"The Private Roots and Public Branches of Regulation-by-Information: Understanding The Legal Incorporation of Rating in Finance and Accreditation in Healthcare (1900s-1970s)"

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ABSTRACT

This dissertation lies at the intersection of economic sociology, political sociology, and organizational sociology, and examines broadly, the emergence and transformation of regulation-by-information—a form of regulating producers through information products without specifying enforcement mechanisms. Existing scholarship emphasizes the effects and effectiveness of regulation-by-information above all. It neglects the processes through which regulation-by-information emerged and changed through time, and consequently, it fails to conceptualize and explain this kind of regulation. This dissertation addresses these gaps by tracing the evolution of two systems of regulation-by-information and their operators: rating and securities rating agencies in finance, and accreditation and hospital accreditation organizations in healthcare, in the United States. Using theories on the state regulation of industries and theories of institutionalization, and data on congressional records and hearings about the legal recognition of certain private rating and accreditation organizations, organizational histories and accounts, examinations of industry publications, and newspaper articles, I examine the emergence of securities rating and hospital accreditation as mainly private enterprises and their transformation into increasingly public endeavors, culminating with the legal incorporation of their sources. This study traces the history of legal incorporation to reveal the political and cultural struggles surrounding the emergence and transformation of regulation-by-information. I argue and show that the organizational identity work of rating agencies and accreditation organizations—how they presented their product and themselves—contributed to their successful institutionalization, their regulatory power, and their selection for incorporation into government rules and regulations.

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Ailelerim icin

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CHAPTER 1

Introduction

The Power of Information in Regulation

Ratings have become a symbol of the power of information to regulate lives. They are condensed ways of presenting information about people, organizations, or their products and activities. They take different forms and come from different sources. However, only some of these ratings have gained tremendous regulatory power over the lives of individuals and organizations as they evaluate compliance with certain standards of behavior. Most scholars and analysts regard ratings' regulatory power an inevitable, natural and functional response to conditions of increasing market expansion and uncertainty. This project examines the evolution of ratings and their sources for two large sectors—finance and healthcare—in the United States. In both fields ratings with regulatory power come from a few specialized private agencies.

The recognition by law of those few specialized private agencies - credit rating and hospital accrediting agencies respectively - as legitimate sources of information to evaluate organizations' worth, is a key moment in the history of ratings for both fields. How and why were specific private agencies recognized as legitimate sources of ratings instead of alternative governmental or professional forms of regulation? How did ratings gain their regulatory power over healthcare and financial organizations? What was the role of the state and law in the emergence of ratings as a new institution? How did their meaning change over time? The answers to these questions will highlight institutional configurations without neglecting the agents that make possible their maintenance, change and stability. They also contribute to the demystification of new regulatory forms as inevitable, natural and functional outcomes necessitated by conditions of uncertainty and increasing market expansion. The comparison of two different fields helps reveal the interdependences of different fields and the crucial role policy makers play in shaping new forms of regulation: legitimizing them, contributing to their implementation, and mediating their power to shape social life.

This project combines data on congressional records and hearings about the formal recognition in federal legislation of certain specialized private agencies as legitimate sources of ratings, organizational histories and accounts, examinations of field specific publications, and newspaper data to trace the processes through which regulation-by-information emerged as a new institutional form in two major fields of activity in the US. It uses theories of institutional emergence to examine the political and cultural struggles surrounding the emergence of ratings by certain specialized private agencies as regulation-by-information and the sidelining of alternative sources of ratings like associations or government agencies. The project aims to clarify the meaning of ratings, the conditions under which they constitute 'regulation-by-information,' and present a more coherent framework for examining other emerging forms of regulation.

Motivation for the Study

Regulation and its Discontents

The most widespread understanding of regulation in scholarly as well as non-scholarly work is that of an activity initiated, conducted, and propagated by the state through legislation and its own rule-making agencies. In the sociology of markets, for example, the debate over regulation becomes one about the degree of government involvement into processes of market making and redesign through laws that shape competition and market participants' behavior (Fligstein 1990, 2001; Abolafia 2001; Dobbin 1994). Economic sociologists following Polanyi (1944) and Schumpeter (1947) point out the historical specificity of thinking about markets as self-regulating institutions that need to be left alone, as natural perfect ways of coordinating relationships through competition and the motive of gain. They argue that planning and regulation by the state are necessary conditions for the successful operation of markets, as well as for ensuring freedom and justice in society.

Therefore, the sociological debate over regulation is part of a broader literature on the relationship between the state and the economy. Scholars recognize the emergence of the nation state and the capitalist economy as two intertwining interdependent processes (Collins 1990; Weber 1948; Polanyi 1944, Schumpeter 1947; Tilly 1990; Mann 2012), but the relative contributions of each dynamic remain contested. They regard the command-and-control form of regulation as the most consequential (intentionally or unintentionally) for markets and industries (Schneiberg and Bartley 2001; Dobbin 1994; Polanyi 1944). Polanyi (1944), for example, noted that the Speenhamland law in England aimed to prevent the creation of a labor market but ended up fostering it instead, by creating paupers in the countryside who later became the labor force for corporations. Furthermore, state officials with their policy-making capacities, were at the center of the 'double movement', either following the principle of economic liberalism or that of social protection (Polanyi 1944, 138). Fligstein (1990), for instance, shows how antitrust laws pushed managers to diversify their products and forced mergers. Similarly, Dobbin (1994) attributed differences in state regulatory styles, modes of market intervention, and firm organization, to the combination of different state policies. Even more recent work by Schneiberg and Bartley (2001) and Fung, Graham, and Weil (2007) concentrates on explaining state regulation of industry and markets, above else.

While the state-market relationship remains at the heart of debates on regulation, scholars argue that the political, economic, and cultural processes of globalization have transformed regulatory environments, highlighting new forms of regulation that go "beyond bureaucratic enforcement" (Schneiberg and Bartley 2008). The role and capacity of the state have changed, markets have expanded exponentially, and communication technology has increased awareness of the similarities among different communities through enabling shared experiences and movement of people across borders (Waters 2001; Beck, Giddens, and Lash 1994; Campbell and Pedersen 2001; Guillen 1994).

Scholars calling for the examination of new regulatory forms recognize multiple sources of regulation, highlighting the practices of both state and non-state actors. "Capitalist enterprise does not lack regulators," argues Schumpeter (1947, 195), as both state regulation and self-regulation through monopolistic and oligopolistic strategies are necessary stabilizing adaptations during depressions. Many studies highlight how industries and professions are producers, not only consumers, of regulation: generating their own rules, standards, and codes of practice that affect governance of policy issues (Bartley 2007; Braithwaite 2000; Gorman 2014; Gunningham and Rees 1997; Evetts 1998; Schneiberg and Bartley 2008; Faulconbridge and Muzio 2008; Seabrooke 2014). Current research draws attention to the increasing role of transnational social movements and organizations in shaping private regulation (Bartley 2007; Faulconbridge and Muzio 2008; Seabrooke 2014; Suddaby, Cooper, and Greenwood 2007; Hale and Held 2011; Jacobsson and Sahlin-Andersson 2006). It also recognizes the need for mediating institutions like communities and local organizations that connect state and industry regulation (Gunningham and Rees 1997; Sabel, Fung, and Karkkainen 1999; Braithwaite 2000; Whelan and Ziv 2012).

Recent work emphasizes the need for a holistic view of regulation that examines the *variety of forms* regulation takes and seriously considers the *interactions* between private authority and public authority shaping these different forms. New forms involve configurations of multiple actors and redefinitions of organizational roles and identities (Braithwaite 2000; Gunningham and Rees 1997; Sabel 1994; Sabel, Fung, and Karkkainen 1999). They constitute nested and networked regulatory frameworks, that require attention as instances of co-regulation i.e. constellations of regulators and rule-makers—not purely state regulation or self- regulation (Braithwaite 2000; Schneiberg and Bartley 2008; Healy and Braithwaite 2006; Jacobsson and Sahlin-Andersson 2006; Gunningham and Rees 1997). In a recent review of the literature, Schneiberg and Bartley (2008) point out four new forms of regulation - regulation for competition, regulation by information, trade regulation by permits and caps, and soft law and experimentalist governance. They call for more attention to the practices that made possible these new forms and their interconnections.

Existing work on new forms of regulation emphasizes their functions and effectiveness (Seidman 2007; Hale and Held 2011; Trubek and Trubek 2005; Sabel, Fung, and Karkkainen 1999; Sabel 1994; Espeland and Sauder 2007) and explains their existence in terms of the challenged sovereignty and regulatory capacity of the state under conditions of crisis, increasing uncertainty, and globalization (Braithwaite 2000; Bartley 2007; Abbott and Snidal 2000; Hale and Held 2011; Fung, Graham, and Weil 2007; Krippner 2012). Bartley's (2007) study is one of the few attempts to highlight the cultural and political *processes* through which a new form of regulation by transnational private authority—certification associations in the forest products and apparel sectors—emerged. He considers social and environmental certification systems as negotiated compromised results i.e. settlements of political contention, rather than simply solutions to collective action problems. Another attempt is Sabel and Zeitlin's (2008) outline of the emergence of what they call 'experimentalist governance' in the EU—a new form of rule-making that relies on periodical revision of the framework goals, performance measures, and decision-making procedures by actors at different levels in the EU system. They trace this framework to the requirement that lower-level actors (e.g. regulatory bodies of Member States) share information and make oneself subject to peer review in return for their autonomy in implementing standards established by higher-level actors (e.g. Member States and EU institutions).

Although scholars from different disciplines call for more attention to new forms of regulation, few examine empirically and systematically the emergence of new regulatory forms as institutions within the existing regulatory framework. They do not carefully identify the processes of negotiation and political contention through which different actors made *alternative* forms of regulation either unthinkable or futile, to establish the new form. Existing research remains limited to a particular social sector or a specific instantiation of a new regulatory form. Consequently, it fails to acknowledge how the meaning of a form changes through time as a result of developments beyond one particular field of social activity.

My project contributes to this conversation by tracing the emergence of a new form of regulation—regulation-by-information. Regulation-by-information describes systems, operated by private or public sector actors, that rely on the collection, processing, and presentation to a broader public, of the information organizations disclose about themselves[1] to regulate their

[1] This disclosure can be voluntary but also required, and it can be made through formal or informal channels.

behavior without specifying sanctions (Schneiberg and Bartley 2008). Ranking systems and labelling initiatives are some examples of regulation-by-information.

Considering regulation as an institution, I highlight the processes through which alternative forms of regulation are sidelined and the new regulatory form is institutionalized i.e. becomes a taken-for-granted 'natural' solution to a problem or an institutionalized myth (Meyer and Rowan 1977). As the conceptualization of new forms of regulation is at its early stages, I examine the processes of institutionalization in two different social sectors or fields of activity. A comparison of dynamics between two different fields clarifies these forms and starts delineating a sociological framework for the study of new forms of regulation.

This dissertation research project focuses on the emergence and transformation of 'regulation-by-information' in healthcare and finance, more specifically examining the evolution of rating and accreditation and their role in these fast-changing sectors in the United States. As distinct fields of activity, healthcare and finance differ in many respects: the kind of professional identities involved (e.g. physicians compared to bankers), the type of services offered (e.g. health compared to money), and how evaluations and adjudications are given and used (e.g. in accreditation form compared to the ratings form). The evaluation of compliance with certain standards of behavior in both fields—rating in finance and accreditation in healthcare—are similarly performed by a few specialized private agencies—the trio Moody's, Standards and Poor, Fitch and the Joint Commission, respectively. Despite differences, I note how rating and accreditation as information management systems have transformed in both fields: from being mostly privately operated—by specialized private agencies—to becoming increasingly publicly operated—through their legal incorporation in government rules and regulations. It is in this form private-to-public form of regulation-by-information that rating and accreditation have become highly visible and powerful regulatory mechanisms in each field—sidelining alternatives like rating and accreditation offered by government agencies or by professional and business associations.

Why and how did the private-to-public form of regulation-by-information emerge? Why was the evaluation of producers' trustworthiness in both fields left to these specific private agencies, which followed their own standards, instead of being conducted by business or professional associations or the government agencies? These questions motivate my proposed study. I draw attention to the way in which regulation-by-information—rating and accreditation systems of information management—have changed through time, constituting a new form of regulation nearly at the same time, through fairly similar processes, in two different fields. While ratings have a longer history in finance, their emergence as a new form of regulation happens earlier in time in healthcare—in 1965 with the Social Security Act Amendments (Medicare legislation specifically) for the former and in 1975 with the Securities Act Amendments for the later. Furthermore, ratings in healthcare have undergone not only changes in meaning as in finance, but also in form—as decisions for accreditation, certification, and list of top performers in quality reports, rather than just one kind of rating given to financial products. These cases are puzzling in that they both show how a form of regulation originating in the private sector—rating—remains framed as such even after state's involvement in its development as regulation-by-information. Tracing the processes that sidelined alternative forms of regulation and contributed to rating's and accreditation's transformation into a form of 'regulation-by-information' can shed light into the meaning of public and private regulation.

Understanding the processes through which new forms of regulation like regulation-by-information become institutionalized is a pressing matter, for sociologists as well as policy makers. For policy makers, it raises awareness of their own role in shaping new forms of regulation: legitimizing them, contributing to their implementation, and mediating their power to shape social life. Examining the political and cultural struggles through which new forms of regulation take shape demystifies these forms as inevitable, natural and functional outcomes necessitated by conditions of uncertainty and increasing globalization. For sociologists, it offers a context to use institutional analysis as a way of identifying specific mechanisms of change and stability. Most importantly, analyzing institutional configurations without neglecting the agents that make possible their maintenance, change and stability, helps substantiating arguments about the importance of institutional alignment and complementarity compared to diversity and decoupling among elements of institutions (Schneiberg and Clemens 2006; Greenwood et. al. 2011; Schneiberg 2013). Furthermore, it provides a basis for better understanding the permeability of field boundaries and its role for institutional change (Greenwood and Hinings 1996).

