International Review of Accounting, Banking and Finance
Vol 11, No. 4, Winter, 2019, Pages 1-25

IRABF
ⓒ2019

Will Peer Pressure Cause Credit Rating Inflation?

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**Accepted December 2019*

A B S T R A C T

This study investigates the effect of peer pressure on credit rating among three credit rating agencies, S&P, Fitch and Moody's, from 2002 to 2013. The peer pressure effect suggests that raters assign favorable ratings when CRAs face competition from peers. First, the results show that rating agencies may assign more favorable credit ratings to banks with assigned ratings from two or three rating agencies, i.e., credit rating quality declines when rating agencies face peer pressure. This result holds for all three CRAs in developed countries. By contrast, CRAs do not assign more favorable ratings in developing countries. Second, the peer pressure effect holds mainly for investment-grade credit ratings. Third, CRAs are more likely to upgrade bank ratings when another CRA is entering the market and has assigned ratings to the same bank.

Keywords: Credit ratings; peer pressure; competition; rating quality; banks
JEL classification: G15; G21