup>425</sup> Furthermore, the role

---

<sup>421</sup> *Id.*

<sup>422</sup> *Id.*

<sup>423</sup> *About the Office of Credit Ratings*, SEC. GOV., <http://www.sec.gov/about/offices/ocr/ocr-about.shtml>.

<sup>424</sup> *Id.*

<sup>425</sup> *Id.*

of the Office is not just a small division, but also serves as a supervisor who encompasses a wide range of responsibilities of watching the overall CRA industry.

Unfortunately, there is no department exclusively for credit rating industry in the Financial Supervisory Service in Korea. They deal with credit rating businesses in various departments, such as Financial Investment Supervision or Bank Supervision Department. When the need arises, several departments convey trends of the U.S. CRAs and news of the credit ratings in the form of reports. Financial Investment Supervision mainly deals with CRAs and releases annual report of CRAs performance. In this department, a special office which governs intensive research on CRAs is required.

With this deficiency, work efficiency decreases accordingly. Credit rating is an important yardstick to check the company's financial soundness, and without a department whose sole function is to take care of the issue of credit rating industry, and having to consolidate ideas coming and going from different departments, show that there remain a long road ahead for Korean credit rating industry.

The Financial Supervisory Service should recruit experienced people who are attorneys, CPAs, and other staff who have dealt with the credit rating industry, to staff the new department. Knowing that the CRAs will be held more accountable will make public feel safe in trusting that there is a government watchdog in town.

First, the new office should thoroughly probe into current regulations for the credit rating. Impractical regulations should be removed, and realistic regulations

considering the distinctiveness of Korean securities market should be made. With the refined regulations, they should initiate systematic investigations into conditions of the CRAs quarterly.

Second, the support along with strict supervision of small and medium-sized CRAs must be explored. These CRAs need the government's support in order to make inroads into the foreign market and be encouraged to explore special scope of abilities to prevail.

Third, the new department must become a credit rating-watcher so that the general public is confident of credit ratings issued by the CRAs are made in good faith and not tainted by self-interest. This will spur more investors to jump into the market without worrying about potential conflicts of interest between the CRAs and the issuers. In turn, more businesses will seek out the services of the CRAs, which is a win situation for all involved. These efforts will raise perception and bring more awareness of the roles of CRAs to public.

Finally, this department must be granted the power to make, implement and enforce laws upon CRAs and other parties who violate and breach the securities law in the process of giving and receiving the credit rating.

#### F. Need to Awaken the Academic Field

Given the current situation, the matter of CRAs will soon become a serious area of concern in Korea. When congress tries to make or revise laws, the public hearings are

usually opened for the public. At these public hearings, the relevant industry people, public organizations, experts, shareholders as well as local residents concerned with the enactment of the law (as amended) attend, and voice their concerns, and discuss the pros and cons of the issues together.

This aims for the protection of the rights of opinion for relevant shareholders regarding the enactment of a new law (as amended) and/or administrative action. In modern society, the public hearings regarding potential legislation (amendment) signifies the procedure that collects feedback from the interested individuals, parties, and experts through public discussion. These public hearings represent the protection of the rights of individuals and the concentration of the opinions regarding what is reasonable by the administration.

By the way, who leads these public hearings, how and when? The scholars and professors in universities and academic research institutes act as the “think tanks” during public hearings. They do extensive research on the subject, publish papers, interview the media, collect opinions in various fields of related activities, and often act as the “go to” leaders on social issues. These issues reach the lawmakers in congress and government and it is likely to develop into legislation through several public hearings.

The law scholars who perform intensive research on credit ratings are very rare in Korea. Law scholars have not thoroughly studied the regulations of CRAs. One would

assume that university professors would be interested in doing research on CRA, but there is not much attention there yet.

In Department of Business administration and Economics, methodological research for CRA has been done. However, CRA research at law schools lacks in its breadth and depth and is currently inadequate to help grow Korean CRAs. Currently, the Korea Institute of Finance, Korea Development Institute, Financial Supervisory Service, and Financial Services Commission are dealing with the CRAs. In fact, Financial Supervisory Service and Financial Services Commission are government supervisory agencies for policy-making. The Korea Institute of Finance (“KIF”) and the Korea Development Institute (“KDI”) are “think tanks” where substantial studies take place. KIF and KDI periodically produce reports on the recent trend of U.S. CRAs, and the updates of U.S. Financial market. However, rather than focusing on reports which center on news, the research institutions are necessary to analyze the Korea’s CRA industry and find “real life” solutions to improve the quality of these CRAs.

With one of the two institutions as the center figure, it is necessary to perform intensive research on CRAs. Then, regular reports which analyze improvements of CRAs, the latest trends on the CRAs, and its problems should be released. According to the research, the flow of the capital market due to changes in credit ratings would be easier. Such research may be used as important materials such as diagnosing problems



with the capital market and the proposed improvements. In addition, these efforts are expected to greater synergy in academia.

Due to lackadaisical attitude of governmental agencies and CRAs, the majorities of people do not know what CRAs are, what they do, and how they affect us. What is required is scholarly attention on a range of issues - from a discussion on reforming the liability regulations of compensation of CRAs under the Use Credit Act, to imposing professional responsibility, default of obligation and tort of CRAs, in order to produce a desirable set of recommendations for eventual Congressional reform. Since academic research and discussion have the capacity to influence Congress, the scholars should make an effort to develop proper atmosphere and regulations for the Korean CRAs, as many companies and saving banks went into bankruptcy in last couple of years. Unfortunately, many are not aware that all of these incidents had a common thread, the credit rating. It is a mission for scholars in academia to enlighten the people to the significance of credit rating.

## 8. CONCLUSIONS

This dissertation aims to propose feasible recommendations for Korean CRAs based on the recent experience of U.S. The importance and influence of credit ratings are enormous worldwide. In spite of the tremendous effect, CRAs' responsibilities and duties are relatively very low.

More than anything else, they have been criticized for their partial and inaccurate credit ratings. In addition, CRAs have serious problems such as 1) conflict of interest, 2) lack of competition, and 3) immunity from responsibility.

U.S. CRAs such as Moody's, S&P, and Fitch that monopolize the world stock markets have been criticized about their past poor performance since the U.S. mortgage crisis. To solve these problems, the U.S. has carried powerful law reforms such as Dodd-Frank Act in recent years. International organizations such as G20, IOSCO, and IMF began to discuss the issue and have presented solutions. Despite these efforts, the problems of CRAs remain unresolved.

Korea has not only all these problems, but also the special problems of a market where foreign-owned CRAs are dominant. The U.S. CRAs are greatest shareholders of Korean CRAs, which shows that Korean CRA market has been less self-sustainable. Recently, keeping up with the U.S. reforms, Korea also reformed the CRAs legislation. This may be the strength to develop the Korean CRAs market, but it is doubtful that the law would be realistic and effective.

By analyzing credit ratings of U.S. and Korea in recent years, the poor performance conducted by U.S. CRAs had been verified. Furthermore, they used to produce biased credit ratings for specific countries. Through credit ratings of Korean CRAs during the bankruptcy process of Korean companies, as well as the U.S. CRAs, their credit ratings were less predictable.

After comparing the regulations of U.S. and Korea, Korea has tried to follow the U.S. legislation. Even though the both countries have such an advanced legislation, they could not keep the U.S. major CRAs from being the sole lead. Rather, since the Dodd-Frank Act, their revenues have increased and their businesses have expanded. The issue of competition is never resolved.

To solve the issue of conflict of interest associated with issuer-model, both legislations try to solve the problem indirectly by removing the credit ratings in the rate-dependent regulations and ordering a substitute for credit ratings. As candidates for a substitute, credit spreads, credit default swap spreads, stress test models were examined, but such claims need to be tested empirically over a long period time. Having removed the credit ratings is an impetuous decision.

Based on all those results, Korean CRAs must be take these feasible recommendations which are: 1) adequate policy for small and medium-sized corporation, 2) encouraging overseas expansion, 3) encouraging CRAs to devise and develop their own criteria strengthening competitiveness, 4) radical overhaul of the liability system is

necessary, 5) creating exclusive division of CRAs in Financial Supervisory Service, and 6) waking up the academic filed.

## BIBLIOGRAPHY

### Korea Materials

#### Cases

##### Supreme Court Cases

Supreme Court [S. Ct.], 90647 Da, June 25, 2008 (S. Kor.), <http://eng.scourt.go.kr/eng/crt/dcsns/NewDecisionsView.work?seq=338&currentPage=0&mode=6&searchWord=90647>.