My empirical project helps better understand the evolution of important governance mechanisms—regulation-by-information by legally-incorporated specialized private organizations—in two key sectors: healthcare and finance. The stakes are high in these fields as one deals with human health and the other with the health of the economy. Furthermore, the processes of medicalization and financialization are two important forms of rationalization defining late stages of modernity. These sectors share the problem of establishing trust under uncertainty and continuous expansion, which are key issues in the debate on regulation-by-information and more specifically ratings' role in addressing these problems. Among others, my proposed study of ratings as regulation-by-information in healthcare and finance aims to highlight the interconnections and interactions between different social sectors that shape what are viewed as distinctive field trajectories.

Organization of Chapters

I tell the story of how rating and rating agencies in finance, and accreditation and accreditation organizations in healthcare, got legally incorporated and gained their tremendous regulatory power in the United States through four empirical chapters—two for each specific case and two more theoretical ones. So, chapter 2 presents the literature and the theoretical framework I work with, to examine the emergence of rating and accreditation and the transformation in the identity of the operators of these information management systems—through their legal incorporation into government regulation—as the private-to-public form of regulation-by-information. Chapter 3 gives an overview of cases—bond rating in finance and hospital accreditation in healthcare, as well as delineates the data and methods I used to answer my research questions.

Chapters 4 and 5 examine the legal incorporation of rating and their agencies in the case of finance. In this field, the oldest and largest sources of rating are two credit rating organizations: Moody's and Standard & Poor. Chapter 4 delineates the process through which rating as a product was incorporated in legislation and how it contributed to its institutionalization. In this chapter, I examine the actions and interactions of rating agencies, government and industry organizations and actors between the early 1900s to the late 1930s. Chapter 5 traces the processes through which rating agencies as the producers of ratings got legally incorporated and what this legal incorporation meant for the institutionalization of the regulatory power of ratings in finance. In this chapter, I examine the actions and interactions of rating agencies, government and industry organizations and actors between the late 1930s to the early 1980s.

Chapters 6 and 7 examine the legal incorporation of rating and their agencies in the case of healthcare. In this field, the oldest and largest sources of rating are two accreditation organizations: the Joint Commission and the Healthcare Facilities Accreditation Program. Chapter 6 traces the processes through which accreditation as a product got legally incorporated and what this legal incorporation meant for the institutionalization of the regulatory power of accreditation in healthcare. In this chapter, I examine the actions and interactions of accreditation organizations, industry and government actors between the early 1900s to the late 1940s. Chapter 7 delineates the process through which accreditation organizations as the producers of accreditation were incorporated in legislation and how this contributed to their institutionalization and transformation of their meaning as powerful regulatory mechanisms. In this chapter, I examine the actions and interactions of rating agencies, government and industry organizations and actors between the late 1940s to the early 1980s.

Chapter 8 concludes with a comparison of both cases: their configurations of actors and relationships, and the paths of their transformation, and the discussion of the implications of my findings for understanding what is called a new form of regulation—regulation-by-information. Most scholarly accounts consider the moments of legal incorporation as the beginning of the regulatory power of ratings in both fields. Their regulatory power is seen as the result of a delegation of regulatory power from the state to private actors—rating and accreditation organizations. However, my study indicates that this is only partially true. Based on my analysis of the archival data I collected for this project from different sources—congressional reports and hearings, organizational histories and industry publications, as well as mass media accounts concerning rating and rating organizations for both fields—I conclude by arguing that the origins of the regulatory power of these ratings and their organizations as well as their legal incorporation owe a lot to the effort of industry actors to view and support these organizations and their product of rating as part of their projects of self-regulation. I also suggest that the way rating organizations built their identity—through doing what I call product work and producer work—as complementary and supplementary rather than competing options to existing industry actors, contributed to being implicitly endorsed by the industry and further recognized by legal incorporation. The comparison of how rating and accreditation and their organizations emerged and became part of regulation in finance and healthcare calls for more careful consideration and theoretical reflection on the nature and meaning of this acclaimed new powerful form of regulation—the private-to-public form of regulation-by-information.

CHAPTER 2

Understanding and Explaining Regulation-by-Information

Literature Review

Regulation-by-Information

A new form of regulation that has attracted some scholarly attention is 'regulation-by-information'. Schneiberg and Bartley (2008) use this term to describe voluntary privately or publicly operated systems that rely on self-reports and the collection of information from the regulated and leave sanctions unspecified, to be determined by the audiences of those regulated (consumers, investors, advocacy groups, etc.). Specific disclosure or targeted transparency regulations (Fung, Graham, and Weil 2007), certification or labelling initiatives (Bartley 2007), and rating and ranking systems (Espeland and Sauder 2016) are mentioned as examples of this new form.

- Figure #1 -

Regulation-by-information is different from other forms like self-regulation and command–and-control government regulation, in that it does not specify mechanisms for the enforcement of standards. All forms have in common the object of regulation, which is generally the behavior of producers of certain services or products. They differ in the source or operator of the system and the enforcement mechanisms the system relies on to regulate behavior. In self-regulation, producers regulate themselves through the production of standards that apply to their activity through associations, trade organizations or other forms of organization (for example, among coalitions of dominant market actors). Through those same organizations, they establish mechanisms for the enforcement of those standards. In command-and-control government regulation, it is the state that creates the standards through legislation, regulation or rule-making through its agencies, and specifies the mechanisms for their enforcement. What distinguishes regulation-by-information from the other forms is that even when producers or the government agencies are the source or operator of standards, their enforcement is left dependent on consumers, clients and other indefinite audiences, which are viewed as information-processing rational actors that make decisions based on available information. It is the power of customers to purchase or not an offered service or product from producers, that regulates producers' behavior and keeps them in check.

As there are no clear enforcers to be held accountable for failed implementation or non-adherence, the creation of standards (and consequently their creators) comes to the forefront of public discussion and attracts increasing contestation. Tensions over issues of accountability become more extensive in cases of regulation-by-information, as customers, clients and broader audiences end up becoming enforcers of standards that they did not contribute to creating in the market for a particular service or product.

- Figure #2 -

Scholarly work on regulation-by-information has focused extensively on its effects, without questioning the nature and the mechanisms through which this phenomenon transforms through time – in form and meaning. How are the creators of standards and the operators of the system affected by the increasing tensions arising when consumers, clients and broader audiences become implicit enforcers of the standards that operators of the system establish? Most importantly, how does the contestation over the creation of standards shape the form and meaning of regulation-by-information through time? What are the implications of such transformation for its regulatory power overall? More research is needed on how the interaction between public and private authority shapes the emergence and transformation of regulation-by-information.

Examining the Effects of Regulation-by-Information

The existing scholarship focuses on the effects that regulation-by-information has on individuals, organizations, and broader communities; more on the targeted or regulated by the system, and the consumers of the products and services (clients or audiences) of those targeted or regulated by the system, than on the operators of the system. Espeland and Sauder (2016) call rating and ranking systems “engines of anxiety” and emphasized their ability to recreate social worlds and produce new inequalities (Espeland and Sauder 2007). Some researchers note how regulation-by-information shapes the social understanding of transparency and accountability (Fung et al. 2007; Espeland and Sauder 2016). Others emphasize its ability to transform uncertainty into risk (Carruthers 2013; Langohr and Langohr 2010). Most studies agree on their ability to transform whole fields of activity and result in tremendous organizational and institutional change (Espeland and Sauder 2006; 2007; 2016; Fung et al. 2007; Hale and Held 2011; Healy and Braithwaite 2006; Hedmo et al. 2006; Sabel et al. 2000; Sabel 1994; Suddaby and Greenwood 2007; Wedlin 2006).

a. On the targeted or regulated by the system

The system of evaluation and adjudication that constitutes regulation-by-information affects primarily those evaluated and ultimately implicitly targeted or regulated by the system. These are the organizations or individuals (as producers of certain products and services) that disclose information about themselves to operators of the system (evaluators and creators of standards) and receive from them adjudications about their behavior (to be used internally or to be presented to broader audiences). Fung et al. (2007) examined transparency policies and found that they could effectively organize the activities of targeted organizations when their reporting process was easy to use and sensitive to disclosers' capacities and inclinations. Studies of credit rating agencies noted that municipalities and corporations during times of crisis used credit ratings to market their bonds and distinguish them from others not safe to invest in (Carruthers 2013; Alcubilla and del Pozo 2012; Langohr and Langohr 2010). Some organizations and communities issuing financial products were pressured to disclose information about themselves, following standards that were not clear and they did not have a say in setting up (Carruthers 2013; NPO 2013).

One of the most comprehensive sociological studies of the effects of regulation-by-information examines how media rankings shaped the field of law schools and legal education broadly in the United States (Espeland and Sauder 2016). Researchers showed that rankings discipline in the Foucauldian sense through the mechanisms of surveillance and normalization, creating anxiety, allure and resistance for the evaluated organizations in the field, which led into changing their organizational identities and even their relationships with other organizations and their audiences (Sauder and Espeland 2009; Espeland and Sauder 2016). Some law schools reacted to the rankings by developing ways of cheating the system shaping their reports and disclosures about themselves so that they either improved their ranking or kept it from falling behind. Rankings ended up contributed to either helping or damaging targeted organization's reputation and identity building efforts.

b. On the consumers (clients or audiences) of the products and services of the targeted or regulated by the system

Regulation-by-information affects also the various audiences of the targeted or regulated organizations—consumers of their products and services and other stakeholders and broader publics—by entering as a factor in their decision-making. Major examinations of credit rating agencies noted that, during times of crisis, credit ratings helped investors assess risk (Carruthers 2013; Alcubilla and del Pozo 2012; Langohr and Langohr 2010). Sauder and Lancaster (2006) found that even a small change in the rank given by the *U.S. News & World Report* affected the number of applications to American law schools. Other studies of rankings in the education field, mainly looking at law schools and business schools, also noted that students used rankings to make decisions about schools they wanted to apply to, as they felt they were in a context without enough reliable information (Espeland and Sauder 2016).

Some scholars emphasize the positive effects and others the absent or negative effects of regulation-by-information for consumers. For example, based on the findings of their study on nursing homes in Australia, Healy and Braithwaite (2006) argued that regulation tailored to the context and culture of those being regulated and involving more persuasion, deliberation, and dialogue, than coercion (what they call "responsive regulation"), could improve not only nursing homes' compliance but also the quality and safety of the care patients received. Looking at the certification schemes in the apparel and garment industry, Seidman (2007) concluded that these new forms of regulation alone were not able to protect workers and guarantee their rights. Espeland and her colleagues (1998; 2006) just point out the processes of commensuration and self-fulfilling prophecy through which rankings produce their effects in the behavior and responses of organizations and their member.

c. On the operators of the system

Existing literature has not examined as extensively the effects of regulation-by-information on those that operate the system of evaluation by creating and maintaining standards—rating or evaluating organizations. Scholars show that the number of evaluators matters for the extent of their effects. For example, the impact of rankings for MBA programs was attenuated by the existence of multiple raters (Hedmo et al. 2006; Sauder and Espeland 2006).

As a result of this gap, researchers neglect an important venue for the transformation (in form and meaning) of regulation-by-information: the changes in its operator, and fail to conceptualize the phenomenon with the variety of its instantiations. How are the producers of the system, that is the sources of regulation-by-information, shaped by the operation of their own system and their interaction with users and other audiences of the system? What explains their transformation, and what does it tell us about the emergence of regulatory power?

Recognizing and Explaining the Variety of Regulation-by-Information

Scholars have implicitly recognized the variety of regulation-by-information by examining different kinds of systems of evaluation and adjudication to understand regulation-by-information. They have studied disclosure or reporting (Fung et al. 2007; Olegario 2003; Cohen 2012), rating (Cohen 2012; Carruthers 2013; Langhor and Langhor 2010; Alcubilla and del Pozo 2012), ranking (Espeland and Sauder 2016; Hedmo et al. 2006; Sauder and Espeland 2006; Wedlin 2006), and certification or accreditation systems (Seidman 2007; Bartley 2007; Hedmo 2004).

However, researchers have examined these systems individually, without examining their relationship to each other as different instantiations of the same phenomenon: regulation-by-information. Some studies examine the same kind of regulation-by-information in different fields, sectors, or industries, but not with the aim of theorizing and conceptualizing the particular form they examine (Bartley 2007).

The first venue for taking seriously the variation of regulation-by-information that studies of regulation-by-information point to, lies in examining the differences in the systems of evaluation and adjudication involved in regulation-by-information. This enterprise involves recognizing disclosure or reporting, rating, ranking, and certification or accreditation systems as different products resulting from certain kinds of information management or work. It requires a careful look at the process through which information is handled and new information products emerge.

The second more neglected venue for examining the variation of regulation-by-information in the existing literature involves the studying of differences in the operators of the systems of evaluation and adjudication entailed in regulation-by-information. Researchers taking this path would focus their attention on those that handle information to produce new information products: the organizations that do the evaluation and adjudication for other entities through managing information about them. They would put at the center of their analysis and highlight the emergence and transformation of these organizations that produce different forms of regulation-by-information: disclosure or reporting, rating, ranking, certification systems. They would also trace the transformation of operators or producers as a result of the reception of the product they produce by customers and other audiences.

Both venues are important for fully understanding the emergence and transformation of regulation-by-information, as products and producers shape each other. Certain products become powerful enough to shape an organization's identity as producer (securities rating). And certain kind of organizations or producers with certain kinds of identities end up producing only certain kinds of products (e.g. Islamic banks, sustainable fish producers, etc.)

However, I will follow the second venue for recognizing the variety of regulation-by-information as the literature's neglect of operators and producers of the systems of evaluation is much more extensive. Understanding how the transformation of evaluators affects the meaning and form of regulation-by-information has broader implications for our understanding of the phenomenon. Evaluators are the makers of standards, either explicitly by creating and formalizing them or implicitly by using them in making adjudications about the worth and value of an entity. These producers of standards are the key operators of the system of evaluation and adjudication entailed by regulation-by-information.

