Have credit ratings become more accurate?

Abstract

Rating agencies play a central role in bond markets. However, the quality of credit ratings is continuously debated. We suggest that the tightening of rating standards observed in prior literature may be partially explained by rating accuracy improvement. We reconfirm that corporate credit ratings have become more stringent over time. Firms with similar accounting profile have a lower rating then they used to have previously. This paper sheds new light on the evolving quality of credit ratings and their underlying trends. Our analysis shows that ratings are now more correlated with market data than before and less correlated with accounting data than before. Furthermore, we find evidence for improving credit rating quality over time in terms of default prediction. We conclude that rating accuracy has improved over time, and hence, some of prior studies' critique on rating agencies seems outdated.