Supreme Court [S. Ct.], 82625 Da, Apr. 12, 1998 (S. Kor.).

Supreme Court [S. Ct.], 56416 Da, May 25, 1999 (S. Kor.).

Supreme Court [S. Ct.], 16007 Da, Jan. 28, 2010 (S. Kor.).

Supreme Court [S. Ct.], 64627 Da, Oct. 10, 2009 (S. Kor.).

Supreme Court [S. Ct.], 1646Daca, Nov. 10, 1987 (S. Kor.).

Supreme Court [S. Ct.], 395Daca, Jan. 28, 1993 (S. Kor.).

##### District Court Cases

Seoul Central District Court [Dist. Ct.], 2012hwoi-hap185, Oct. 11, 2012 (S. Kor.).

Seoul District Court [Dist. Ct.], 2000Na32740, Nov. 23, 2000 (S. Kor.).

#### Statutes

Gongjeonggeolaebob [Monopoly Regulation and Fair Trade Act] Act. No. 4198, Dec. 8, 1992 (S. Kor.).

Jabonshijang-gwa gumyoongtoojaupe gwanhan beobyul [Financial Investment Services and Capital Markets Act], Act No.8863, Feb. 28, 2008, *amended by* Act No.113845, May 28, 2013 (S. Kor.).

Jasanyoudongwha beobyul [Asset-backed Securitization Act], Act. No. 9258, Dec. 26, 2012 (S. Kor.).

Minbeob [Civil Act], Act. No. 471, Feb. 22, 1958, art. 750 (S. Kor.).

Shinyongjoengboui iyong mit bohoui gwanhan beopyul [Use and Protection of Credit Information Act], Act. No. 4866, Jan. 5, 1995, *amended by* Act. No. 11845, May 28, 2013 (S. Kor.).

Shinyongjoengboui iyong jeongbohoui gwanhan beop syhengryung [Enforcement Decree of the Use and Protection of Credit Information Act] Presidential Decree No. 24076, Aug. 31, 2012, *as amended* (S. Kor.).

## **Executive Materials**

Financial Supervisory Service of South Korea, 2008 *Nyun shinyongpyunggaui shinyoungpyunggasiljeok boonseok* [The present status of Korean CRAs in 2008] (May 13, 2009) (S. Kor.), [http://www.fss.or.kr/fss/kr/promo/bodobbbs\\_view.jsp?seqno=13571&no=34&s\\_title=%BD%C5%BF%EB%C6%F2%B0%A1&s\\_kind=content&page=5](http://www.fss.or.kr/fss/kr/promo/bodobbbs_view.jsp?seqno=13571&no=34&s_title=%BD%C5%BF%EB%C6%F2%B0%A1&s_kind=content&page=5).

Financial Supervisory Service of South Korea, 2011 *Shinyongpyungga hoisau shinyoungpyungga shiljeok boonseok* [Performance analysis of CRAs in 2011] (Apr. 16, 2012) (S. Kor.), [http://www.fss.or.kr/fss/kr/promo/bodobbbs\\_view.jsp?seqno=15850&no=41&s\\_title=%BD%C5%BF%EB%C6%F2%B0%A1&s\\_kind=title&page=1](http://www.fss.or.kr/fss/kr/promo/bodobbbs_view.jsp?seqno=15850&no=41&s_title=%BD%C5%BF%EB%C6%F2%B0%A1&s_kind=title&page=1).

Financial Services Commission of South Korea, *Jae 309 Gookhwe jeongmoo wuiwonhwe upmoohyunhwang* [The 309th Extra session of the National Assembly: present condition of National Policy Committee] (July 26, 2012) (S. Kor.), [http://www.fsc.go.kr/info/ntc\\_news\\_view.jsp?bbsid=BBS0030&page=4&sch1=content&sword=저축은행&r\\_url=&menu=7210100&no=28755](http://www.fsc.go.kr/info/ntc_news_view.jsp?bbsid=BBS0030&page=4&sch1=content&sword=저축은행&r_url=&menu=7210100&no=28755).

Financial Services Commission of South Korea, *Jeochook-eunhaeng gunjungyungyounge l wuihan chooga jaedogaeseon bangan* [Additional plan for improving system for the sound management of saving banks] (Sept. 13, 2012) (S. Kor.), [http://www.fsc.go.kr/info/ntc\\_news\\_view.jsp?bbsid=BBS0030&page=4&sch1=content&sword=저축은행&r\\_url=&menu=7210100&no=28820](http://www.fsc.go.kr/info/ntc_news_view.jsp?bbsid=BBS0030&page=4&sch1=content&sword=저축은행&r_url=&menu=7210100&no=28820).

Financial Supervisory Service of South Korea, *Shinyongpyunggui gongshideung Mobeomgyujoon Jaejung shiheng* [Enactment and implementation of example criteria on disclosure of credit ratings business] (Nov. 27, 2012) (S. Kor.), [http://www.fss.or.kr/fss/kr/promo/bodobbs\\_view.jsp?seqno=16377&no=1&s\\_title=%BD%C5%BF%EB%C6%F2%B0%A1%B5%EE%B1%DE&s\\_kind=title&page=1](http://www.fss.or.kr/fss/kr/promo/bodobbs_view.jsp?seqno=16377&no=1&s_title=%BD%C5%BF%EB%C6%F2%B0%A1%B5%EE%B1%DE&s_kind=title&page=1).

Financial Supervisory Service of South Korea, *2012nyundo Shinyongphyungga hoisaui shinyongpyungga Shiljeok Boonsuk* [Performance analysis of CRAs in 2012] (Apr. 29, 2013) (S. Kor.), [http://www.fss.or.kr/fss/kr/promo/bodobbs\\_view.jsp?seqno=16726&no=44&s\\_title=%BD%C5%BF%EB%C6%F2&s\\_kind=title&page=1](http://www.fss.or.kr/fss/kr/promo/bodobbs_view.jsp?seqno=16726&no=44&s_title=%BD%C5%BF%EB%C6%F2&s_kind=title&page=1).

## **United States Materials**

### **Cases**

#### **Federal Cases**

##### **Circuit Courts of Appeals Cases**

*Bear Stearns & Co. v. Daisy Sys. Corp. (In re Daisy Sys. Corp.)*, 97 F.3d 1171 (9th Cir. 1996).

*Compuware Corp. v. Moody's Inv. Servs., Inc.*, 499 F.3d 520 (6<sup>th</sup> Cir. 2007).

*In re Lehman Bros. Mortgage-Backed Securities Litig.*, 650 F.3d 167 (2d Cir. 2011).

*In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407 (9th Cir. 1994).

*Jefferson County School District No. R-1 v. Moody's Investor's Services, Inc.*, 175 F.3d 848 (10th Cir. 1999).

*Quinn v. McGraw-Hill Companies*, 168 F.3d 331 (7th Cir. 1999).

##### **District Court Cases**

*Abu Dhabi Commercial Bank v. Morgan Stanley & Co. Inc.*, 651 F. Supp. 2d 155 (S.D.N.Y. 2009).

*County of Orange v. McGraw-Hill Companies, Inc.*, 245 B.R. 151 (C.D. Cal 1999).

*Gale v. Value Line, Inc.*, 640 F. Supp. 967 (D.R.I. 1986).

### **State Cases**

*Budd v. Nixen*, 491 P.2d 433 (Cal. 1971).

*California Pub. Employees' Ret. Sys. v. Moody's Corp.*, No. 09-490241 (S.F. Super. Ct. order filed June 1, 2010), available at <http://www.callawyer.com/clstory.cfm?eid=915589&ref=updates>.

*Jackson v. Johnson*, 7 Cal. Rptr. 2d 482 (Cal. Ct. App. 1992).

*Toukara v Fernicola*, 914 N.Y.S. 2d 161 (N.Y. App. Div. 2011).

### **Statutes**

U.S. CONST. amend. I.

Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

SARBANES OXLEY ACT OF 2002, PUB. L. NO. 107-204, § 702(B), 116 STAT.745 (2002)

Securities Exchange Act of 1934, Definitions and application, Nationally recognized statistical rating organization, 15 U.S.C. § 78c(a)(62) (2010).

### **Regulations**

Securities Exchange Act of 1934, Application for registration as a nationally recognized statistical rating organization, 17 C.F.R. § 240.17g-1 (2007).