The existing lack of attention to the role of operators or producers of the systems of evaluation and adjudication involved in regulation-by-information could be due to the fact that the phenomenon is recent. Attempts to understand and put a name to the phenomenon started with Schneiberg and Bartley's (2008) article in the *Annual Review of Law and Social Science*.

This gap could also reflect the tendency to emphasize the commonality of all of these systems, that they manage information by gathering, processing, and presenting it, rather their distinguishing features. I argue that highlighting the variety of regulation-by-information means recognizing the social, political, and cultural nature of information management or work.

Variation by System or Producer

Regulation-by-information has many instantiations because it involves several kinds of information management activities: information gathering, information processing, and information presentation. While these processes of managing and using information are interconnected, each system ends up being recognized by the kind of information product that results from such information work.

- Figure #3 –

a. Disclosure or Reporting

Disclosure is the practice of making certain knowledge about oneself available to a broader audience in a written form in order to make them aware of your activities. Some scholars consider the release of specific information a voluntary process, arguing that it enhances communication by respecting the 'rights' of the releasing entity to select the content and extent of self-report[2]. In their view, disclosure makes complex practices of organizations more transparent to those who are impacted by their services or products (Fung et al. 2007).

Reporting systems are not new to different kinds of organizations; what is new is that they are not internally designed and implemented to enhance their performance as individual organizations, but externally required by another entity or set of entities in its broader environment (Cohen 2012; Fung et al. 2007). As audiences and environments become more diverse and numerous for organizations, enforcement of disclosure and evaluation of its implementation is left unspecified (at least in written form), though this does not mean that implementation remains voluntary through time.

Disclosure or reporting is a prerequisite for all other forms of regulation-by-information. It involves the minimal amount of information work by the operator of the system: designing

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[2] The voluntary nature of disclosure is questionable. Many times disclosure is required either formally through regulations or informally through market pressures. It reflects the position of actors in a particular field of power. Dominant market actors can disclose more because of their extensive resources as well as their ability to collect, process, and advertise information about themselves more easily. Fung et al. (2007) noted that powerful actors used disclosure required by government regulation to compete or cooperate over a shared interest/concern. Non-dominant actors would feel compelled to disclose, if dominant actors or the majority are doing so. Espeland and Sauder (2016) found that many law schools ended up providing information to the *U.S. News and World Report* media ranking agency, even though they resisted it at the beginning. The alternative to disclosure is being seen as having 'missing data'. In an age of information, this can have negative connotations and repercussions for organizations.

ways of gathering information by the targeted organizations. The collection of information can be done through designing questionnaires or surveys or in less formal ways, leaving the content and extent of self-report unspecified (Olegario 2003). The organization that operates the disclosure or reporting system organizes the collected information, and maybe puts it into summary form as needed. Such information processing, however, is limited, and depends on the extent to which the operator has specified the content to be reported. The information collected is made available as it is, or with limited changes to consumers and other audiences. The operators of the system offer a platform for gathering and presenting information but do not evaluate those reports and give feedback to the targeted or reporting organizations as a result of their disclosure.

b. Rating

Rating is the practice of evaluating the extent to which individuals, organizations, and their products or services are in line with some implicit or explicit standards of quality and performance[3]. This evaluation is based on information gathered *about* them, not only from them through self-reports and other informal investigations, but also from other diverse sources (Alcubilla and del Pozo 2012; Cohen 2012). Rating systems, therefore, rely on disclosure or reporting systems, but do not depend on them completely, as the information considered relevant to the evaluation is less specific.

Rating systems are characterized by extensive information processing, using formal as well as informal analysis for the evaluation of gathered information (Langohr and Langohr 2010; Alcubilla and del Pozo 2012). The adjudication is made based on the application of implicit and explicit standards, which are generally not clear to the entities evaluated. Information processing

[3] The standards used to evaluate entities can be either formal or informal. Rating does not require formal standards, in the sense of an agreed-upon set of characteristics that are considered best-practices or necessary by a community for an entity to have. However, rating requires informal standards, in the sense of an implicit understanding that certain features of an entity are of more interest than others, though there was no formal list of them.

is central to rating and it consist of condensing information into summary forms and standardizing it to some extent.

Operators of rating systems do considerate work on the way in which information is presented to audiences, that is their information product. They provide summary reports that vary in length as well as standardized symbols that represent their final adjudication. Their information products are made available to interested audiences, including the evaluated entities. However, it is the symbols that are the most accessible to most audiences, rather than the more detailed summary reports (Carruthers 2013). The accessibility and visibility of their information products to the broader public, either other producers or consumers of a service or product, has changed through time and context (NPO 2013).

c. Certification

Certification is the practice of evaluating an entity and its activities and adjudicating a certificate or label as a symbol that it met an explicit set of standards of quality and security considered necessary in the field. The certificate or label as a symbol represents a set of standards about quality and performance agreed upon by several actors interested in keeping each other accountable and legitimizing certain activities and practices over others. Therefore, it informs the public about the quality of activities and processes involved in the production of a certain service or product by an organization or other entity, as it is approved by a particular community.

Operators of certification and labelling systems do extensive work on collecting information about the entities to be evaluated. They generally rely on self-reports made through formal designed surveys or questionnaires as well as on-ground formal or informal investigations of the entities to be evaluated. The information gathering process is not very challenging as the entities evaluated tend to demand this certification service from operators of the systems. An entity would not be certified if it did not ask to be evaluated by a certification organization. Furthermore, certification systems are more specific on the kind of information that is considered relevant and is being gathered for evaluating the targeted entity.

The gathered information undergoes formal analysis and is evaluated by the certifying entity using mostly explicit standards. The evaluator decides on whether the evaluated meets each standard and finally whether it meets enough standards to be considered worth of its approval, that is the symbol of quality and security that is a certificate or label. The final adjudication requires the application of an explicit threshold, the minimum amount of standards that indicate trustable quality of an evaluated entity.

The result of information processing involved in certification systems is a certificate or label or approval that the evaluated organization carries to show its audiences compliance with certain standards. The information product offered by operators of these systems is a summary detailed report as well as the fixed symbol showing approval by an evaluator. The symbolic form of the certificate or label, rather than the lengthier evaluation report, is the most accessible to the other interested audiences. Furthermore, its visibility depends on the evaluated entities actions and efforts to use it in public spaces.

What makes certification a form of regulation-by-information is the fact that consumers and other public actors, can use this information to make decisions regarding a particular service or product. Their increasing visibility among a broader public, larger than the field of producers, creates a different source of regulatory power: consumers, not just producers[4].

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[4] The reverse also can happen where certification is provided to keep track of consumers. For example, consumers who want to buy marijuana for medical use in MA, need to be certified by their physicians. The Medical Use of Marijuana Program offered by the government's Bureau of Health Care Safety and Quality and the Department of Public Health certifies physicians, who then certify patients (and also register their personal care givers) and the marijuana dispensaries that can serve these patients. The information this certification indicates is used by the government (who tracks marijuana users and distributors) but also by consumers (who can go to certain certified physicians and dispensaries) (for more see https://www.mass.gov/medical-use-of-marijuana-program).

d. Ranking

Ranking is the practice of listing an institution or their products according to their degree of compliance with a set of explicit or implicit standards of quality and performance, generally in decreasing order: from the ones with the higher level of compliance at the top to those with the lowest level of compliance at the bottom. It relies on considerate efforts of information gathering from the evaluated entities: using publically available information about them, as well as self-reports or answers to specific surveys or questionnaires and other requests for information. Operators of ranking systems are generally more specific about the kind of information they will consider for evaluating the targeted entity. Similar to operators of rating systems and in contrast to those of certification systems, they tend to evaluate and rank entities irrespective of their request or desire to be evaluated and ranked (Espeland and Sauder 2016).

The evaluators use formal analysis to process the collected data. They rate quantitatively each entity based on mostly explicit, but also implicit, standards. The evaluation involves summarizing and standardizing information into numbers for a set of categories considered important to take into consideration in the evaluation of the overall quality or performance of that entity.

Rating systems result in numbers as the standardized form of representing condensed information, which allows mathematical computations. However, the ultimate information product they offer is a rank—an ordinal position among all evaluated entities. Their information product of the overall rank is accessible and generally available to most interested audiences. They are mostly public and updated with certain regularity.

Rankings use numerical ordering to confer the hierarchical nature of a particular field of organizations and their product. They imply the need to compare and consider each organization within a particular field, evaluating its activities by looking at its position in that field. However, rankings offer a linear way of thinking for users—either you are up or down in the list—hiding other kinds of relationships that structure a field of activities. They produce this new form of knowledge by gathering, processing, and transforming information from different sources.

Though what they do is relatively simple, rankings have gained importance and are used widely in different fields. The sociological literature on regulation-by-information has gained momentum with a series of studies on rankings. Scholars in this stream of research consider them as 'one kind of public measures of performance' (Sauder and Espeland 2009), 'quantitative evaluative social measures' that serve as signals of quality (Sauder and Lancaster 2006), and more broadly an instance of the general process of quantification i.e. the production and communication of numbers (Espeland and Stevens 1998; Espeland and Vannebo 2007). Most studies examine their role in the field of higher education, but to understand them fully as forms of regulation-by-information scholars need to look at other organizational fields, either with similar or different attributes than higher education.

Variation by Operators

The literature on regulation-by-information emphasizes the activities that make up each system of managing information, implicitly considering the operator of the system as not having implications for the form this phenomenon with take, that is, its instantiations. In their conceptualization, Schneiberg and Bartley (2008) indicate that the information management systems involved in regulation-by-information can be either publicly or privately operated.

The majority of studies on regulation-by-information examine the different systems of information management as mostly privately operated—either by producers, associations, or private specialized evaluation organizations. Those that identify a different operator of the system like the government and its own organizations, tend to portray the operator as static and not changing through time. The few studies that recognize the transformation of the operator of the system involved in regulation-by-information, do only so in passing, without reflecting on the implications of such transformation for the information management system and the meaning of regulation-by-information.

- Figure #4 –

a. Remaining Mostly Private

Scholars tend to focus on the privately operated systems of information management involved in regulation-by-information. Studies of credit reporting, rating and ranking systems note the role of certain private firms like the Dun and Bradstreet, Moody's, and *U.S. News* respectively, in beginning such activities (e.g. Cohen 2012; Olegario 2006; Carruthers 2013). Research on certification systems also underlines their origins in the private sector, as an attempt for private sector actors to regulate themselves and either avoid or preempt government intervention (Bartley 2007; Gunningham and Rees 1997).

Studies see regulation-by-information mainly indicating the rise of private authority in the context of neoliberalism. Bartley (2007) considered certification systems in forestry and apparel sectors as instances of self-regulation, a phenomenon well-known for industries or professions i.e. non-state actors (Gorman 2014; Evetts 1998). Gunningham and Rees (1997, 399) suggested considering certification organizations as mediating institutions between public and private authority whose moral primacy results from how close they are to the regulated. Carruthers (2013) also talks about rating agencies in finance as an example of the rise of regulation by private sector actors, arguing that they were invented in the 19th century to transform uncertainties into risk—making the incalculable controllable and calculable.

Existing research implies that the privately operated systems remain as such through time. While it is worth examining the private roots of these systems, more studies need to trace the evolution of their meaning, their operators or sources, and regulatory role within a field of activity. The proliferation and increasing visibility of their operators can transform the form regulation-by-information takes: disclosure or reporting, rating, certification, and ranking, as well as its meaning for the regulated and their audiences.

b. Remaining Mostly Public

Literature on publicly operated systems of information management involved in regulation-by-information is scarce, most probably because those systems are considered under the umbrella of government regulation. For example, in their book *Full Disclosure,* Fung et al. (2007, xiii) coined the term ‘targeted transparency regulation’ to talk about government regulation that requires disclosure of specific information from organizations interested in a common area of activity. They survey 18 policy episodes, the majority of them in the US, under two main policy objectives: risks reduction to public (e.g. Disclosing Corporate Finances to Reduce Risks to Investors; Disclosing Medical Mistakes to Reduce Deaths and Injuries) and performance improvement of critical services through quality and fairness checks (e.g. Disclosing Union Finances to Minimize Corruption; Disclosing Lending Practices to Reduce Discrimination). However, the book implies that the kind of information management system in place affects the efficacy of regulation and its implementation. Fung et al. (2007) argue that to effectively collect this information and ensure implementation, transparency regulations need to make reporting simple and easy for disclosers, and offer feedback on the efficacy of their disclosure through generating improved updated information on the implementation.

Existing studies of regulation-by-information that emphasize the role of public operators, assume that their meaning and form remain the same through time. Many scholars acknowledge the transformation of states' capacity and power, and what is expected from them (Krippner 2012; Braithwaite 2000). However, few acknowledge the implications of these changes for the meaning and form of regulation-by-information systems it operates. Braithwaite (2000) views the emergence of publicly operated systems of regulation-by-information as the consequence of the spread of a logic of risk management and the pressures on states created by the innovations of communication and technology.

c. Transforming from Mostly Private to Increasingly Public

There are few studies on the emergence of a particular kind of regulation-by-information that acknowledge the increasing involvement of public authority in the operation of what were mostly privately operated systems of information management or work. Bartley (2007, 302-3), for example, mentions instances in which certification was endorsed by governments and international organizations, in some cases being treated as functionally equivalent to government action. Carruthers (2013) recognizes the transformation of bond rating into a quasi-policy instrument through its legal incorporation in financial regulations in the United States.

