
MMA Research Seems to Counter Some Concerns About S&P Ratings.

Municipal Market Advisors' recent research on ratings seems to counter recently raised concerns that Standard & Poor's ratings for some local governments may be too high and out of step with current credit conditions.

Tom Kozlik, an analyst with Janney Capital Markets, expressed these concerns in a report last month and suggested S&P's higher ratings would increase the potential for rating shopping among issuers. Nuveen last December expressed concerns about S&P upgrades of tax-backed municipal credits during the Great Recession.

But MMA's ratings research, published in an article in its latest Weekly Outlook, provides a different view. MMA summarized the results of its recent survey of split ratings from S&P and Moody's Investors Service on the same municipal bonds, as well as an examination of market share among the rating agencies.

"This is just data," said Matt Fabian, an MMA managing director, "I think it shows, at a minimum, that if S&P is trying to use its ratings to increase its market share, it's not working."

MMA said the prevalence of split ratings increased to 46% in mid-August from 43% in November of last year. The advisory firm looked the universe of 108,000 outstanding municipal Cusips with ratings from both Standard & Poor's and Moody's Investors Service that were uninsured, non-refunded, fixed rate, and with an investment grade rating from Moody's as of Aug. 15 and compared those results to a similar survey it did as of Nov. 27, 2013.

"Consistent with the last time, split ratings are more likely at lower rating categories, with S&P more often the provider of the higher rating," MMA said.

In addition, MMA found rating splits have increased at different rates in different rating categories as of the third quarter of this year. For example, 54% of Cusips with a Baa1 rating from Moody's had a different rating from S&P, compared to 43% last year.

Until now, many market participants have contended that S&P's upgrades on its methodological adjustments and Moody's bearish view on fundamental credit quality would help S&P catch up to the higher ratings produced by Moody's recalibration in 2010, MMA said.

But this latest "data imply that S&P's ratings continue to move up and away from Moody's," the advisory firm said.

However, MMA said, "At this point, we caution against thinking that S&P's ratings, in being higher, are necessarily less accurate. To the contrary, MMA believes that, in an asset class with such low default and impairment experience, higher ratings are better supported by the data."

General obligation bonds have a default rate over the last year of 0.03%, with default defined as an “ongoing, uncured payment default on bondholders,” MMA said.

Defaults of tax-backed appropriation credits are more prevalent, but are still only 0.23%. The default rate is 0.03% for water/ sewer bonds and 0.06% for electric power bonds, the advisory firm said.

MMA said that S&P’s higher ratings may result from a difference in methodologies, especially with respect to loss-given-default expectations and perceptions of willingness to pay dynamics, as well as a more optimistic view of fundamental credit vectors. But it said it “find[s] little evidence” that S&P is trying to buy market share.

“In fact, the opposite appears to be occurring,” the advisory firm said. Market share for S&P this year is 81.3%, compared to 72.1% for Moody’s and 48.8% for Fitch Ratings. But while Moody’s is 9.2 percentage points behind S&P, it lagged behind S&P by 7.9 percentage points last year. Fitch’s market share gap with S&P has widened to 32.5 percentage points this year from 32.0 last year. For uninsured bonds, Moody’s and Fitch have actually closed their market share gaps with S&P slightly compared to last year.

MMA suggested that Moody’s may be becoming less negative in its ratings.

“There’s been a slowing pace of downgrades compared to upgrades in recent quarters, suggesting greater stability and marginal improvement in overall sector quality,” the firm said.

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