### **Final Rules**

Alternatives to the Use of External Credit Ratings in the Regulations of the OCC, 77 Fed. Reg. 35253 (June 13, 2012) (to be codified at 12 C.F.R. Parts 1, 5, 16, 28, and 160).

Interactive Data to Improve Financial Reporting, 74 Fed. Reg. 6776 (Feb. 10, 2009).



Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, 72 Fed. Reg. 33564 (June 18, 2007).

### **Proposed Rules**

Capital Requirements for Brokers or Dealers under the Securities Exchange Act of 1934, 62 Fed. Reg. 68018 (Dec. 30, 1997).

Concept Release on Possible Rescission of Rule 436(g) under the securities Act of 1933, 74 Fed. Reg. 55162 (Oct. 27, 2009).

Definition of Nationally Recognized Statistical Rating Organization, 70 Fed. Reg. 21306 (Apr. 25, 2005).

Proposed Rules for Nationally Recognized Statistical Rating Organizations, 73 Fed. Reg. 36212 (June 19, 2008) (to be codified at 17 C.F.R. pts. 240, 249b).

References to Ratings of Nationally Recognized Statistical Ratings Organizations, 73 Fed. Reg. 40124 (July 11, 2008).

References to Ratings of Nationally Recognized Rating Organizations, 74 Fed. Reg. 52374 (proposed Oct. 9, 2009) (to be codified at 17 C.F.R. pts. 229, 230, 239, 240, 242, 249, 270, and 275).

Removal of Certain References to Credit Ratings under the Securities Exchange Act of 1934, 76 Fed. Reg. 26550 (May 6, 2011).

### **Executive and Public Institution Materials**

*Approaches to Improving Credit Rating Agency Regulation: Hearing Before the Subcomm. on Capital Mkts., Ins. & Gov't Sponsored Enters. of the H. Comm. on Fin. Servs.*, 111th Cong. (2009).

COPELAND, CURTIS, CONG. RESEARCH SERV. R41472, RULEMAKING REQUIREMENTS AND AUTHORITIES IN THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT (2010).

*Enhancing Investor Protection and the Regulation of Securities Market: Hearing Before the S. Comm. on Banking, House and Urban Affairs*, 111th Cong. (2009).

*Oversight of the Credit Rating Agencies Post-Dodd-Frank: Hearing Before the Subcomm. on Oversight and Investigations of the H. Comm. on Fin. Servs.* 112th Cong. (2011).

*Report of the Senate Committee on Banking, Housing, and Urban Affairs to Accompany S. 3850, Credit Rating Agency Reform Act of 2006*, S. Report No. 109–326, 109th Cong., 2d Sess. (2006).

*Rating the Raters: Enron and the Credit Rating Agencies: Hearing Before S. Comm. on Gov't Affairs*, 107th Cong. (2002).

*Rating the Rating Agencies: The State of Transparency and Competition: Hearing Before the Subcomm. on Capital Mkts., Ins. & Gov't Sponsored Enters. of the H. Comm. on Fin. Servs.*, 108th Cong. (2003)

*Regulatory perspectives on the Obama administration's financial regulatory reform proposals: Hearing before the Comm. on Capital Servs. of the H. Comm. on Fin. Servs.*, 111th Cong. (2009) (testimony of SEC Chair Mary Schapiro).

STAFF OF S. COMM. ON GOVERNMENTAL AFFAIRS, 107TH CONG., ENRON'S CREDIT RATING: ENRON'S BANKERS' CONTACTS WITH MOODY'S AND GOVERNMENT OFFICIALS (Comm. Print 2003).

STAFF OF S. COMM. ON GOVERNMENTAL AFFAIRS, 107TH CONG., FINANCIAL OVERSIGHT OF ENRON: THE SEC AND PRIVATE-SECTOR WATCHDOGS (Comm. Print 2002).

*The Credit Rating Agency Duopoly Relief Act: Hearing on H.R. 2990 Before the H. Comm. On Fin. Servs.*, 109th Cong. (2005).

U.S. Department of the Treasury, *Fact Sheet: Administration's Regulatory Reform Agenda Moves Forward CRA Reform Legislation Sent to Capitol Hill* (July 21, 2009), <http://www.treasury.gov/press-center/press-releases/Pages/tg223.aspx>.

## **Securities and Exchange Commission**

SEC, *Annual Report on Nationally Recognized Statistical Rating Organizations as Required by Section 6 of the CRA Reform Act of 2006* (June 2008), <http://www.sec.gov/divisions/marketreg/ratingagency/nrsroannrep0608.pdf>.

SEC, *Annual Report on Nationally Recognized Statistical Rating Organizations as Required by Section 6 of the CRA Reform Act of 2006*, (Mar. 2012), <http://www.sec.gov/divisions/marketreg/ratingagency/nrsroannrep1212.pdf>.

SEC, *Annual Report on Nationally Recognized Statistical Rating Organizations as Required by Section 6 of the CRA Reform Act of 2006* (Dec. 2013), <http://www.sec.gov/divisions/marketreg/ratingagency/nrsroannrep1213.pdf>.

SEC, *Appendix: SEC Staff Levels Have Not Kept Pace with Industry Growth* (2009), <http://www.sec.gov/news/testimony/2009/ts060209mls-app.pdf>.

SEC, *Briefing Paper: Roundtable to Examine Oversight of CRAs* (Apr. 2009), <http://www.sec.gov/spotlight/cra-oversight-roundtable/briefing-paper.htm>

SEC, *SEC Announces Agenda for Credit Ratings Roundtable* (Apr. 2013), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171514902#.UtEiwFRDvIs>.

SEC, *Examinations by the Securities and Exchange Commission's office of compliance inspections and examinations* (Feb. 2011), <http://www.sec.gov/about/offices/ocie/ocieoverview.pdf>.

SEC, *Notice of Effectiveness of Rating and Investment Information, Inc.'s ("R&I") Withdrawal from Registration as a Nationally Recognized Statistical Rating Organization ("NRSRO")* (Nov. 2011), <https://www.sec.gov/news/digest/2011/dig112811.htm>.

SEC, *Registered NRSROs*, <http://www.sec.gov/about/offices/ocr.shtml>.

SEC, *Report on the Role and Function of Credit Rating Agencies in the Operation of the Securities Markets, As Required by Section 702(b) of the Sarbanes-Oxley Act of 2002* (Jan. 24, 2003), <https://www.sec.gov/news/studies/credratingreport0103.pdf>.

SEC, *Report on Review of Reliance on Credit Ratings: As Required by Section 939A(c) of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (July 2011), <https://www.sec.gov/news/studies/2011/939astudy.pdf>.

SEC, *Rating Agencies and the Use of Credit Ratings under the Federal Securities Laws*, 68 Fed. Reg. 35258 (June 12, 2003).

SEC, *Summary Report of Issues Identified in the Commission Staff's examinations of Select Credit Rating Agencies* (July 2008), <http://www.sec.gov/news/studies/2008/craexamination070808.pdf>.

SEC, *Seven Credit Rating Agencies Register with SEC as Nationally Recognized Statistical Rating Organizations* (Sept. 24, 2007), <http://www.sec.gov/news/press/2007/2007-199.htm>.

SEC, *Statement on Proposal to Increase Investor Protection by Reducing Reliance on Credit Ratings* by Christopher Cox (June 2008), [http://www.sec.gov/news/speech/2008/spch062508cc\\_credit.htm](http://www.sec.gov/news/speech/2008/spch062508cc_credit.htm).

SEC, *2012 Summary Report of Commission Staff's Examinations of Each Nationally Recognized Statistical Rating Organization As Required by Section 15E(p)(3)(C) of the Securities Exchange Act of 1934* (Nov. 2012), <http://www.sec.gov/news/studies/2012/nrsro-summary-report-2012.pdf>.

## **International**

Basel Committee on Banking Supervision of Bank for International Settlements, *International Convergence of Capital Measurement and Capital Standards* (June 2006), <http://www.bis.org/publ/bcbs128.pdf>.

Basel Committee on Banking Supervision of Bank for International Settlements, *Consultative Document: Revisions to the Basel Securitization Framework* (Dec. 2012), <http://www.bis.org/publ/bcbs236.pdf>.

Committee on the Global Financial System of Bank for International Settlements, *The role of ratings in structured finance: issues and implications*, <http://www.bis.org/publ/cgfs23.pdf>.