Those few studies on the emergence of regulation-by-information do not explain the transformation of the operators of information management systems involved in regulation-by-information, from being mostly private into being increasingly public. They treat the increasing legal incorporation through state rules and regulations as simply an indicator of the beginning of an institutionalization process for the forms of regulation-by-information they examine. Guseva

(2008, 144), for example, noticed that it was market leaders not the state that institutionalized credit reporting and cooperation in information sharing among Russian banks, by creating their own affiliated credit bureaus. In her account, the creation of credit bureaus and the push for institutionalizing credit reporting followed the consumer credit boom beginning in the 2000-2001; more specifically, when credit bureaus were mentioned as an essential part of the presidential housing-and-mortgage program (Guseva 2008). Fung et al. (2007) considers transparency policies to be enabled by the sovereign authority of the government but not an alternative to 'command and control' regulation.

Very few studies of regulation-by-information examine systematically the emergence and transformation of this phenomenon. Many scholars mention in passing the history of the systems of evaluation and adjudication entailed in regulation-by-information (see Espeland and Sauder 2016; Alcubilla and del Pozo 2012; Seidman 2007). Bartley's (2007) study of certification systems in two industries, and Sabel and Zeitlin's (2008) examination of European Union's public rule-making framework – 'the experimentalist architecture', are two exemplar studies that take seriously the processes through which regulation-by-information emerges and transforms.

However, they do not acknowledge and explain fully *the variation in form and meaning of regulation-by-information* and the *implications of the transformation of its operator* for the phenomenon overall. How and why do mostly privately operated systems of regulation-by-information transform into increasingly publicly operated ones? What explains the emergence and transformation of regulation-by-information, in meaning and form? What are the implications of understanding this variety for regulation-by-information as a new form of regulation?

THEORY

The Private-to-Public Form of Regulation-by-Information

The transformation of operators of regulation-by-information, from being mostly private to being increasingly public, complicates the relationships involved in regulation-by-information. The identity of the operator becomes less clear and more ambiguous to consumers and audiences, in a way becoming two-faced. The consumers and audiences that first were more distinct and separate, end up being connected more extensively to each other and as a group become more diverse. The relationships between operators (producers, governments) and the targeted and users of the systems of information systems offered (consumers and other audiences) become more complex and interconnected. The increasing complexity introduced by the changes in the operator of regulation-by-information systems affects the way in which those systems work, their significance as well as their longevity.

I argue that there are two related features of the private-to-public form of regulation-by-information that distinguish it from the other mostly private and mostly public forms: their perseverance and their regulatory power. By examining this form of regulation-by-information I aim to highlight the extent of their institutionalization and how they ended up developing their regulatory power. I expect the private-to-public form to be extensively institutionalized, therefore more long-lasting, resilient, and more difficult to be challenged successfully.

By tracing the processes through which the private-to-public form of regulation-by-information emerges for two different (though related) systems of information management—rating and certification, I will be able to show how it impacts our understanding of the phenomenon overall. If the transformation of the operator affects these different systems in a similar way, it will indicate the importance of considering such transformation when thinking about regulation-by-information. The differences may be indicators of field-level differences between finance and healthcare, or it may help understand also the extent to which the variation among systems of information management involved in regulation-by-information matters.

- Figure #5 –

Nested Systems of Information Management involved in Regulation-by-Information

I consider the different systems of information management that regulation-by-information entails, to be related to each other. Disclosure or reporting systems are the fundamental system on which the others build. Rating systems do not only use self-reports for gathering information, but they involve extensive evaluation and adjudication of that information based both on explicit and implicit standards.

Certification systems also use a rating system, but add to it reliance on mostly explicit standards and a threshold used to evaluate and adjudicate collected information. Certification puts a rating in context by comparing it to an explicit agreed-upon standard. An organization and its services or products are certified when their rating exceeds a particular threshold level of performance. Different from rating, certification systems end up presenting information in the standardized form of the certificate, rather than a more graded symbol.

Ranking systems share reliance on explicit standards for evaluation in certification systems, but instead of a threshold of standards they use formal analysis and numerical quantification as a basis for adjudicating entities based on collected information. Thus, the presentation of information takes the form of a listing of entities by number or position, and provides an ordinal comparative classification. Rankings use the summary form of information ratings provide and put them in a particular order—from highest to lowest. They are a particular way of presenting existing information: bundled, re-packaged and contextualized for 'easier' use[5].

- Figure #6 –

I compare the emergence of the private-to-public form for rating and certification systems involved in regulation-by-information, because I consider these two systems to be more similar, in terms of the degree of public visibility and audience reach they enable, than disclosure and ranking systems. Both rating and certification involve a considerate amount of work on the part of operators for presenting information gathered and processed. They both result in presenting information in a standardized symbolic form—a grade and a certificate respectively, mostly to interested audiences and evaluated organizations. Disclosure and ranking systems generally present information for certain audiences or nearly to most interested audiences respectively.

- Figure #7 –

Explaining the Emergence and Transformation of Regulation-by-Information: Why and How Mostly Private Operators of Information Management Systems Become Increasingly Public

Being a fairly recent line of research, work on regulation-by-information does not provide comprehensive and systematic explanations for the emergence and transformation of this form. Therefore, I will rely on the existing literature on state regulation of industries and treat

[5] The construction of rankings requires some form of rating. However, the rating process used to construct rankings does not have to be formalized and explicit and it does not have to be using the same set of standards every time. The rating entity may be inconsistent in its use of standards: they may rely on different set of standards every time they rate an organization or another entity and rank entities based on those inconsistent ratings. Examples of rankings based on such kind of ratings would be those found on Yelp. Yelp ranks organizations and producers according to the number of stars they got or according to the amount of reviews they got or a combination of those. However, this ranking is based on consumer ratings which are ratings made by individual consumers who used their own set of implicit or explicit standards.

regulation as an institution in order to understand more comprehensively the emergence and transformation of regulation-by-information.

The Why(s)

The literature on state regulation of industries offers three kinds of explanations for the emergence and transformation of regulation-by-information from the mostly privately operated form to the increasingly publicly operated one (Schneiberg and Bartley 2001). Each explanatory approach emphasizes different actors, driving logics, enabling contexts, understandings of regulation, the role of politics, and view of consumers and other audiences.

- Figure #8 –

a. The capture theory: focusing on powerful producers and market dynamics

Emphasizing the power of producers and industry actors, capture theory claims that regulation is a strategic tool firms use for their own benefits by restricting competition and monopolizing the market at the expense of consumers (Kolko 1963; Stigler 1971; Noll 1989). When firms fail to fulfill their interests in limiting competition, and becoming monopolies through market dynamics, by forming mergers or cartels, they create or capture state agencies and use state power to enforce market control and overcome collective action problems involved in the private organization efforts (Olson 1971; Chandler 1977).

For capture theory, resort to government regulation depends on market conditions, especially its size and heterogeneity (Stigler 1971; Posner 1974). As the number of firms in an industry grows, their interests become more diverse, their actions less detectable, and cooperation, and more difficult. Under these conditions, firms become interested in demanding the state to enforce their cooperation through legislation, regulations or rules. Because of large numbers and the possibility of creating capture coalitions, their political leverage is also high enough to enable them to be successful in their demands.

Political processes become an arena for the manipulation of firms, especially powerful ones which have more resources, expertise, and organizing capacities than consumers. Firms can influence state officials and bureaucrats, contribute to political campaigns, withhold information and use other strategies to ask for the favor of government regulation. Consumers cannot organize as they lack information and are large in number but dispersed geographically. According to capture theory, regulation is not in consumers' interest as it is producer-determined; thus they will not demand it (Stigler 1971). Politics and the state are therefore seen as easily captured, generally ending up following, affirming and supporting the interests of producer firms through their legislative and regulatory action.

However, this explanatory approach acknowledges that sectors with strong anti-company politics, public debate and political struggles over industry practices will be less likely to demand regulation. State regulation can end up in appropriation and also can empower industry outsiders, mobilize resistance through increasing politicization of prizes (Stigler 1971; Bowman 1989).

b. *The interest group theory: focusing on resourceful consumers and political dynamics*

Recognizing multiple non-market actors and struggles among different interest groups as drivers of regulation, the interest group theory offers a purely political account of regulation (McCraw 1975; Wilson 1980; Meier 1988; Fishback and Kantor 1996). Consumers and non-industry groups are considered as sufficiently powerful actors, able to use the state, organize and demand regulation of an industry. The power of these different groups such as consumers, small firms, merchants, and farmers, lies in being large in number, with homogenous interests, high stakes, and considerate resources (Meier 1988; Fishback and Kantor 1996; Peltzman 1976; Noll 1989).

For interest groups, state regulation can be a mechanism opposing corporate power and sharing rewards that result from regulation, or one for limiting concentrated corporate power, a compromise between them and industry actors. The demand for public oversight over an industry is an example of the latter motivation, which accepts private market control and does not aim to defeat it (Sklar 1988; Sanders 1999). This demand for compromise can come from adversaries or trading partners of the industry, a source not recognized by capture theory.

Interest group theory considers politics as opening an opportunity for the emergence of challengers and alternatives that threaten corporations with the use of the state. In a context where anti-company forces are vocal and politically powerful, corporations may demand state regulation to preempt and try to prevent greater interventions. Demands for regulation will take the form of weaker indirect measures, involving limitations on the power of regulators, and more publicity (Sklar 1988; McGuire 1989). Firms within the industry that perceive the threat of state intervention will demand regulation, keeping in mind and acknowledging the political power of consumers and other audiences.

c. The institutionalist approach: focusing on configurations of multiple actors, legitimacy, and institutionalization

While it acknowledges the role of multiple (market, state, non-market, non-state) actors in shaping regulation, the institutionalist approach emphasizes the embedded nature of these actors in society and politics, that is, the normative and cultural implications of institutional and organizational configurations (DiMaggio and Powell 1983; Edelman 1990; Fligstein 1990; Dobbin 1994; Scott 1995; Meyer et al. 1997). This explanatory approach considers regulation as an institution, takes the state and professions seriously as agents of regulatory change, and emphasizes the embeddedness of sectors into broader organizational fields, whose dynamics shape regulatory emergence and transformation.

According to the institutionalist approach, demand for regulation emerges in a context of crises: legitimacy crises that involve questioning market order overall after cases of private firms failing to control the market on their own. State regulation ends up being an attempt to re-establish legitimacy for a particular group of actors, aligning their governance practices with the prevailing principles of rational or just order and enhancing their credibility through positive evaluations and even certification. The state becomes an agent of this alignment, when it is supported by professions and experts and public authorities such as courts, and it has the administrative capacity to implement models of order impartiality (Carruthers 1994; Schneiberg and Bartley 2001; Meyer and Rowan 1977; Edelman 1990; Scott et al 2000). However, the state is generally pressured into such regulation by the perception of a crisis. State regulation happens as part of the Polanyian 'double movement' – the regulatory action of the state triggered by the dire consequences of the previous wave of deregulatory legislation (Polanyi 1944).

Regulation is understood as a mechanism or arena for making meaning and as such, an opportunity for alternative models of order and rationality to emerge and compete for prevalence. Politics plays a crucial role in enabling such contestations among different sources and forms of meaning making (from private and public authorities). The role for consumers and other industry outsiders becomes to create and receive controversy, and participate in understanding the situation to involve a legitimacy crisis. While they are both enabled and constrained by institutional arrangements they are important to changing the regulatory environment.

The How(s): Understanding Regulation-by-Information as an Institution

While there is still no sociology of regulation, Schneiberg and Bartley's (2001; 2008; 2010) work suggests that one way of making the study of regulation sociological is to consider regulation as an institution. This move enables researchers to use an extensive literature on institutional analysis and rely on more sociological work in the way to constructing a framework for understanding regulation.

It is in this context that I consider regulation-by-information to be a new institutional form whose emergence and transformation needs explanation. I rely on the institutionalist literature in sociology to trace four under-examined themes in the existing literature on regulation.

1. The fate of alternatives to the private-to-public form of regulation-by-information

First, I recognize the variety of regulation-by-information, tracing the transformation in the system of information work or management involved and in the operators of those systems. This is in line with the institutionalist literature that draws attention to alternative forms of governance and what happens to them in the process of institutional emergence and transformation[6]. New institutional forms often arise in interaction with old forms as settlements are reached through processes of negotiation and contestation (Schneiberg and Bartley 2008). Bracketing questions of institutional change from the study of institutional emergence risks neglecting the politics involved in reaching certain settlements and hiding alternative institutional forms and trajectories.

[6] Many reviews of institutionalist work present research on institutional construction separately from that on institutional change, though they also recognize the arbitrariness and problematic nature of such distinction (Greenwood et al. 2011; Fligstein and McAdam 2012; Scott 2008). I will consider studies of institutional emergence and transformation as all relevant to the understanding of regulation-by-information.

The dominant view on regulation-by-information is that it represents the rise of private authority and the privatization of regulation, originating from the private sector and not having any alternative source. Cases that recognize the role of public authority in making regulation-by-information possible generally consider the government as the traditional regulator that *designs* standards, gathers information on compliance with its own standards, and also *enforces* their implementation through careful evaluation. Using recent literature on new forms of regulation, I argue for a re-conceptualization of 'regulation-by-information' that highlights the ways in which the *interaction* between public and private authority makes this new form possible. Therefore, I question the extent to which regulation-by-information relies on voluntary action and absence of enforcing mechanisms other than informational ones.

2. Tracing transformation in meaning and form through time

Second, I highlight how regulation-by-information changes in meaning and form through time, and its implications for being institutionalized and gaining regulatory power. This is in line with several scholars who support the move from the kind of institutional analysis that examines the effects or implications of a particular institutional order to the kind that traces the dynamic and contested processes through which institutions emerge and change (Greenwood et al. 2011; Schneiberg and Clemens 2006; Scott 2008)[7].

I emphasize the institutionalist literature that acknowledges that processes of institutionalization do not involve only battles for gaining legitimacy but also for longevity, persistence, and sustainability in time (Colyvas and Johnsson 2011).

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[7] There are many institutionalisms and different ways of doing institutional analysis (Campbell and Pedersen 2001; Schneiberg and Clemens 2006; Powell and DiMaggio 1991). Hall and Taylor (1996) distinguish between rational choice, historical (comparative), organizational (sociological) traditions. To this classification, Campbell and Pedersen (2001) add discursive institutionalism. Even within organizational institutionalism, Powell and DiMaggio (1991) distinguish between old and new institutionalism.

