**S&P’s Sovereign Ratings Have No “Home Bias”**

Two University of Heidelberg academics, Andreas Fuchs and Kai Gehring, claim to have discovered a “home bias” in sovereign ratings assigned by nine ratings agencies headquartered in six different countries. The authors further claim that this “home bias” is why Standard & Poor’s, despite its 2011 downgrade of the United States, hasn’t since lowered its rating to the level they deem appropriate.

We dispute the authors’ findings as well as their methodology. Standard & Poor’s ratings display no “home bias”— as an international rating agency with offices in major cities and capitals of over twenty countries, we apply the same criteria to each of the 128 sovereigns we rate without exception. Our publicly available ratings transition statistics demonstrate that sovereign ratings work well in ranking relative probabilities of default. Indeed, no less an institution than the IMF found our sovereign ratings to be a reliable predictor of sovereign default.

In part, a major difference between the authors’ approach and Standard & Poor’s (and that of other rating agencies) is that, in contrast to the authors’ backward looking analysis, Standard & Poor’s sovereign ratings offer an opinion about future creditworthiness. It is, therefore, not surprising that the authors’ “home bias” conclusion is based on a rating algorithm that fails to reflect important subtleties of future sovereign behavior, and this speaks directly to the credibility of the authors’ conclusions. One striking deficiency is the algorithm’s failure to account for monetary flexibility—a fundamental component of sovereign credit analysis and one of the credit strengths of the United States’ status as custodian of the dollar, the world’s leading reserve currency.

As important as their algorithm’s lack of sensitivity is the authors’ failure to explain why it is better than the methodologies of the agencies the authors claim to investigate. Standard & Poor’s, for example, has gone to considerable lengths in the name of transparency to select and weigh the qualitative and quantitative key factors on which it bases its sovereign ratings. We explain our thinking in numerous criteria publications, commentaries, “requests for comment” and in sovereign ratings analyses. The authors provide no such explanations or rationale for their algorithm.

By contrast, they rely on a “smoking gun”: because the rating for the U.S. produced by their algorithm is one notch lower than the rating assigned by S&P, there must be “home bias”. There is no attempt at explanation or justification—except for what can only be described as conspiracy theories.

The authors imaginatively claim, without adducing any evidence, that “home bias” is caused by fear of legal actions or the withdrawal of the rating agency’s regulatory approval by the home country. This is wrong, as is their claim that analysts’ judgment may be blurred by “national sentiments” or even “patriotic loyalty”.

Sovereign rating committees are composed of analysts of many different nationalities who live and work all over the world. Their common link is their desire to apply Standard & Poor’s criteria fairly and in an even-handed manner. These analysts are bound by a Code of Conduct that requires them to follow company policies, procedures and ratings criteria and to report deviations. Before committees are commenced, chairpersons ask participants to declare conflicts of interest.

Apart from these formal safeguards, committee discussions are wide ranging and lively—while open to others’ views, committee participants are not afraid of advocating and defending their own. “Going soft” on a sovereign for reasons of “home bias” would expose any proponent of that idea to strong criticism. In summary, attendees of a Standard & Poor's sovereign committee would not in any way recognize the authors’ claim of institutional partiality or “home bias”.

Similarly incorrect is the claim that a chair can “overturn” rating outcomes. At S&P, committee outcomes are gospel. An analyst discussing a sovereign credit in committee spends hours preparing written and tabular materials for committee consideration. Each voting committee member has one vote. The chair has no veto power. Aside from the strong reaction of committee members, were a committee chair (or anyone else) to disregard the vote of the committee, the controls that Standard & Poor’s has put into place to monitor such an occurrence would come into effect.

We reject the authors’ “one-size-fits-all-agencies” algorithm not only for its unsupported premises and substantive deficiencies, but also because it does not seek to offer what a Standard & Poor’s rating does: a forward-looking opinion about future creditworthiness. The authors’ “home bias” claim is supported neither by their algorithm nor by fact. And their theories of “patriotic loyalty” and the like show very clearly that they have not studied their subject.