Financial Stability Board, *Principles for Reducing Reliance on CRA Ratings* (Oct. 27, 2010), [http://www.financialstabilityboard.org/publications/r\\_101027.pdf](http://www.financialstabilityboard.org/publications/r_101027.pdf).

Financial Stability Board, *Roadmap and Workshop for Reducing Reliance on CRA Ratings* (Nov. 5, 2012), [https://www.financialstabilityboard.org/publications/r\\_121105b.pdf](https://www.financialstabilityboard.org/publications/r_121105b.pdf).

Financial Stability Board, *Credit Rating Agencies Reducing Reliance and Strengthening*

*Oversight* (Aug. 29, 2013), [http://www.financialstabilityboard.org/publications/r\\_130829d.pdf](http://www.financialstabilityboard.org/publications/r_130829d.pdf).

IMF, *World Economic Outlook: Coping with High Debt and Sluggish Growth* (Oct. 2012), <http://www.imf.org/external/pubs/ft/weo/2012/02/pdf/text.pdf>.

OECD, *Hearings: Competition and Credit Ratings* (Oct. 5, 2010), <http://www.oecd.org/data/competition/sectors/46825342.pdf>.

OECD, *Medium and Long-term Scenarios for Global Growth and Imbalances*, OECD Economic Outlook, Vol. 2012/1 (2012), <http://www.oecd.org/berlin/50405107.pdf>.

*Russia G20: G20 Leaders' Declaration*, G20.ORG (Sept. 2013), [https://www.g20.org/sites/default/files/g20\\_resources/library/Saint\\_Petersburg\\_Declaration\\_ENG.pdf](https://www.g20.org/sites/default/files/g20_resources/library/Saint_Petersburg_Declaration_ENG.pdf).

The Board of the International Organization of Securities Commission (IOSCO), *Credit Rating Agencies: Internal Controls Designed to Ensure the Integrity of the Credit Rating Process and Procedures to Manage Conflicts of Interest: Final Report* (Dec. 2012), <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD398.pdf>.

The Board of the International Organization of Securities Commission (IOSCO), *Supervisory Colleges for Credit Rating Agencies: Consultation Report* (Dec. 2012), <http://hb.betterregulation.com/external/Supervisory%20Colleges%20for%20Credit%20Rating%20Agencies%20-%20Consultation%20Report.pdf>.

Technical Committee of the International Organization of Securities Commission (IOSCO), *Code of Conduct Fundamentals for Credit Rating Agencies* (Dec. 2004), <http://www.eesc.europa.eu/self-and-coregulation/documents/codes/private/065-private-act.pdf>.

Technical Committee of the International Organization of Securities Commission (IOSCO), *The role of Credit Rating Agencies in Structured Finance Market: Final Report* (May 2008), <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD270.pdf>.

## **Books**

BAKER, KENT & NOFSINGE, JOHN, *SOCIALLY RESPONSIBLE FINANCE AND INVESTING* (2012).

CHUNG, CHANHYUNG THE KOREAN BILLS OF EXCHANGE AND PROMISSORY NOTES ACT (2004).

CROCKETT, ANDREW ET AL., CONFLICTS OF INTEREST IN THE FINANCIAL SERVICES INDUSTRY: WHAT SHOULD WE DO ABOUT THEM (2003).

DAS, SUBHAMOY, PERSPECTIVES ON FINANCIAL SERVICES (2009).

DUCHAC, JONATHAN ET AL., FINANCIAL ACCOUNTING: AN INTEGRATED STATEMENTS APPROACH (2006).

DÜMKE, RICCARDA, CORPORATE REPUTATION AND ITS IMPORTANCE FOR BUSINESS SUCCESS: A EUROPEAN PERSPECTIVE AND ITS IMPLICATION FOR PUBLIC RELATIONS CONSULTANCIES (2002).

ELSON, ANTHONY, GOVERNING GLOBAL FINANCE: THE EVOLUTION AND REFORM OF THE INTERNATIONAL FINANCIAL ARCHITECTURE (2012).

ENGEL, KATHLEEN & MCCOY, PATRICIA, THE SUBPRIME VIRUS: RECKLESS CREDIT, REGULATORY FAILURE, AND NEXT STEP (2011).

FIGHT, ANDREW, THE RATINGS GAME (2001).

FRANKS, SANDY & NUNNALLY, SARA, BARBARIANS OF WEALTH: PROTECTING YOURSELF FROM TODAY'S FINANCIAL ATTILAS (2010).

FRIED, JOSEPH, WHO REALLY DROVE THE ECONOMY INTO THE DITCH? (2012).

GAILLARD, NORBERT, A CENTURY OF SOVEREIGN RATINGS (2011).

GILBERT, HAROLD, BOND RATINGS AS AN INVESTMENT GUIDE: AN APPRAISAL OF THEIR EFFECTIVENESS (1938).

GREENE, EDWARD ET AL., U.S. REGULATION OF THE INTERNATIONAL SECURITIES AND DERIVATIVES MARKETS (9TH ED. 2008).

HOSSAIN, AKHAND, CENTRAL BANKING AND MONETARY POLICY IN THE ASIA-PACIFIC (2009).

IMF INDEPENDENT EVALUATION OFFICE, THE IMF AND RECENT CAPITAL ACCOUNT CRISES: INDONESIA, KOREA, BRAZIL (2003).

INTERNATIONAL MONETARY FUND, GLOBAL FINANCIAL STABILITY REPORT: MARKET DEVELOPMENTS AND ISSUES (2004).

IPB USA, U.S COMMODITY FUTURES TRADING COMMISSION (2009).

JEWELL, JEFF & LIVINGSTON, MILES, A COMPARISON OF BOND RATINGS FROM MOODY'S S&P AND FITCH IBCA (1999), <http://onlinelibrary.wiley.com>.

JOHNSON, STAFFORD, BOND EVALUATION, SELECTION, AND MANAGEMENT (2010).

KAWAI, MASAHIRO ET AL., IMPLICATIONS OF THE GLOBAL FINANCIAL CRISIS FOR FINANCIAL REFORM AND REGULATION IN ASIA (2012).

KNORR, KARIN ET AL., THE OXFORD HANDBOOK OF THE SOCIOLOGY OF FINANCE (2013).

Korea Ratings, *Sinyongpyung-gaui ihaewahwalyong* [Practice of Credit Ratings] (2008) (S. Kor.).

LANGOHR, HERWIG & LANGOHR, PATRICIA, THE RATING AGENCIES AND THEIR CREDIT RATINGS: WHAT THEY ARE, HOW THEY WORK AND WHY THEY ARE RELEVANT (2008).

LEVICH, RICHARD ET AL., RATINGS, RATING AGENCIES AND THE GLOBAL FINANCIAL SYSTEM (2002).

LEWIS, MICHAEL, PANIC: THE STORY OF MODERN FINANCIAL INSANITY (2009).

LIU, QIAO ET AL., FINANCE IN ASIA: INSTITUTIONS, REGULATION AND POLICY (2013).

MAULDIN, JOHN ET AL., ENDGAME: THE END OF THE DEBT SUPER CYCLE AND HOW IT CHANGES EVERYTHING (2011).

MARKHAM, JERRY, A FINANCIAL HISTORY OF THE U.S. (2002).

MOBIUS, MARK, BONDS: AN INTRODUCTION TO THE CORE CONCEPTS (2012).

RESTATEMENT (SECOND) OF TORTS (1977).

SOPHASTIENPHONG, KIATCHAI & KULATHUNGA, ANOMA , *GETTING FINANCE IN SOUTH ASIA 2009: INDICATORS AND ANALYSIS OF THE COMMERCIAL BANKING SECTOR* (2008).

UJIE, JANICHI, *JAPANESE FINANCIAL MARKETS* (2d ed. 2002).

ZHAO, YUAN, *CORPORATE GOVERNANCE AND DIRECTORS' INDEPENDENCE* (2011).

### **Working Papers**

Becker, Bo & Milbourn, Todd, *How did increased competition affect credit ratings?* (NBER, Working Paper No. 16404, 2010).

Flandreau, Marc et al., *Ratings Performance, Regulation and the Great Depression: Lessons from Foreign Government Securities* (CEPR, Discussion paper No. 7328, 2009).

Hartelius, Kristian et al., *Emerging Market Spread Compression: Is it Real or is it Liquidity?* (IMF, Working Paper No. 08/10, 2008).