We need to understand how practices of disclosure and reporting systems, rating, ranking, and certification play into each other. Regulation-by-information does not only entail the evaluation of organizations but also the institutionalization of particular relationships and assumptions about quality and safety, especially through its system of summarizing information about an organization's performance in different ways. The different forms of regulation-by-information are based on the idea that transparency, compliance with certain standards, and their implementation is voluntary i.e. not being formally or directly enforced by the agency delineating those standards. However, this assumption that information sharing alone enables regulation, hides the political struggles through which these forms have emerged and the different sources of authority that supported their institutionalization.

3. Emphasizing the role of organizations as agents of institutional construction

Third, I draw attention to the role of organizations and organizational processes in shaping regulation-by-information and in the political construction of market institutions. While systems of evaluation for institutions and products have existed before, and the politics of information and expertise is not new, we still do not have a good account of why and how some forms of regulation-by-information remain either privately or publicly operated while others operate in a hybrid form, where private authority and public authority come together to support their functioning. Some scholars argue that one avenue for understanding regulation-by-information is the information work organizations do: examining how information and knowledge is generated, used, and circulated (Jost 1994a; Espeland and Stevens 2008). Others insist on a close examination of how different organizational actors acquire their competency and ability to make the world auditable through their measuring systems and standards (Power 1999; Espeland and Vannebo 2007; Seabrooke 2014).

In line with the institutionalist literature – especially the organizational school—that considers organizations as actively constructing institutions, not just being a context for them (Greenwood and Hinings 1996; Oliver 1991; Pfeffer and Salancik 2003), I argue that the emergence of regulation-by-information can be better understood by looking at the emergence and transformation of the operators of regulation-by-information—rating and accreditation organizations.

4. Highlighting the configuration of context and agency

Fourth, I stress the importance of combining context and agency driven explanations to institutional emergence and transformation. Institutional theory requires linking different levels of analysis and specifying cultural mechanisms that make possible higher-order effects (Greenwood et al. 2011; Schneiberg and Clemens 2006; Scott 2008; Thornton et al. 2012). Many institutionalists call for more studies focusing on the processes through which institutions arise and several of them propose ways to address the problem of emergence (Barley and Tolbert 1997; Fligstein and McAdam 2012; Greenwood et al. 2011; Padgett and Powell 2012; Scott 2008). Padgett and Powell (2012), for example, focus on the relational aspect of emergence, tracing the historical co-evolution and interaction of multiple social networks that constitute actors—organizations—within particular settings—markets. Fligstein and McAdam (2012, 165) propose examining the emergence of the field by identifying key actors competing for control, their alternative conceptions of the field, their resources, reasons for the prevalence of particular actors, external actors' role in the outcome and its terms, as well as mechanisms for maintaining the settlement. Several reviewers of the literature on institution building note that most research employs the concept of field, emphasizing its relational foundations more than the cultural ones (Scott 2008; Greenwood et al. 2011).

The context-driven frameworks tend to present institutions as necessary and natural consequences of certain environmental conditions and institutionalization as an undirected unconscious process (Strang and Sine 2002). Most ecological studies (e.g. Carroll and Hannan 1989), diffusion studies (e.g. Tolbert and Zucker 1983), and network studies (e.g. Baum and Oliver 1992) that view legitimacy as a consequence of a structural characteristic of a field or community exemplify such naturalistic conception of institutions. Some studies view new institutional arrangements as problem-solving mechanisms for which there is either a high demand—through the framing of situations as exceptional (Suchman 1995) or a high supply—through the increasing rationalization agents like the sciences and professions (Meyer 1994). Mohr and Guerra-Pearson's (2010) study of the emergence of different welfare organizations in New York City from 1888 to 1907 demonstrates well the naturalistic account of institutions: they attributed different forms to the existence of a particular status system with different features and rewards, as well as the identification of certain social needs, problems, and solutions.

More agent-driven approaches tend to emphasize the strategic and interest-driven nature of action. They present institutions as the result of certain dominant organized interests and powerful visions of a small set of actors (Scott 2008). For instance, studies emphasizing 'institutional entrepreneurship' following DiMaggio's (1991) work. emphasize the kind of actors that are more likely to participate and be influential in the creation of new institutional forms. For many scholars, the nation-state with its law making and enforcing capacity is one of the most powerful agents of institutional construction and change (Fligstein 1990; Baron, Davis-Blake, and Bielby 1986; Campbell and Pedersen 2001). Studies also identify professional occupations like legal experts, managers, accountants, and military officers, as crucial to institutional emergence as creators of certain knowledge systems and contributors to regulatory as well as normative frameworks (Brunsson and Jacobsson 2000; Strang and Meyer 1993). Associations (trade or professional ones) and other non-governmental organizations (national, international, or transnational) are seen as collective actors capable of initiating and propagating institution building (Boli and Thomas 1997). While some scholars like Fligstein (1990, 2001) focus on the elite as key players in institutional construction, others like Leblebici et al. (1991) and social movements scholars (e.g. Clemens 1993; Bartley 2007; Scheiberg and Lounsbury 2008) highlight the role of marginalized players at the intersection of several fields in institution building: as sources of innovative forms of organizing and crucial initiators of change.

Comparative (e.g. Bartley 2007) and historical studies (Leblebici et al. 1991) show that both context and agent driven approaches are relevant to understanding institutional emergence and transformation. Exemplary institutional work that recognizes the dynamic development of institutions through time can be identified in several clusters of research on institutional change. Though scholars of law and society like Edelman and her colleagues (Edelman 1992; Dobbin 1992; Edelman and Suchman 1997; Dobbin and Dowd 2000) seem to emphasize legislative changes by the state and as triggers of institutional construction efforts, they propose a nuanced approach that traces the interaction between professions, state regulators and organizational managers in creating new institutions. Recent Scandinavian scholarship on voluntary and privately-enforced regulation like standards (Brunsson and Jackobsson 2000), rankings (Wedlin 2006) and accreditations (Hedmo 2004) extends attention to the role of transnational agencies in the emergence of the new institutional form that displaces coercive, state-enforced regulation - ‘soft’ regulation (Djelic and Sahlin-Andersson 2006). I would argue that more work is needed examining the emergence of new regulatory forms *within* particular societies in collaboration with state regulatory efforts.

Research at the intersection of institutionalism and social movement theory has also been a productive venue for understanding institutional emergence and change. Though generally reflecting agent-driven explanations, it attempts to bring together both exogenous approaches to institutional change that focus on crisis, uncertainty, or the state as triggers of institutional projects and endogenous approaches to change that emphasize gradual slow processes of transformation. The strength of such literature is in encouraging processual examinations of emergence and change, that enable closer attention to alternative institutional projects and their fate in settlements of contests (Rao 1998; Rao and Kenny 2008; Dezalay and Garth 1996; Bartley 2007; Schneiberg and Lounsbury 2008).

The Empirical Project and Key Research Questions

To understand systematically and comprehensively the emergence and transformation of regulation-by-information, I conduct a comparative study of the processes through which rating in finance and accreditation in healthcare became legally incorporated in the United States. My study highlights which of the existing explanations for the state regulation of industries are able to explain the legal incorporation of rating and accreditation, that is, the emergence of the private-to-public form of regulation-by-information, in finance and healthcare respectively. Furthermore, tracing the processes through which rating in finance and accreditation in healthcare transform in meaning and form, my work draws attention to the kind of institutional analysis that helps better make sense of the private-to-public form of regulation-by-information.

I take a close look at the historical, cultural and political struggles through which legal incorporation of private regulation became possible and the settlement on their source or operator i.e. rating agencies and accreditation organizations was reached. I argue that the *operators and sources* of regulation-by-information matter for the degree of regulatory power the *systems* of information management or work involved in regulation-by-information (rating in finance and accreditation in healthcare). Not all rating and accreditation is regulatory. Therefore, I focus my study on the processes through which rating and accreditation from *certain specialized private agencies* rather than other alternative sources like business or professional associations, or state organizations, become legally incorporated and institutionalized as ways of evaluating producer organizations and their services or products.

I answer several questions that help understand the transformation of regulation-by-information and the emergence of its private-to-public form: How did the interaction between public and private authority shape this settlement on rating and rating agencies in finance, and accreditation and accreditation organizations in healthcare, as the best ways to govern the respective fields of activity? How did rating and accreditation gain legitimacy, credibility, and regulatory power? How and why were these forms of regulation-by-information constructed and defended as the only possible alternatives, eliminating other options for managing uncertainty and use information in different fields?

I argue that the regulatory power of rating and accreditation increases with the extent to which to they are made public or visible to consumers, customers, clients and more other audiences, and that role of both private and public authority should be considered more carefully in this regard. The transformation of the operators and sources of rating and accreditation, that is, the rating agencies and accreditation organizations, from mostly private actors to increasingly public ones, will result in a more extensive process of institutionalization, and increased regulatory power for them. The recognition of certain private organizations and their systems of information management or work in formal nation-wide rules and regulations would make them more accessible and visible to other actors besides producers themselves, changing their meaning and opening opportunities for changes in their form too.

CHAPTER 3

Data and Methods

Rationale for Selection of Cases: Regulation-by-Information in Finance and in Healthcare

To understand the emergence and transformation of regulation-by-information in form and meaning, I intend to look at the operators of the information management systems involved in two sectors in the United States: finance and healthcare. They are both high-risk industries, fields characterized by rapid organizational change, "complexity, plurality of players, and proliferation of regulatory agencies and strategies" (Healy and Braithwaite 2006, S56); what Schneiberg and Bartley (2010, 296) call "coupled systems where errors spread".

Several scholars and practitioners recognize the usefulness of comparing the dynamics in these two fields. Gunningham and Rees (1997, 397) cite Scharge's (1995, F3) comparison of the Joint Commission on Accreditation of Healthcare Organizations (JCAHO) with "the Moody's, Standard & Poor's and Good Housekeeping" but for hospital ratings. Schneiberg and Bartley (2010, 296) note striking parallels between health and innovations in medicine, and finance, identifying randomized trial experiments in pharmaceutical testing from the healthcare field as a model for redesigning finance. Examining the evolution of credit reporting agencies and their authority, Olegario (2006, 204) mentions that one practitioner explicitly "characterized the granting of trade credit as similar to medicine, in that it is an "inexact exact science"[12]."

These broad similarities make the comparison of rating systems in each field telling, especially as the arguments for the necessity of this new form of regulation emphasize the role of increasing uncertainty, instability, and crisis in creating information asymmetries and practical problems that require particular solutions. The comparison will help specify mechanisms and processes through which these information management systems—rating in finance and accreditation in healthcare—come to be seen as natural, necessary, inevitable solutions to the problem of uncertainty, and become powerful regulators of entire fields, as regulation-by-information.

In both fields, emphasis has been on initiatives of regulation by private authority or self-regulation by the professions, specifically through associations. Few highlight the role of interactions between private and public authority in transforming existing regulatory frameworks and creating new regulatory mechanisms. Examining the emergence of new forms of regulation within existing regulatory constellations will help put rating agencies and accreditation organizations in perspective and better understand their position in each field (Healy and Braithwaite 2006; Braithwaite 2000; Sabel and Zeitlin 2008; Gunningham and Rees 1997; Ayres and Braithwaite 1992).

The United States are the best place to start such examination: the US it is where ratings first emerged as a form of evaluating individuals and organizations. Furthermore, the US generally provides a model to follow whose comprehension will offer a framework for comparison and analysis of other newly developing regulatory systems in other parts of the world. Understanding the institutionalization of the American model can help understand the expanding role of regulation-by-information in other countries and its place in debates about global governance. The position of the US in many international organizations and transnational fora tend to make its version of regulation attractive and a powerful transforming force for fields in other countries (Hale and Held 2013; Olegario 2003).

I trace the emergence and transformation of the *oldest* and *most prominent sources* of rating in finance and accreditation in healthcare, as the rise and transformation of these *specialized private agencies* is key to uncovering the political and cultural struggles that led to the institutionalization of regulation-by-information. The oldest and biggest producers of ratings in finance are three private for-profit organizations: S&P, Moody's, and Fitch Ratings (Alcubilla, Garcia, and del Pozo 2012; Langohr and Langohr 2010). In the healthcare field, the oldest accrediting agencies are two private not-for-profit organizations: The Joint Commission and the Healthcare Facilities Accreditation Program (Jost 1982; Jost 1994b; Medicare et al. 2013).

Cases

Credit Rating Agencies for Corporate and Sovereign Bonds

Rating agencies in US financial markets emerged at the beginning of the 20th century, with the creation of sovereign and corporate debt markets. Local government and private corporations as well as US states issued debt to finance infrastructure projects, especially the construction of railroads. Alcubilla et al. (2012) identify three predecessors of the credit rating agencies (CRAs) in finance: credit-reporting agencies (e.g. *Dun & Bradsteet* beginning with the Mercantile Agency in 1841), specialized publications (e.g. *The American Railroad Journal* in 1832, *Poor's Manual of the Railroads of the United States* with first volume in 1868, *Moody's Manual of Industrial and Miscellaneous Securities* in 1990, and *The Fitch Bond Book* and *Fitch Stock and Bond Manual* in 1913), and investment bankers (e.g. financial intermediaries whose reputation was involved in bond issuance) (2-4). CRAs, they argue, "evolved as a natural consequence of this need for specialized information based on three institutions [predecessors] mentioned" (4).

Scholars have examined the emergence of credit *reporting* agencies (Olegario 2006) and their importance for the development of credit *ratings* (Cohen 2012; Carruthers 2013). Among others, they recognize Moody's introduction of the AAA-D rating scale in 1909 for railroad bond as an adaptation of the rating key introduced by the credit reporting agency Bradstreet in 1857 (Olegario 2006, 2003, 129; Carruthers 2013, 537). Despite the historical legacy of credit reporting on credit rating, scholars consider them as two different industries. Olegario (2003, 135) argues that the credit reporting industry is much more competitive and open to newcomers than the credit rating one. She shows that credit reporting agencies' authority is contestable—checked by competition, easier comparability of products, absence of regulations requiring use of their services, and the credit profession's shared sense of its own limited authority—thus, more limited than that of credit rating agencies (Olegario 2003; 2006). In contrast, many observers of finance suggest that credit rating agencies "see themselves as quasi-regulatory institutions" that do not just provide information to be put in context, but make authoritative judgments about accounts, required by several state and federal level regulations (Sinclair 2000, 496; Olegario 2003; Carruthers 2013).

I will focus on the credit rating industry rather that the credit reporting one, because while both industries used similar quantitative methods of rating credit, only the former could make its ratings a new form of regulation. From 1909 on, the credit rating agencies Moody's, Poor's, Standard Statistics, and Fitch gradually expanded their coverage, rating bonds from all industries after 1924. First, CRAs followed a 'subscription-paid' or 'user pays' business model. In the 1930s only bank regulators referenced 'recognized rating manuals' into their regulations (an actual decree mentioned them in 1936). They changed this model in the late 1960s, starting with municipal bond ratings, claiming that subscriber fees could not cover rating costs (Carruthers 2013). This 'issuer pays model' became the standard in the mid-70s. Some attribute this change to the surprising bankruptcy of Penn Central in 1970, which increased the need of corporate bond issuers to visibly affirm their creditworthiness (Cantor and Packer 1994). Others also link it to the incorporation of ratings into federal financial regulation, after insurance regulators had used them in regulations, US Securities and Exchange Commission (SEC) incorporated the need to get ratings assigned by a 'Nationally Recognized Statistical Rating Organization' (NRSRO) as a condition for abiding to certain rules regarding bank and broker-dealer net capital requirements (Carruthers 2013). In the 70s the CRAs began using the 'issuer pays' model as rating were seen giving market access.

The industry has grown since then with 150 local and international CRAs, but it remains a natural oligopoly as three large US-based agencies—Fitch, Moody's, and S&P—dominate globally (Alcubilla et al. 2012, 9; Laghor and Laghor 2010). Carruthers (2013, 539) argues that the increasing use of ratings by public and private actors alike "led to unintended synchronization and correlation of the economic decisions of an otherwise uncoordinated set of actors." He concludes that ratings have spread despite absence of evidence for their performance before the 1930s, and they become a coordinating but also destabilizing tool for the financial system (540). I will focus on why and how those rating agencies were recognized by the state and their ratings publicly sanctified through incorporation into formal regulation. Furthermore, how did such state action affect the meaning and interpretation of ratings as regulation-by-information?

Accrediting Agencies for Healthcare Organizations

In the health care field, ratings for hospitals started in 1919 as an initiative of the American College of Surgeons that established the Hospital Standardization Program (HSP) supported by a grant from the Carnegie Foundation. The first standards manual was printed in 1926 and by 1950 more than 3,200 hospitals were approved under the program. Other professional associations and the American Hospital Association joined the American College of Surgeons to establish the Joint Commission on Accreditation on Hospitals (JCAH) in 1951 that latter became the Joint Commission on Accreditation of Healthcare Organizations (JCAHO). Today the agency is called the Joint Commission (JC). Kinney (1994) argues that the establishment of this private accrediting body for health care organizations was a move by hospitals and the medical profession to maintain their model of private regulation and their autonomy in defining and controlling standards and rules governing the field. Scholars mention the incorporation of their accreditation into formal regulations by the state as the trigger for such moves.

In the early 20th century, hospital quality assurance was mainly a private matter, but it has gradually become more public. State licensure of hospitals and other health care institutions followed private accreditation especially after the Hill-Burton Act in 1946 required it as a condition for receiving construction funds and other financial assistance. The conditionality in the Hill-Burton Act was extended to nonprofit long-term care facilities (e.g. nursing homes) in 1953. JCHO expanded its scope of accreditation developing standards for long-term care organizations in 1965, with the enactment of the Medicare and Medicaid programs. Initially, accreditation information was seen as confidential peer review information. However, disclosure of information to government agencies became increasingly required with the amended Social Security Acts in 1972 and 1989. The Commission has moved towards greater disclosure of its accreditation information, especially starting in the 1990s, not only as a requirement by the government to ensure its accountability but also as a way of addressing its expanding range of users—focusing on patients as consumers (Jost 1994a). The Commission started billing for surveys in 1964, with the model becoming subscription based in 2005.

The JCAHO first established accreditation programs for hospitals and continued to receive deemed status for rating of a broader range of healthcare organizations by 1987. In this process, its emphasis shifted from the implementation of minimal standards towards achieving optimal levels of quality and patient-centered care. With the development of an indicator-based performance monitoring system (Indicator Measurement System) in 1988, the standards of the *Accreditation Manual for Hospitals* started to emphasize performance improvement concepts. The JCAHO made its organization-specific performance reports available to the public in 1994 and only ten years later did so for quality reports. The certification programs and quality reports including ratings with both symbols and numbers followed the JCAHO's accreditation programs. The Joint Commission created a Gold Seal of Approval to be displayed on all certificates of accreditation awarded after 2003 and it also has a Special Quality Awards section where it lists hospitals receiving the 'Merit badge' in 2004. It is important to note, however, that the Commission has always had a fine-graded (not binary) classification for healthcare organizations: an organization would get either an 'accredited', 'provisional accreditation', 'conditional accreditation', 'preliminary denial of accreditation', or 'denial of accreditation' status. Surveyors who are employed and certified on quality-related performance evaluation by the Commission itself make these decisions.

The Healthcare Facilities Accreditation Program (HFAP) is a not-for-profit organization representing osteopathic physicians, established in 1943 by the American Osteopathic Association that started surveying hospitals in 1945. It applied to become a recognized accrediting agency with deeming authority, after the enactment of the Medicare and Medicaid programs. The HFAP has three categories of accreditation: 'full accreditation', 'interim accreditation' and 'denial'. Its surveyors are paid volunteers, not employees of the organization, as in the case of the JC, recruited from HFAP-accredited facilities. By 2009, the HFAP had accredited nearly 200 hospitals and more than 200 other healthcare facilities as well as laboratories. Similar to the JC, it conducts on-site surveys of hospitals every three years. It also has several certification programs, though less comprehensive in coverage those of the Commission. The cost of its services is on average lower than those of the JC though they vary with the size and complexity of the facility surveyed ($25,000 for three years compared to $33,000 of the JC) (Meldi et al. 2009). Because of the relatively small size of the HFAP compared to the JC (the latter by 2009 provided accreditation or certification services to nearly 5,000 hospitals and 10,000 other healthcare organizations), there is not a lot of information on the detailed history of the organization.

The use of the term ‘rating’ has been confined to the field of finance, while ‘accreditation’ has not acquired any field-specific meaning. Despite the language differences, I argue that the processes through which a rating and accreditation is given to an organization or its services are similar in both cases: rating and accreditation involves the evaluation by a specialized diverse team of the degree to which an organization or its product comply with specified standards. Often I will use the term rating for accreditation in order to challenge the ingrained meaning of this term as exclusive to a particular field—that of finance. Though the processes followed by agencies to rate and accredit or certify are similar, what is being evaluated i.e. the object the rating and accreditation is attached to might be somehow different: in finance, ratings are given to a financial product whereas in healthcare, they are given to a healthcare organization or its services. Several scholars in finance distinguish credit ratings from bond ratings (Carruthers and Ariovich 2010, 9-10), though the terminology is still contested (Miller 2003, 17). In healthcare, there is also a distinction between accreditation—given to the organization, certification—given to a particular program, and quality report—given to the services of an organization. While these distinctions among ratings are important, what matters most for my study is that they all involve the production of authoritative judgements of trustworthiness by specialized private agencies after having evaluated compliance of producers with their own specific standards. Part of the puzzle I aim to resolve with my research is why this evaluation was concentrated in the hand of specialized private agencies—trusting their standards and giving power to their process of evaluation—while there existed other alternative ways of handling ratings—through (business or professional) associations or government organizations.

Examining the history of these agencies, one notes that the ratings produced by these organizations in both fields became powerful mechanisms of regulation at the same period of time—around mid 1960s and 1970s, when federal regulation officially recognized and made getting their ratings a condition for showing compliance with existing policies. In 1965, the United States Congress nationally recognized the above accreditation agencies with deeming authority such that complying with their evaluation criteria meant being able to automatically meet the Medicare Conditions of Participation and as a consequence benefit from Medicaid reimbursements (Medicare et al. 2013; Jost 1982; Jost 1994b; Kinney 1994). In 1975, the U.S. Securities and Exchange Commission (SEC) used the term 'nationally recognized statistical ratings organizations' (NRSRO) to designate organizations whose approval was needed for banks and other financial institutions to show compliance with certain set capital requirements, as an affirmation of securities' safety (Alcubilla et al. 2012; Langohr and Langohr 2010; Carruthers 2013).

Some scholars attribute the establishment of accrediting agencies for hospitals to professional groups' concern about the quality of services provided in healthcare organizations

(Kinney 1994). In the case of credit rating agencies, recent research see their foundation as a necessary consequence of the expansion of credit markets and the need of investors to manage increasing uncertainty (Alcubilla et al. 2012; Langohr and Langohr 2010; Carruthers 2013; Olegario 2003). In both cases, only a few agencies and their ratings came to dominate each field, even though there was not a lot of widespread evidence for their value and contribution to improving the performance of the regulated organizations (Carruthers 2013; Mumford et al. 2013). Furthermore, state involvement through the use of these agencies' ratings for regulatory purposes was a very important factor in shaping both settlements. Sociological explanations of the emergence and institutionalization of regulation-by-information through the recognition of these agencies and their ratings remain underexplored. Comparing processes in two different fields will help clarify the meaning of regulation-by-information and understand its emergence through time. It will also make scholars aware of the possible interdependences of different fields and the way in which they might shape each other.

Methodology

To study the process through which rating and accreditation, and their organizations emerged as proto-institutions (Lawrence et al. 2002) in two dynamic fast-changing fields - finance and healthcare- in the United States, I employed a historiographic approach to data collection and analysis (Ventresca and Mohr 2002). For the analysis of my data, I rely also on principles from pattern-matching (Campbell 1975) and process-tracing (Brady and Collier 2004; George and Bennett 2005) methods for within-case analysis and qualitative comparative methods for between-case analysis (Ragin 2000; Rihoux and Ragin 2009[8]; Marx, Rihoux, and Ragin 2014).

The historiographic approach. This approach focuses on the intensive scrutiny of archival materials taken from a single or a few organizations or entities. In historiographic investigations, the researcher collects data by strategically and diligently reading through large amounts of archival information from many different sources and continuously taking notes. The historiographic approach is a way of gaining insights, making discoveries and generating "informed judgments about the character of historical events and processes" (Ventresca and Mohr 2002, 14). Attention to the rich details of organizational life and interest in studying the origins or emergence of certain institutional arrangements and understanding the character of power relations (especially conflict and control) distinguishes historiographic research (e.g. Selznick 1949, Chandler 1977; Perrow 1991). As Ventresca and Mohr (2002, 5-6) put it, work in this tradition resembles that in ethnographic studies though "conducted through the medium of archival materials".

Data Collection

The interdisciplinary literature on rating and accreditation, and their organizations, and the historical nature of my project, as well as my research question, necessitated a mixed data collection approach. I employed different types of data coming from different sources in order to produce a more comprehensive and balanced approach to my research question. As several scholars have argued, "the greatest value in combining types of data lies in the ability of one type

[8] There references are more specifically about Qualitative Comparative Analysis (QCA) as a more formal way of comparing configurations of a not-too-small and not-large-enough number of (N=5-50). I refer here to qualitative comparative methods more broadly defined given that I have a small number of cases (N=2). However, the principles espoused in the QCA approach can help systematize the presentation of my between-case comparison.

to compensate for the weaknesses of the other" (Small 2011, 64).[9] I was reluctant to limit the kind of knowledge I had to address my research question, recognizing that each kind of data offers a specific kind of knowledge (Sale 2002).

Besides the confirmatory design to mixed data collection delineated above, I also followed a sequential design to data collection. This means that I looked at congressional data first as I wanted to understand the legal incorporation of rating and accreditation, and their organizations, and then continued with the collection of data from the rating and accreditation organizations themselves and the relevant actors within each industry. The sequential design to mixed data collection helps address specific questions that emerge in the process of data collection and ultimately strengthens my argument. Scholars have been able to identify "underlying mechanisms behind newly discovered associations or to test emergent hypotheses" (Small 2011, 68).[10]

I started the data collection process by identifying the legislation that incorporated rating agencies and accreditation organizations: the Securities Acts Amendments of 1975 and the Social Security Amendments of 1965 for finance and healthcare respectively. I searched both ProQuest Legislative Insight and HeinOnline databases for the respective legislative histories of these acts, and checked the content of the different legislative history compilations so that I had

[9] Small (2011) uses the distinction between quantitative and qualitative data and gives his examples accordingly. Broadly, he defines the mixed method study as a mix of quantitative and qualitative data collection methods but I find this distinction problematic as the variation of data collection methods at least within what is called qualitative data collection merits more attention and acknowledgment. For example, he could have examined also the combination of archival methods with interviews, or newspaper data with organizational data, etc.

[10] A sequential approach may be unplanned and result from the emergence of the researcher in the field and their data collection guided by intuition and continuous discovery. In line with the long-standing grounded theory tradition Glaser & Strauss 1967), Becker (2009) emphasized that the absence of a specific design for data collection can lead to the best ethnographic research results and rejected the attempts to systematize and codify the process of ethnographic and interview-based data collection.

the most comprehensive legislative history as my initial dataset.[11] I downloaded every document of the legislative history for the finance case and only those in which the term ‘Joint Commission on Accreditation of Hospitals’ or its acronym ‘JCAH’ were mentioned for the healthcare case. There were in total 122 and 111 documents in my comprehensive legislative history compilation for the finance case and for the healthcare case respectively. This dataset contains congressional reports, hearings, bills, congressional records, other documents and studies, presidential statements, and congressional committee prints. I also gathered and examined secondary accounts on the historical development of the regulatory framework in the US broadly, as well as for the fields of finance and healthcare more specifically, in order to better locate the legislative history of the particular acts in the regulatory configuration of the fields at the time.