Hunt, John, *The SEC's Proposed Rating Agency Rules: Unresolved Conflicts* (Berkeley (Berkeley Ctr. for Law, Bus. & the Econ., White Paper, 2008).

Jaramillo, Laura, *Determinants of Investment Grade Status in Emerging Markets* (IMF, Working Paper No. 10/117, 2010).

Keller, Sonja et al., *International Pricing of Emerging Market Corporate Debt: Does the Corporate Matter?* (IMF, Working Paper No. 10/26, 2010).

Kodres, Laura, & Narain, Aditya, *Redesigning the Contours of the Future Financial System* (IMF, Staff Position Note No. SPN/10/10, 2010).

Morley, John et al., *The Future of Financial Regulation* (Yale L. & Econ. Res. Paper No. 386, 2009).

Murdock, Charles, *The Financial Reform Act: Will it Succeed in Reversing the Causes of the Subprime Crisis and Prevent Future Crises?* (Loy. U. Chi. L., Res. Paper, 2010).

Partnoy, Frank, *The Paradox of Credit Ratings* (San Diego L. & Econ., Res. Paper No. 20, 2001).



Partnoy, Frank, *How and Why Credit Rating Agencies Are Not Like Other Gatekeepers* (San Diego Legal Stud., Res. Paper No 07-46, 2006).

Partnoy, Frank, *Rethinking Regulation of Credit Rating Agencies: An Institutional Investor Perspective* (San Diego Legal Stud. Paper No. 09-014, 2009).

Partnoy, Frank, *Overdependence on Credit Ratings was a Primary Cause of the Crisis* (San Diego Legal Stud. Paper No. 09-015, 2009).

Sy, Amadou N. R., *The Systemic Regulation of Credit Rating Agencies and Rated Markets* (IMF, Working Paper No. 09/129, 2009).

White, Lawrence, *A New Law for the Bond Rating Industry - For Better or For Worse* (NYU, Working Paper No. EC-06-19, 2006).

White, Lawrence, *Financial Regulation and the Current Crisis: A Guide for the Antitrust Community* (NYU, Working Paper No. EC-09-11, 2009).

White, Lawrence, *The Credit Rating Agencies: Understanding Their Central Role in the Subprime Debacle of 2007-2008* (NYU, Working Paper No. EC-09-06, 2009).

## **Periodicals**

Bai, Lynn, *The Performance Disclosures of Credit Rating Agencies: Are They Effective Reputational Sanctions*, 7 N.Y.U. J. L. & BUS. 47 (2010).

Baklanova, Viktoria, *Regulatory Use of Credit Ratings: How It Impacts the Behavior of Market Constituents*, 10 INT'L FIN. REV. 65 (2009).

Bernanke, Ben, *Nonmonetary Effects of the Financial Crisis in the Propagation of the Great Depression*, 73 AM. ECON. REV. 257 (1983).

Black, Barbara, *Protecting the Retail Investor in an Age of Financial Uncertainty*, 34 U. DAYTON L. REV. 61 (2009).

Blundell-Wignall, Adrian, *Structured Products: Implications for Financial Markets*, 2007 OECD J. FIN. MARKET TRENDS no. 1 (2007), <http://www.oecd.org/finance/financial-markets/39654605.pdf>.

Boyack, Andrea, *Lessons in Price Stability from the U.S. Real Estate Market Collapse*, 4 MICH. ST. L. REV. 925 (2010).

Burnie, David et al., *How SOX Affects Investing through Credit Rating Agencies*, 15 Corp. L. & ACCT. & FIN. J. 49 (2004).

Cheng, Mei et al., *An Empirical Analysis of Changes in Credit Rating Properties: Timeliness, Accuracy and Volatility*, 47 ACCT. & ECON. J. 108 (2009).

Cheung, Stephen & Chan, Bob, *Bond Markets in the Pacific Rim: Development, Market Structure and Relevant Issues in Fixed-income Securities Markets*, 9 U.N. ASIA-PAC. DEV. J. (July 2002).

Choi, Stephen, *Market Lessons for Gatekeepers*, 92 NW. U. L. REV. 916 (1998).

Coffee, John, *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301 (2004).

Coffee, John, *Ratings Reform: The Good, The Bad, and The Ugly*, 1 HARV. BUS. L. REV. 231 (2011).

Dam, Kenneth W., *The Subprime Crisis and Financial Regulation: International and Comparative Perspectives*, 10 CHI. INT'L. L. J. 581 (2010).

Deats, Caleb M., *Talk that Isn't Cheap: Does the First Amendment Protect Credit Rating Agencies' Faulty Methodologies from Regulation?*, 110 COLUM. L. REV. 1818 (2010).

Evans, Alicia, *The Investor Compensation Fund*, 33 J. CORP. L. 223 (2007).

Fulghieri, Paolo et al., *The Economics of Solicited and Unsolicited Credit Ratings*, 27 REV. FIN. STUD. 484 (2014).

*G7 Borrowing from Abroad*, 49 IMF FIN. & DEV.(1) (June 2012), <https://www.imf.org/external/pubs/ft/fandd/2012/06/pdf/fd0612.pdf>.

Gudzowski, Milosz, *Mortgage Credit Ratings and the Financial Crisis: The Need for a State-Run Mortgage Security Credit Rating Agency*, 2010 COLUM. BUS. L. REV. 245 (2010).

Hill, Claire, *Rating Agencies Behaving Badly: The Case of Enron*, 35 CONN. L. REV. 1145 (2003).

Hill, Claire, *Regulating the Rating Agencies*, 82 WASH. U. L.Q. 43 (2004).

Hosp, Phil, *Problems and Reforms in Mortgage-Backed Securities: Handicapping the Credit Rating Agencies*, 79 MISS. L. J. 531 (2010).

Hunt, John, *CRAs and the 'Worldwide Credit Crisis': The Limits of Reputation, the Insufficiency of Reform, and a Proposal for Improvement*, 2009 COLUM. BUS. L. REV. 605 (Sept. 5, 2008).

Hunt, John, *One Cheer for the Rating Agencies: How the Mark-to-Market Accounting Debate Highlights the Case for Rating-Dependent Regulation*, 60 S. CAR. L. REV. 749 (2009).

Hur, Jungwon, *A Study on Current Liability Regulations of Korean Credit Rating Agencies through Comparison with U.S. Regulations*, 13 INHA L. J. 205 (2010).

Husisian, Gregory, *What Standard of Care Should Govern the World's Shortest Editorials: Analysis of Bond Rating Agency liability*, 75 CORNELL. L. REV. 411 (1990).

Kelly, Claire et al., *The Hardening of Soft Law in Securities Regulation*, 34 BROOK. INT'L. L. J. 883 (2009).

Kisgen, Darren, *Credit ratings and capital structure*. 61 FIN. J. 1035 (2006).

Krinsman, Allan, *Subprime Mortgage Meltdown: How did it Happen and How will it End?*, 13 J. STRUCTURED FIN. 5 (2007).

Lall, Subir & Karasulu, Meral, *Korea: Economic Prospects and Challenges after the Global Recession*, 27 KOREA'S ECONOMY 6 (2011), available at [http://www.keia.org/sites/default/files/publications/30848\\_bergsten\\_sp.pdf](http://www.keia.org/sites/default/files/publications/30848_bergsten_sp.pdf).

Lee, Wonsam, *Shinyong pyunggaui beobjeok jeongui* [Legal Definition of Credit Ratings], 18 BUS. ADMIN. L. J. 483 (2008) (S. Kor.).

Lee, Wonsam, *Shinyong pyunggaui hoisau minsa chekim* [Civil Liability of CRAs], 23 CORP. L. J. 59 (2009) (S. Kor.).

Lee, Wonsam, *Mikook Shinyong phyungga hwesa gaehyukbeobui Jaejeong* [Implications of U.S. Credit Rating Agencies Reform Act to Korean legislation under Korean law], 15 COMP. PRIVATE. L. J. 373 (2008) (S. Kor.).

Listokin, Yair and Taibleson, Benjamin, *If You Misrate, then You Lose: Improving Credit Rating Accuracy through Incentive Compensation*, 27 YALE J. ON REG. 91 (2010).

Lupica, Lois R., *Credit Rating Agencies, Structured Securities, and the Way Out of the Abyss*, 28 REV. BANKING & FIN. L. 639 (2009).