The initial analysis of the congressional data helped identify key actors in congressional conversations about rating agencies, give a broad overview of the fields and the broader regulatory issues discussed. It also served as a field in which, similar to an ethnographer, I could emerge myself and get a grasp of the language, discourse and relationships involved in this specific environment. However, my preliminary findings indicated that there was not much debate over the legal incorporation of rating and accreditation organizations.

To explain this limited debate on the incorporation of rating and accreditation organizations (an issue that had considerable repercussions for both fields) and address other questions raised by the initial analysis, I needed to collect more data on the rating and accreditation organizations themselves and the history of the phenomenon of rating and accreditation. Therefore, I moved on to collecting organizational data from the major recognized

[11] The content of legislative history compilations differs as compilers of legislative histories also differ in what they consider relevant to understand the development of a particular legislation. There were not major differences in content though between the compilations I compared.

rating and accreditation organizations and the key actors within each industry (finance and healthcare).

My organizational dataset consists of the official organizational histories of the rating and accrediting organizations and historical publications, and other documents, from searching HathiTrust databases as well as the Web. Regarding organizational histories, I received an unpublished manuscript from Moody's which was commissioned for its 100th anniversary, and a published book from the Joint Commission which had also been commissioned for its 50th anniversary. I also consulted the organizations' websites for their organizational timelines and collected secondary sources—academic articles and industry publications—that examined their history. I did not get anything directly from the Standard&Poor's and Fitch's main offices despite several inquiries by phone and email. The most challenging to find historical information about was the American Osteopathic Association's Healthcare Facilities Accreditation Program (AOA- HFAP). Though I could find some accounts on the history of the development of osteopathic medicine and its practice as well as the American Osteopathic Association, they did not address extensively the history of its accreditation program that I was interested in. Therefore, I have only limited primary data from this organization.

The preliminary analysis of the organizational dataset gave me an understanding of the way in which rating and accreditation organizations viewed themselves and their rise to regulatory power. My initial findings indicated that rating and accreditation organizations embraced the rhetoric of 'being chosen' and 'selected' by government, because of the recognized value of their services. They considered their regulatory power as mainly a delegation of power by the government and mostly implied that they had not sought this regulatory power and position in the field, though they had engaged in several activities that contributed to this regulatory power. Furthermore, they neglected not only the role of their activities, but also those of the action of their respective industries, especially leading associations and powerful actors.

In order to complement the rating and accreditation organization's perspective with the field understanding and consideration of rating and accreditation and their organizations, I moved on into the third phase of data collection: gathering historical publications from the major associations and relevant industry actors that were vocal and played a role in the process of legally incorporating rating and accreditation and their organizations in each field. To put association publications and key industry actors' statements in perspective, I also gathered secondary sources on the history of each organization and its relationship to the field too. This dataset is very rich. Its richness as well as its analysis confirmed that industry actors played a major role in shaping the regulatory power of rating and accreditation and their organizations.

Lastly, I collected mass media data, mainly in the form of newspapers, to see how the different accounts of rating and accreditation and their organizations were presented to the broader public. This mass media dataset consists of newspaper articles collected by searching historical newspapers databases (mainly the Proquest Historical Newspaper Database)[12], covering the period between 1900s to the mid 1980s. In finance, I used the following keywords for my search: 'rating', 'credit rating', 'bond rating', 'rating firm', and the names of the specific rating agencies. I conducted searches also into the archives of individual newspapers and magazines like the New York Times and the Economist, and ended up with around 88 relevant articles in total. In healthcare, I conducted advanced searches for the terms 'American College of Surgeons', 'hospital','standardization', 'approval' (38 results with 34 relevant articles) and for

[12] This database contains full-text, searchable access to articles from the *New York Times* (1851-2001), the *Wall Street Journal* (1889-1997), the *Chicago Tribune* (1890-1985), the *Chicago Defender* (1901-1975), the *Los Angeles Times* (1881-1985), and the *Washington Post* (1877-1987).

the terms ‘Joint Commission’, ‘accreditation’, ‘hospital’, ‘approval’ (175 results with 95 relevant articles), and ‘American Osteopathic Association’, ‘hospital’, ‘approval’ (21 results with 10 relevant articles). The term ’Healthcare Facilities Accreditation Program’ appears for the first time in the 2000s, as initially the Committee on Hospitals was responsible for accreditation. The newspaper dataset for healthcare had 139 articles in total.

During each of the above-mentioned phases of data collection, in order to make each dataset as comprehensive as possible, I engaged in snowball sampling to find data sources: I started looking at histories of the rating industry, noted down the primary sources they referred to, and tracked down and read them in addition to my own search of the archives. To complement this strategy, I also did searches of electronic databases and library catalogs covering my period of interest (1900-1985). I searched until I discovered new materials no more.

Data Analysis

In line with historical methods, the historiographic approach relies on an iterative process of data analysis. The researcher starts with a provisional selection of facts based on a provisional interpretation of events and situations, and ends up consciously or unconsciously changing that interpretation and selection by his work of going back and forth between facts and interpretations (Carr 1961; Evans 1997; Calhoun 1998; Gaddis 2002).

Within-case Analysis: Pattern matching and process tracing

As many historical methods, my approach underlines temporal change. However, I rely on process tracing for converting “a purely historical account that implies or asserts a causal sequence into an analytical explanation couched in theoretical variables that have been identified in the research design" (George and Bennett 2005, 225). Process tracing involves identifying causal mechanisms and developing propositions to be tested in different settings. It aims to determine which of several possible explanations is in line with a continuous string of evidence "from hypothesized cause to observed effect" (Bennett 2004, 22). Process tracing goes beyond pattern matching (Campbell 1975), as it involves not only the identification of certain similar patterns or sequences in cases, but also putting them together into a complete continuous story for each case (Bennett 2004).

I used process tracing to link the actions of pioneers of rating and accreditation and its organization, and the actions of industry and professional actors, to their rise into powerful regulatory mechanisms in each field and the ultimate outcome of being legally incorporated. I employ this method for my within-case analysis, to build theory "in constant dialogue with the historical data" (Kieser 1994, 618).

I started my data analysis by looking at congressional reports, as ProQuestCongressional suggested that they are the best place to start research because they present all sides and parties' positions over a subject matter in a concise way. I organized the reports by year and then conducted a search using different keywords.

In the finance case, in none of the reports was the 'nationally recognized statistical rating organization' keyword or its acronym 'NRSRO' or 'nationally recognized' phrase used.[13] When I searched for the term 'rating', it was mentioned only in three documents overall three times, its variation 'rated' was mentioned only once. The term 'Moody's' was mentioned twice in two separate documents, and Standard and Poor's was mentioned only once. I looked at each instance where these terms were mentioned and took notes on how and why the terms were used, by

[13] One reason for this is that the NRSRO phrase was coined by a rule amendment by the SEC.

whom, and in what context. Then I did the same kind of keyword search and overall analysis for the rest of the documents in my congressional (legislative history) dataset. Overall, I had to look at 36 documents with 228 instances and take notes on these instances.

In the healthcare case, I used the keyword ‘accredit’ and other variations like ‘accredits’, ‘accrediting’, ‘accreditation’, ‘accredited’ to search first the congressional reports and then the congressional hearings and other documents in the legislative history dataset. The search identified the term ‘accredit’ and its variations in 137 instances spread over 7 out of 10 documents of the reports folder, and in 670 instances spread over 24 out of 42 documents of the hearings folder.

For the organizational and industry dataset, I read different accounts of the rating organizations’ history carefully, focusing on identifying how they talked about rating and the role it played in their organizational transformation through time. I also noted the ways in which they talked about the possibility of alternatives to their product and their organizations - government and other industry and professional actors. I focused the analysis of the data from important industry and professional actors like associations (like the National Association of Securities Dealers in finance and the American Hospital Association in healthcare, for example) and other self-regulatory organizations (like the New York Stock Exchange in finance and the Blue Cross Plans in healthcare) on the way in which they talked about rating and accreditation and their sources—whether they saw any alternatives to the private organizations as providers of rating (like the government or other industry actors) and whether they questioned their existence, performance, and utility at all. I noted also the contexts in which rating and accreditation was mentioned and whether issues were raised about either the process of rating or its source and necessity.

Regarding the newspaper data, I read carefully each article in its entirety. My analytical strategy was to use this kind of data to not only understand how the reporting of issue related to rating and the private rating agencies changed through time, but also to identify the kind of image of rating and their private source was presented to the public. Similar to my focus in the analysis of other datasets, I identified the relationship between possible alternatives to ratings and their private source—the specialized 'independent' organizations.

My within-case analysis is presented in the form of a strategic narrative: telling a story about processes and configurations of actors and events in time but for a selected subset of cases, those thought to be most valuable for building theory from history (Stryker 1996; George and Bennett 2005). I coded archival evidence for themes highlighted in previous research and also identified evidence of institutionalizing activities not emphasized in previous research.

However, each case is in itself what Hirschman and Reed (2014) call a 'formation story': a study that traces the formation of a new social kind as a historical process. My within case analyses are accounts of the formation of rating and accreditation with great regulatory power and their consideration as a form of regulation-by-information in finance and healthcare. Formation stories explain "how social things come to be stable enough to force or be forced" (Hirschman and Reed 2014, 260) and as such set empirical, historical boundaries to forcing-cause claims by not assuming fixed unchanging entities and meanings through time. Even the social mechanisms approach that recognizes *processes* as *generating* outcomes, does not examine the history of social kinds themselves or "how entities subtly change their nature, meaning, or essential properties through some historical path (Hirschman and Reed 2014, 265). In this context, the explanations I offer are causal as formation stories - not just description and interpretation.

The language I use to tell these stories is still one of mechanisms and variables, as the methodology and method for telling formation stories are in their emerging phase (Hirschman and Reed 2014, 274). It is difficult to present in a simple parsimonious way a formation story that relies on assemblages of all different kinds of 'stuff' to explain an outcome. For example, Eyal (2013) offers the formation story of autism as an epidemic by identifying as the key cause "the deinstitutionalization of mental retardation - a lengthy process that began in the early 1970s and lasted at least two decades" (267-8). Nevertheless, he presents his main argument using a different language—one about the role of experts and expertise in this lengthy process, locating causality therefore in another more specific location—the experts—not in the transformation of the institutional constellation and configuration he previously talked about. Therefore, and unfortunately, my language generally fails to be outside of the dominant approaches to causality, trying to tell these stories in terms of variables and mechanisms.

Between-case Analysis: The comparative method

Comparison is a widespread and common method of research in both humanities and social science. It refers to the research approach that explores the parallels and differences between two or more cases on a particular dimension or a certain phenomenon (Azarian 2011, 113-4). Comparison has a special place in sociology because it helped define and build the academic discipline: some of the classical sociological works like Weber's *The Protestant Ethics and the Spirit of Capitalism* and Durkheim's *The Study of Suicide* rely on the comparative method. Durkheim (1982) maintained that "the comparative method is the sole one suitable for sociology" (147) and "comparative sociology is not a particular branch of sociology; it is sociology itself, in so far as it ceases to be purely descriptive and aspires to account for facts (157).”

Comparative methodology differs from textbook social science in many respects (see Fiss 2007 for a concise overview). Comparative researchers use this method to make sense of a relatively small number of cases selected for their theoretical or substantive importance. Researchers’ definition of their ‘cases’ and what they represent (“what are these cases of?”) can change throughout the process of research as they learn more about the phenomenon of interest and refine their guiding concepts and analytical strategies. The focus of their work is a phenomenon of interest because of its rarity but also its cultural significance. Therefore, empirical depth for comparative researchers is more important than breadth. One of the primary objectives of comparative research is concept formation, elaboration, and refinement, and theory development. Their value lies in advancing areas of research where existing theory is not well-formulated and insufficiently-developed to formulate and test explicit hypotheses (Fiss 2007; Marx et al. 2014).

One of the most important distinctions between the comparative method and other typical textbook social science methods is the understanding of causation. Comparative researchers explain outcomes in terms of configurations: combinations of factors rather than single factors cause outcomes. They account for equifinality—how different combinations of causes may lead to the same outcome (Rihoux and Ragin 2009). Therefore, the comparative method directs attention into examining the formation of configurations: how different aspects and characteristics combine and come together in each case to lead to the outcome of interest. The researcher’s use of the comparison, however, is based on a careful analysis and understanding of the individual cases and also serves to strengthen and deepen the understanding of each case (Ragin 2000).

There are several typologies developed to make sense of the variety of purposes for which researchers use comparison as a scientific research method (some of the most well-known ones are those of Charles Tilly (1984), Skocpol and Somers (1978) and Ragin (1987)). These perspectives, generally developed with historical comparative sociologists in mind, indicate three main uses of comparison: 1) to highlight particularity, 2) to discover convergences and deviations, and 3) to reveal causal generalizations (Azarian 2011, 117-20).

First, comparison helps researchers see things in perspective and question the implicit taken-for-granted nature of exiting practices and phenomena. As Tilly (1984, 145) notes this kind of comparisons ('individualizing comparisons') have a "rare clarifying power" as they can lead to noticing problems and issues with existing explanations and even raise new significant questions (for example, Weber on capitalism).

Second, researchers have used the comparative method to identify and make sense of the variation of a particular phenomenon or outcome. These kind of studies examine sufficiently similar entities that differ with respect to their outcome of interest. By comparing multiple forms of a single phenomenon, they aim to develop a principle of variation either based on the character or the intensity of that phenomenon. These comparative researchers are interested in highlighting the different paths through which certain outcomes develop, and do not aim to reach large historical generalizations, but provide a preliminary orientation with mapping the terrain of conditions that enables the existence and formation of a certain phenomenon (for example, Moore 1966 on democracy).