Lynch, Timothy, *Deeply and Persistently Conflicted: Credit Rating Agencies in the Current Regulatory Environment*, 59 CASE W. RES. L. REV. 227 (2009).

Manns, Jeffrey, *Rating Risk after the Subprime Mortgage Crisis: A User Fee Approach for Rating Agency Accountability*, 87 N. C. L. REV. 1011 (2009).

Oh, Peter, *Gatekeeping*, 29 J. CORP. L. 735 (2004).

Park, Hwonil, *Shinyongpyunggae ddarun sonhaebaesangcheongguui beobjeok moonjae* [Legal Issues on the Breach of Contract or Tort Claims against Erroneous Credit Ratings], 14 BUS. ADMIN. & L. J. 129 (2004) (S. Kor.).

Partnoy, Frank, *Siskel and Ebert of Financial Markets; Two Thumbs Down for the Credit Rating Agencies*, 77 WASH. U. L.Q. 619 (1999).

Partnoy, Frank, *Barbarians at the Gatekeepers?: A Proposal for a Modified Strict Liability Regime*, 79 WASH. U. L. Q. 491 (2001).

Partnoy, Frank, *A Revisionist View of Enron and the Sudden Death of 'May'*, 48 VILL. L. REV. 1245 (2003).

Partnoy, Frank, *Historical Perspectives on the Financial Crisis: Ivar Kreuger, the Credit-Rating Agencies, and Two Theories about the Function, and Dysfunction, of Markets*, 26 YALE J. ON REG. 431 (2006).

Partnoy, Frank, et al., *The Promise and Perils of Credit Derivatives*, 75 U. CIN. L. REV. 1019 (2007).

Partnoy, Frank, *Second-Order Benefits from Standards*. 48 B. C. L. REV. 169 (2007).

Partnoy, Frank et al., *Credit Default Swap Spreads as Viable Substitutes for Credit Ratings*, 158 U. PA. L. REV. 2085 (2010).

Pinto, Arthur, *Control and Responsibility of Credit Rating Agencies in the United States*, 54 AM. J. COMP. L. 341 (2006).

Powers, Charlotte, *The Changing Role of Chaebol*, 10 STAN. J. E. ASIAN AFF. 105 (2010).

Sabarwal, Tarun, *Common Structures of Asset-Backed Securities and Their Risks*, 4 CORP. OWNERSHIP & CONTROL 258 (2006).

Yim, Gyungmook, *Chaegwonshijang eseoui shinyongpyungga gineung gaeseoneul wuihan jeongchaekbanghyang* [Recommendations for Developing Function of Credit Ratings in the Korean Bond Market], 28 KOREA DEV. J. 10 (2004) (S. Kor.).

White, Lawrence, *The Credit Rating Agencies: How Did We Get Here? Where Should We Go?*, 4 CPI ANTITRUST CHRONICLE(1) (2012), available at <https://www.competitionpolicyinternational.com/file/view/6654>.

### News & Newspaper Source

*A game of leapfrog*, ECONOMIST.COM (Apr. 28, 2012), <http://www.economist.com/node/21553498>.

Ahn, Daegyu et al., *Jabonjamsik Ssangyong Gunsul* [Capital erosion Ssangyong Engineering & Construction], Hankyung (Feb. 13, 2013) (S. Kor.), <http://www.hankyung.com/news/app/newsview.php?aid=2013021464161>.

Brady, Dennis & Ylan, Mui, *Senate passes amendment on debit and credit card swipe fees*, WASH. POST.(May 14, 2010), <http://www.washingtonpost.com/wp-dyn/content/article/2010/05/13/AR2010051303571.html>.

Choi, Myungyong, *Duitbook Shinyongphyungga Eje Gueman* [No need too late credit rating, Circulation Assessment is the only solution], MONEYTODAY (Feb. 22, 2011) (S. Kor.), <http://www.mt.co.kr/view/mtview.php?type=1&no=2011022214415039172&outlink=1>.

Han, Hyungyong, *Yonchaeyool hwakdae Boodowuigi jeonmoongunsulsa nuleo* [‘Bankruptcy crisis’ Professional construction companies have increased], CNNEWS

(June 21, 2012) (S. Kor.),

<http://www.cnews.co.kr/uhtml/read.jsp?idxno=201206201030349950277>.

Ishmael, Stacy-Marie, *DBRS, or the rating agency you've never heard of*, FTA

LPHAVILLE IN FIN. TIMES (May 24, 2010),

<http://ftalphaville.ft.com/2010/05/24/241181/dbrs-or-the-rating-agency-youve-never-heard-of/>.

Kim, Jiyoung, *Shinyongsa Deunggeupun Gupoom* [CRAs that have lost their trustworthiness "credit bubbles"], ETODAY (Dec. 12, 2012) (S. Kor.),

<http://m.etoday.co.kr/view.php?idxno=639863&mn=1>.

Kim, Moonho, *Shinpyungsa Hyundaicha Yonbi Gwajang Pyungga* [Foreign CRAs said Hyundai Motor Company's credit ratings are overly rated], FINANCIAL NEWS (S. Kor.), Nov. 13, 2012,

[http://www.fnnews.com/view?ra=Sent0301m\\_View&corp=fnnews&arcid=201211120100101650005677&cDateYear=2012&cDateMonth=11&cDateDay=12](http://www.fnnews.com/view?ra=Sent0301m_View&corp=fnnews&arcid=201211120100101650005677&cDateYear=2012&cDateMonth=11&cDateDay=12).

Kim, Taegyu, *Korean Banks Will Lose W42 Tril. By 2010*, KOREA TIMES (Mar.13, 2009),

[http://www.koreatimes.co.kr/www/news/biz/2009/03/123\\_41234.html](http://www.koreatimes.co.kr/www/news/biz/2009/03/123_41234.html).

Kim, Taejong, *Woongjin Group affiliate declared bankrupt*, The Korea Times (Sept. 26,

2012), [http://www.koreatimes.co.kr/www/news/biz/2012/09/123\\_120935.html](http://www.koreatimes.co.kr/www/news/biz/2012/09/123_120935.html).

Kong, Kanga, *Deal Between Woongjin, MBK in Korea Collapses*, WALL ST. J. (Sept. 28, 2012),

<http://online.wsj.com/news/articles/SB30000872396390443328404578022103309493538>.

Koppel, Nathan et al., *Judge Limits Credit Firms' 1st-Amendment Defense*, WALL ST.

J.(Sept. 7, 2009), <http://online.wsj.com/news/articles/SB125201681110884761>.

Myung, Soongyoung, *Hankook Shinyongdeunggeup Ilbon Choowol* [Korea's credit rating overtook Japan's], MK ECONOMY (Sept. 10, 2012) (S. Kor.),

[http://mbnmoney.mbn.co.kr/news/view?news\\_no=MM1000680246](http://mbnmoney.mbn.co.kr/news/view?news_no=MM1000680246).

Nah, Jihong, *Ile Shinyong Eucjeon Hankook... Jalduingeotdo Bujungjuk Moseupdo* [Korea: overtaking Japan... following Japan from the good to the bed], CHOSUN.COM

(Sept. 8, 2012) (S. Kor.),

[http://news.chosun.com/site/data/html\\_dir/2012/09/08/2012090800190.html](http://news.chosun.com/site/data/html_dir/2012/09/08/2012090800190.html).

O'Brian, Matthew, *There is only thing that can save Japan now: Inflation*, The Atlantic (Nov. 20, 2012), <http://www.theatlantic.com/business/archive/2012/11/there-is-only-one-thing-that-can-save-japan-now-inflation/265421/>.

Olsen, Kelly, *Fitch lowers credit outlook on emerging economies*, FOXNEWS.COM (Nov. 10, 2008), [http://www.foxnews.com/printer\\_friendly\\_wires/2008Nov10/0,4675,ASEmergingEconomiesFitch,00.html](http://www.foxnews.com/printer_friendly_wires/2008Nov10/0,4675,ASEmergingEconomiesFitch,00.html).

Paletta, Damian et al., *Law Remakes U.S. Financial Landscape*, WALL ST. J (July 16, 2010), <http://online.wsj.com/news/articles/SB10001424052748704682604575369030061839958>.

Park, Donghui et al., *Woongjin Coway Insoojeon Jaesamhoobo Geupboosang* [A third candidate emerges for takeover battle for Woongjin Coway], HANKYUNG.COM (July 12, 2012) (S. Kor.), <http://www.hankyung.com/news/app/newsview.php?aid=2012071219771&intype=1>.

Rapoza, Kenneth, *IMF Warns China On Rising Government Debt*, FORBES (May 29, 2013), <http://www.forbes.com/sites/kenrapoza/2013/05/29/imf-warns-china-on-rising-government-debt/>

*Ssangyong Engineering to file for debt workout this week*, YONHAPNEWS (Feb. 24, 2013), <http://english.yonhapnews.co.kr/news/2013/02/24/0200000000AEN20130224001700320.HTML>.

Shin, Jaewoo et al., *Superpower dashi ggumgguneun Ilbon* [Japan wants to dream of Superpower...how well has Avenomics worked?] YONHAPNEWS (Mar. 28, 2013) (S. Kor.), <http://www.yonhapnews.co.kr/bulletin/2013/03/27/0200000000AKR20130327189500008.HTML>.

Yim, Myunggyu, *2012nyun Jeungshigyohoon: Woongjin shinhwaui mollak* [2012 stock market lesson: Woongjin the fall of Myth], EDAILY (Dec. 19, 2012) (S. Kor.), <http://www.edaily.co.kr/news/NewsRead.edy?newsid=01439926599760160&SCD=DB11&DCD=A10102>.

#### **Internet Sources**

*About KED*, KEDKOREA.COM, <http://www.kedkorea.com/en/ENINT01R1.do>.

*About the Office of Credit Ratings*, SEC. GOV., <http://www.sec.gov/about/offices/ocr/ocr-about.shtml>.

*Credit Rating Agencies—Globally*, DefaultRisk.com, [http://www.defaultrisk.com/rating\\_agencies.htm](http://www.defaultrisk.com/rating_agencies.htm).

*Credit Ratings of Hyundai Rotem*, KOREA INVESTORS SERVICE, [http://www.kisrating.com/eng/ratings/rsearch\\_business.asp?kiscd=119613](http://www.kisrating.com/eng/ratings/rsearch_business.asp?kiscd=119613).

*Dagong Puts the U.S. of America's Credit Ratings on Negative Watch List*, EN.DAGONGCREDIT.COM (Dec. 25, 2012), [http://en.dagongcredit.com/content/details20\\_6873.html](http://en.dagongcredit.com/content/details20_6873.html).

European Securities and Markets Authority, *List of registered and certified CRA's* (June 3, 2013), [http://ec.europa.eu/internal\\_market/rating-agencies/index\\_en.htm](http://ec.europa.eu/internal_market/rating-agencies/index_en.htm).

*Federal Debt: Total Public Debt as Percent of Gross Domestic Product (GFDEGDQ188S)*, Federal Reserve Bank of St. Louis (2013), <http://research.stlouisfed.org/fred2/series/GFDEGDQ188S>.

*Financial Disclosure Report*, KOREARATINGS.COM (Sept. 2012), <http://www.korearatings.com/kr.jsp>.

*Financial Services Committee Unveils “Dodd-Frank Burden Tracker”*, Press Release of the H. Comm. on Fin. Servs. (Apr. 17, 2012), <http://financialservices.house.gov/news/documentsingle.aspx?DocumentID=291036>.

Friedman, Thomas, PBS interview (Feb. 13, 1996), <http://www.pbs.org/newshour/gergen/friedman.html>.

*French public debt in new high after stimulus spending*, BBC News (Dec. 30, 2009), <http://news.bbc.co.uk/2/hi/business/8434545.stm>.

*Russia G20: G20 Leaders' Declaration*, G20.ORG (Sept. 2013), [https://www.g20.org/sites/default/files/g20\\_resources/library/Saint\\_Petersburg\\_Declaration\\_ENG.pdf](https://www.g20.org/sites/default/files/g20_resources/library/Saint_Petersburg_Declaration_ENG.pdf).

Gallagher, Daniel, Commissioner of SEC, *A renewed focus on SEC priorities: AICPA/SIFMA Financial Management Society Conference on the Securities Industry*



(Oct. 25, 2013),

[http://www.sec.gov/News/Speech/Detail/Speech/1370540102737#.UtY5D\\_RDvIs](http://www.sec.gov/News/Speech/Detail/Speech/1370540102737#.UtY5D_RDvIs).

*GS E&C Consortium, 2.2 Billion USD Project LOA Received(Ruwais 4th NGL Train Project)*, GS E&C (June 16, 2009),

<http://www.gsconst.co.kr/en/Pr/PrNewsView.aspx?Lang=en&BoardCode=B007&CompositionNo=1321&GotoPage=8&SearchItem=&SearchWord>.

*GS E&G Yoyakjaemoojipyo [Rating history and Summary of Financial Statements of GS E&C Consortium]*, KISRATING.COM (S. Kor.),

[http://www.kisrating.com/ratings/rsearch\\_business.asp?kiscd=500143](http://www.kisrating.com/ratings/rsearch_business.asp?kiscd=500143).

*History of S&P Credit Rating Services*, STANDARDANDPOORS.COM,

<http://www2.standardandpoors.com/aboutcreditratings/>.

*JCR regulatory affairs*, JCR.CO.JP,

<http://www.jcr.co.jp/english/company/regulatoryaffairs.html>.

*JCR was recognized as an eligible ECAI by Luxembourg Government*, JCR.CO.JP (June 4 2008),<http://www.jcr.co.jp/reportqa/pdfen/08d0050e.pdf?PHPSESSID=672efff0ba43a69153c6894d9fe663c3>.

*JCR was recognized as an eligible ECAI by Germany*, JCR.CO.JP (May 29, 2008),

<http://www.jcr.co.jp/reportqa/pdfen/08d0258e.pdf>.

*JCR Recognized as an Eligible ECAI by Hong Kong*, JCR.CO.JP (Dec. 22, 2011),

<http://www.jcr.co.jp/reportqa/pdfen/2011122210e.pdf?PHPSESSID=1ab19f729dd6965bb38fa45534faecdc>.

Kiff, John, *Uses and Abuses of Sovereign Credit Ratings*, IMF (Oct. 19, 2010),

[http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/H1-UsesandAbusesof\(Sovereign\)Ratings.pdf](http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/H1-UsesandAbusesof(Sovereign)Ratings.pdf).

Kim, Hohye, *Shinyongphyangga Jedo Gesun [A sketch of the improvement of CRAs]*, THEBELL.CO.KR (Dec. 20, 2011) (S. Kor.),

[http://www.thebell.co.kr/front/free/contents/article\\_view.asp?key=201112300100047670002700](http://www.thebell.co.kr/front/free/contents/article_view.asp?key=201112300100047670002700).

Korea Exchange, [http://eng.krx.co.kr/m1/m1\\_3/m1\\_3\\_1/JHPENG01003\\_01.jsp](http://eng.krx.co.kr/m1/m1_3/m1_3_1/JHPENG01003_01.jsp).

Korea Federation of Small and Medium Business, *Daegiup-Joongsogiupgan gyukcha Youjeon* [Gap between large companies and small and medium business] (Jan. 21, 2013) (S. Kor.), <http://www.kbiz.or.kr/bbs/bbs.jsp?utype=H&site=www.kbiz.or.kr&ch=infolnoticelnews&boardid=B200901091745484965470> (follow “No. 2431” hyperlink).

Moody's, *Moody's 2010 Annual Report* (Feb. 25, 2011), [http://files.shareholder.com/downloads/MOOD/0x0x549102/63FE2998-B052-4E99-B69F-60165C7944E2/MOODY\\_S\\_2011AR\\_FINAL.PDF](http://files.shareholder.com/downloads/MOOD/0x0x549102/63FE2998-B052-4E99-B69F-60165C7944E2/MOODY_S_2011AR_FINAL.PDF).

*Moody's Role in the Capital Markets*, MOODYS.COM, <http://v3.moodys.com/Pages/atc002.aspx>.

*Moody's 2010 Annual Report* (Feb. 25, 2011), [http://files.shareholder.com/downloads/MOOD/0x0x549102/63FE2998-B052-4E99-B69F-60165C7944E2/MOODY\\_S\\_2011AR\\_FINAL.PDF](http://files.shareholder.com/downloads/MOOD/0x0x549102/63FE2998-B052-4E99-B69F-60165C7944E2/MOODY_S_2011AR_FINAL.PDF).

*Moody's expands African ratings coverage assigning sovereign ratings to Kenya, Nigeria and Zambia*, Moody's.com (Sept. 3, 2013), [https://www.moodys.com/research/Moodys-expands-African-ratings-coverage-assigning-sovereign-ratings-to-Kenya--PR\\_259338](https://www.moodys.com/research/Moodys-expands-African-ratings-coverage-assigning-sovereign-ratings-to-Kenya--PR_259338).

Mortgage Bankers Association, *Residential Mortgage Delinquencies Increase, According to MBA National Delinquency Survey*, (Mar. 16, 2006), <http://www.mortgagebankers.org/NewsandMedia/PressCenter/40245.htm>.

Mortgage Bankers Association, *Some Delinquency Measures Increase in Latest MBA National Delinquency Survey*, (Dec. 13, 2006), <http://www.mortgagebankers.org/NewsandMedia/PressCenter/47057.htm>.

Mortgage Bankers Association, *National Delinquency Survey Q208* (2008), [http://www.vermontmba.org/files/Q208\\_NDS.pdf](http://www.vermontmba.org/files/Q208_NDS.pdf).

NICE Information Credit, *Indonesia Eseo CB Seminar Gechoi* [NICE Group conducted CB seminar in Indonesia] (Apr. 27, 2011) (S. Kor.), [http://www.nice.co.kr/nb0113.nice?b01\\_seq=658](http://www.nice.co.kr/nb0113.nice?b01_seq=658).

OECD/World Bank Institute, *Korea and the knowledge-based economy* (2000), <http://browse.oecdbookshop.org/oecd/pdfs/product/9200061e.pdf>.

Philyaw, Jason, *S&P ‘Incorrectly Analyzed’ Re-Remic Mortgage Bonds*, HOUSINGWIRE.COM (Dec. 16, 2010), <http://www.housingwire.com/articles/sp-‘incorrectly-analyzed’-re-remic-mortgage-bonds>.

*Rating Action: Moody's lowers Japan's government rating to Aa3; outlook stable*, MOODYS.COM (Aug. 24, 2011), [https://www.moodys.com/research/Moodys-lowers-Japans-government-rating-to-Aa3-outlook-stable--PR\\_224752](https://www.moodys.com/research/Moodys-lowers-Japans-government-rating-to-Aa3-outlook-stable--PR_224752).

*Rating Action: Moody's upgrades Korea to Aa3; outlook stable*, MOODYS.COM (Aug. 27, 2012), [https://www.moodys.com/research/Moodys-upgrades-Korea-to-Aa3-outlook-stable--PR\\_253877](https://www.moodys.com/research/Moodys-upgrades-Korea-to-Aa3-outlook-stable--PR_253877).

*Rating Action: Moody's assigns Aa3 to Japan Expressway Holding & Debt Repayment Agency's bonds*, MOODY'S COM (Aug. 21, 2013), [https://www.moodys.com/research/Moodys-assigns-Aa3-to-Japan-Expressway-Holding-Debt-Repayment-Agency--PR\\_278767](https://www.moodys.com/research/Moodys-assigns-Aa3-to-Japan-Expressway-Holding-Debt-Repayment-Agency--PR_278767).

*Ratings Criteria*, STANDARDANDPOORS.COM, <http://www.standardandpoors.com/ratings/criteria/en/us?filtername=Table>.

*Rating review and history of Korea Line Corporation*, KISRATING.COM, [http://www.kisrating.com/eng/ratings/rsearch\\_business.asp?kiscd=720186](http://www.kisrating.com/eng/ratings/rsearch_business.asp?kiscd=720186).

*Regular review of Woongjin Holdings' non-guaranteed bonds and Commercial Paper*, KOREA RATINGS, <http://www.rating.co.kr/index.jsp> (type Korean “웅진 홀딩스[woongjin holdings]”; then follow “평가의견[review] of Mar. 26, 2012”).

*Ssangyong Engineering & Construction, Separate Financial Statements of Ssangyong* (Dec. 31, 2011), <https://www.ssyenc.com/ivtR/file/eng/report/AuditorsReport2011.pdf>. *Sssanyong Gunsul Yoyakjaemoojipyo* [Rating history and Summary of Financial Statements of Ssangyong Engineering & Construction], KISRATING.COM, [http://www.kisrating.com/ratings/rsearch\\_business.asp?kiscd=500330](http://www.kisrating.com/ratings/rsearch_business.asp?kiscd=500330).

*S&P Commitment: Quality and Independence*, STANDARDANDPOORS.COM, <http://docs.noodls.com/viewDoc.asp?filename=50914%5CEXT%5C200908040059005329083041.pdf>.

Senator Cantwell, *LeMieux-Cantwell Amendment Stops Over-Reliance on CRAs* (May 13, 2010), <http://cantwell.senate.gov/news/record.cfm?id=324942>.

Seoul Credit Rating & Information Inc., <http://www.scri.co.kr/eng/index.jsp>.

*Sovereign Ratings in Fitch*, Fitchratings.com (Aug. 24, 2012), [http://www.fitchratings.com/web\\_content/ratings/sovereign\\_ratings\\_history.xls](http://www.fitchratings.com/web_content/ratings/sovereign_ratings_history.xls).

*Sovereign ratings*, EN.DAGONGCREDIT.COM, [http://en.dagongcredit.com/ratingAnnouncement/countryList\\_3.html](http://en.dagongcredit.com/ratingAnnouncement/countryList_3.html).

Statutes of The Republic of Korea, [http://elaw.klri.re.kr/eng\\_service/main.do](http://elaw.klri.re.kr/eng_service/main.do).

*Speculative-Grade Composite Spread Expands to 647 Basis Points*, STANDARDANDPOORS.COM, <http://www.standardandpoors.com/ratings/articles/en/us/?assetID=1245226681637>.

*The History of Fitch Ratings*, FITCHRATINGS.COM, <http://www.fitchratings.com/jsp/creditdesk/AboutFitch.faces?context=1&detail=3>.

*Tongyong Chaegwon Baekseo: 2012 nyungan Jeonmang [Bonds White Paper: 2012 Annual Forecast]*, TONGYANG SECURITIES (NOV. 2011), <http://file.myasset.com/sitemanager/upload/2011/1104/141635/2011110414163501.pdf>.

*Three Sponsors from China, the U.S.A. and Russia Sponsor the Establishment of a "Multilateral, independent, International CRA"*, EN.DAGONGCREDIT.COM (Oct. 25, 2012), [http://en.dagongcredit.com/content/details20\\_6709.html](http://en.dagongcredit.com/content/details20_6709.html).

*Understanding Credit Ratings*, KISRATING.COM, <http://www.kisrating.com/eng/business/creditrating.asp>.

U.S. Department of Justice, *Department of Justice Sues S&P for Fraud in Rating Mortgage-Backed Securities in the Years Leading up to the Financial Crisis* (Feb. 5, 2013), <http://www.justice.gov/opa/pr/2013/February/13-ag-156.html>.

Voss, Jason, *The Post Ratings Agency World: An Interview with Invictus Group's Kamal Mustafa*, CFA INSTITUTE BLOGS (Mar. 9, 2012), <http://blogs.cfainstitute.org/investor/2012/03/09/the-post-ratings-agency-world-an-interview-with-invictus-groups-kamal-mustafa/>.

*What Credit Ratings Are & Are Not*, STANDARDANDPOORS.COM,  
<http://www.standardandpoors.com/aboutcreditratings/>.

*What is the ICAM?*, INVICTUSGRP.COM, <http://www.invictusgrp.com/about/icam.php>.

Yang, Hoseung et al., *Woongjin Holdings' commencement of reorganization proceedings and relevant bankruptcy law issues*, YOON & YANG LLC (Oct. 2012),  
<http://www.lexology.com/library/detail.aspx?g=b6a54da0-4654-4e28-8173-4a508c4c13e1>.

Yang, Seungyong, *Issuereport KR Credit Seminar: 2012 choigun donghyanggwajeonmang* [Issue Report, KR Credit Seminar: Recent trends and outlook in credit ratings 2012], Korea Ratings (Jan. 19, 2012) (S. Kor),  
[http://www.rating.co.kr/paging/Q\\_research\\_001?biz\\_op\\_code=Q&usr\\_rpt\\_cd=3](http://www.rating.co.kr/paging/Q_research_001?biz_op_code=Q&usr_rpt_cd=3)  
(Type Korean: 2012 년 1 월 KR Credit Seminar).