Third, the comparative method is also used to develop causal theories that can be generalized and applied in different contexts. These universalizing comparisons, as Tilly (1984, 97) calls them, rely on the systematic comparative examination of the chosen cases - the independent instances of the same phenomenon—through mapping of the fundamental similarities between cases. These kind of comparative studies do not see the cases compared as identical, but hope to reduce the parochialism of single-case studies (for example, Skocpol 1979 on social revolutions).

These typologies of the value and uses of the comparative method help be aware of the different dimensions of doing comparative research and make their complexity more manageable. In practice, however, comparative studies rely on a mixture of these strategies and uses of comparison (Azarian 2011, 120).

I started my analysis comparing the historical timelines or paths towards legal incorporation of rating and accreditation, and their agencies of the two fields. I compared the historical (economic, political, cultural and regulatory) contexts in which legal incorporations happen—like the existence and nature of crises, the public visibility of rating and accreditation organizations' work, the development of each field and related industries, etc. I identified the similarities and differences in the trajectories, mainly focusing on explaining how so different fields can have such similar processes and experiences of being legally incorporated.

The most important comparison for my between-case analysis was that involving the source of regulation-by-information: rating and accreditation organizations. I compared the ways in which these organizations built their identities and construct rating as their product and themselves as producers, doing what I call 'product work' and 'producer work' respectively.

The comparison of rating and rating agencies in finance and with accreditation and accrediting organizations in healthcare aimed at raising awareness about the variety of forms of 'regulation-by-information' (rating and accreditation). While I identified the more general and common configuration of actors and processes that led to the legal incorporation of mostly privately operated systems of information management, I also highlighted the differences between the dynamics of emergence and transformation in these fields, and their implications for the fate of these institutions and their regulatory power.

CHAPTER 4

The Cultural Institutionalization of Rating in Finance

The oldest, largest, and most well-known credit rating agencies in finance are Moody's, Standard&Poor (S&P), and Fitch (Cantor and Packer 1994; Sylla 2002; Sinclair 2014). They were the first rating agencies to get designated by the US Securities and Exchange Commission (SEC) as Nationally Recognized Statistical Rating Organizations (NRSROs) in 1975. Since then, scholars and industry experts agree that their power to regulate organizations in finance and participants in capital markets more broadly has increased tremendously (Cantor and Packer 1994; Partnoy 2002; Langohr and Langohr 2010; Sinclair 2014; Sylla 2002; Alcubilla and del Pozo 2012; Poon 2012; Mattarocci 2013). The consensus on the growing regulatory power of rating agencies in finance is reflected also in the persistent citation of Thomas Friedman's famous statement in 1996: *"There are two superpowers in the world today in my opinion. There's the United States and there's Moody's Bond Rating Service. The United States 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."*

While it is clear that ratings given by these private for-profit agencies have become regulatory in finance, there is ambiguity and confusion about why and how exactly did this form of rating attain such regulatory power. Some scholars emphasize the necessity of agency ratings given their successful performance and the belief that rating agencies' reputation (for independence, accuracy, and truthfulness) was at stake when giving their evaluations expressed through a rating (Alcubilla and del Pozo 2012; Smith and Walter, 2002; Langhor and Langhor 2008). Other researchers highlight the power given to agency ratings by their legal incorporation in regulation (Olegario 2003; Sylla 2002; Partnoy 2002; White 2002; Cantor and Packer 1994; Poon 2013). Recent studies point not only to the context and conditions that enabled such regulatory power—like wars, economic and political crises, and economic depression—but also to the active role played by different actors involved in the financial sector and capital markets—for example, lawyers, courts, government regulators, investment bankers, and most importantly rating agencies themselves (Flandreau and Mesevage 2014a; 2014b).

This chapter builds on an interdisciplinary literature concerned with understanding the growing power of rating and their agencies by arguing that agency ratings in finance became regulatory thanks to a successful cultural institutionalization process preceding their legal incorporation. These private agencies were able to make their product of rating and themselves as organizations, an accepted unquestioned necessary part of the financial system. Their ratings became part of everyday practices of different organizations and individuals in finance and ended up being seen as inevitable, natural, and irreplaceable solutions to the problem of evaluating financial instruments (products) and their issuers (producers). I argue that this process of cultural institutionalization involved certain organizations adapting to changing context and as well as actively and creatively making use of the opportunities it offered for doing organizational work, that is, crafting the form and identity of their organization and products in a dynamic, emergent, and fragmented financial field.

First, I present a brief history of the emergence of agency ratings in finance, with the purpose of clarifying terms and highlighting the organizational and institutional context within which the organizational identity work of rating agencies takes place. Second, I note how rating agencies were able to become accepted as part of the field and its actors' practices by building a positive organizational and product identity, that is, presenting themselves not as a competitive alternative to existing practices but as a complementary and supplementary one. This section delineates the processes and mechanisms through which rating and their agencies became culturally institutionalized. Lastly, I provide evidence on the reception of rating agencies' organizational identity work and the success of the cultural institutionalization process. The conclusion of this chapter summarizes the key argument and lays the ground for the following chapter on how this successful cultural institutionalization process contributed to the legal incorporation of rating and their agencies.

A brief history of rating and terminology issues

Rating involves the processing of information gathered from different sources and its presentation in a standardized format as a summary evaluation. Today, in finance and in the United States, the activity of rating is generally located within certain firms and in a particular domain -the for-profit 'independent' rating agencies and the evaluation of debt instruments[14] and their issuers. However, as scholars have noted, rating has a longer and more comprehensive history in the US (Carruthers 2013; Cohen 2012). Its meaning and role in finance has changed gradually through struggles of different actors to define and influence different elements of this phenomenon: the gathering, analyzing, and presentation of information.

The history of rating in finance is closely linked to the history of credit. Mercantile credit—credit in goods used by merchants to smoothly proceed with their commercial activity[15]—was one of the earliest forms of credit to develop in the United States and in the

[14] A 'debt instrument' is an obligation -in paper or electronic form- issued by a borrowing party that uses a lender's funds to raise his own, promising to pay her back in accordance with the terms of a signed contract. For example, notes, bonds, certificates, mortgages, leases are all kinds of debt instruments.

[15] Sellers offering *mercantile credit* (also called commercial credit) did not loan money but provided goods to buyers in exchange for their promise to pay at some future time. This is different from other kinds of credit like consumer/personal credit, bank credit, and investment credit that involve the lending of money for different uses: consumption, building a business' 'working capital' and investing in its growth, respectively (Mishkin and Eakins

world (Carruthers and Ariovich 2010; Olegario 2006). This kind of credit expanded especially with the resumption of trade relations after the signing of the Treaty of Paris in 1783 which ended officially the American Revolutionary War (1775-1783) [16] and brought the recognition of the United States of America by Great Britain. Credit was seen as a distinctive feature of American commerce (Olegario 2016). Commercial bank credit and investment credit were other important forms of credit for businesses that involved an institution or individual offering their money to help businesses maintain and expand their activities, respectively. With the development of the banking system and capital markets in the US, businesses—depending on their size and nature of work—used bank and investment credit in parallel to mercantile credit. As population grew and business expanded, exchanges became more frequent and distant and it became more difficult for creditors to have personal knowledge of businesses and decide whether one was worth their support. Initially, creditors started relying on informal channels to get information about businesses that would help them decide. Those that demanded credit tried to use references from prominent reputable people they knew to indicate their creditworthiness. They found somebody who would write a recommendation letter, either somebody who had previously worked with that business or a reputable member of the potential new customer's or supplier's community like a banker or a lawyer. But in most cases, creditors had to take their chances, as such informal channels were not seen to meet the needs of American business which by the 1830s had grown both in scale and scope (Olegario 2003; 2006).

2014). For example, mercantile credit is more flexible and informal and decentralized in nature than bank credit - it implied creditors and debtors were in a relationship of mutual responsibility (Olegario 2006, 11)

[16] In the United States, it is known as The Revolutionary War and also as the American War of Independence. It was an armed conflict between Great Britain and its North American independent colonies, which declared independence as the United States of America in 1775.

The role information played in the history of credit was transformed radically with the emergence of firms that specialized in gathering and providing information about businesses - today known as the credit reporting agencies. The US experienced hard financial times in the mid 1830s: the financial panic of 1873 followed many banks failures and thousands of businesses bankruptcies. In this context, Lewis Tappan started his enterprise of creating a credit information agency, with the assumption that businesses needed more adequate and reliable information to make decisions on whether to become creditors. Based on his experience of gathering extensive information on the creditworthiness of his customers during his business as a dry goods and silk merchant in New York, he established the Mercantile Agency in 1841 -the first firm to specialize in providing commercial information. In 1849, John Bradstreet founded another similar firm. Bradstreet's company in 1857 compiled and published the commercial information it gathered in the form of a book. By around 1880 the Mercantile Agency—which became the R.G. Dun and Company in 1859—together with the Bradstreet agency were a duopoly in the field of *national* credit reporting, though there were more agencies operating at the local and trade-specific level. The emergence of the credit reporting industry transformed credit and commerce in America, especially by shaping the role of information and its exchange in business (Olegario 2006; 2016). The ability to gather and verify information about businesses and their activities in order to evaluate their creditworthiness gradually became crucial to creditors and investors too.

The first ratings and the first rating system were introduced by a credit reporting agency. One of Bradstreet's publications—the reference books—offered summary information on the character and past behavior of a business as well as an evaluation of the creditworthiness of that business. For example, the Bradstreet's estimation of creditworthiness in a reference book from

1860 was expressed in letters: using Aa for ‘Good for any amount required’, A for ‘Best of credit’, B for ‘Very good credit’, C for ‘Good credit’, D for ‘Good for smaller credit’ and E for ‘Fair for small lines’ (see Olegario 2006, 66-67 for the whole key). Bradstreet’s reference book is considered the first commercial rating book in the world. Other credit reporting agencies adopted its rating system too.[17]

However, even though credit reporting agencies rate businesses and their creditworthiness, they are not considered rating agencies. The activity of ‘rating’ and the identity of a ’rating agency’ in finance are today mostly linked to another group of private for-profit firms specialized in the process of gathering, processing and presenting information in a particular form - generally called ‘credit rating agencies’ or ‘bond rating agencies’. They make up a separate industry and rate not only businesses (as credit reporting firms do), but also financial instruments (products).

The history of the rating agencies and their ratings as we understand them today is generally linked to the development of credit markets[18]. At the end of the eighteenth century, the US followed in the steps of world leading economies like the Dutch Republic at the start of the seventeenth century and England at the end of the seventeenth century, which were able to establish modern financial systems that included extensive financial markets[19]. Bond and stock

[17] Initially, Bradstreet did not use a rating system, just a coded system. The decision to provide symbolic ratings—more vague and generalized summaries of information than those in detailed reports—may have been due to fear of libel suits—suits that argued agency’s credit report defamed the evaluated subject’s character (Norris 1978, pp. 298, 366, 368; Olegario 2006, Chapter 2, Footnote 113)

[18] The credit market, sometimes called the debt market, is a market where investors can purchase debt instruments issued by companies and governments such investment-grade bonds, junk bonds, short-term commercial paper, notes, and securitized obligations - mortgage pools, collateralized debt obligations (CDOs) and credit default swaps (CDSs). The credit market is different from the equity market, which gives investors a chance to invest in the equity of a company - for example, when buying stock, the investor is buying a share of the company’s profits or assuming a share of its losses (see Mishkin and Eakins 2014).

[19] A financial market includes buyers and sellers that trade financial assets such as stocks, bonds, commodities, derivatives and currencies. Two of the most common components of a financial market are money markets -used for short-term assets, with maturity up to one year—and capital markets—used for long-term assets, with maturity greater than one year. Money and capital markets involve different tradeable financial assets i.e. financial

markets were established in several cities shortly after the country's independence. During the early stages of securities trading, in Europe investments were mainly in public bonds—generally issued by governments to finance wars—and investors had trust in governments' ability to repay their debts. During the nineteenth century, even when the international bond market grew, investors focused on sovereign debt, and bank loans and share issues[20] were sufficient to address most need for capital. In the US, however, it was infrastructure projects—railroad construction, most specifically—that created most need for capital. These projects were first financed by some US states and local governments issuing debt, but soon the private sector took over. The US railroads raised money as private corporations and first were able to use bank loans and share issues to finance themselves. After 1850, they started to issue bonds, as their activities expanded and local investors were less likely to know well and trust projects undertaken in faraway territories. This gave rise to a huge corporate bond market -the railroad bond market, and also many new efforts to collect and process (credit) information about business overall (Sylla 2002). It was in this context that John Moody and his company thought to rate the financial instruments issued by businesses.

The first ratings were given to railroad bonds by John Moody and his company in 1909 and published as part of *Moody's Analyses of Railroad Investments.* Before merging in 1941 to form Standard and Poor (S&P), Poor's Publishing Company and Standard Statistics Company published their ratings guide for corporate securities in 1916 and 1922 respectively. Fitch Publishing Company was the latest entry to the rating business—starting ratings for corporate

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instruments: deposits, collateral loans, acceptances and bills of exchange in the former, stocks and bonds in the latter. Though they are both accessible to any individual, corporate, and government entity, they tend to involve different institutional participants: stock exchanges, commercial banks and all types of corporations, including nonbank institutions like insurance companies and mortgage banks, operate in capital markets, and central banks, commercial banks, and acceptance houses, among others, operate in money markets (See Mishkin and Eakins 2014)

[20] See Mishkin and Eakins 2014 for more detailed information.

debt in 1922 and published them formally in the 1923 issue of *The Fitch Bond Rating Book.* After being incorporated in 1914, Moody's started to expand its ratings coverage to bonds issues of US cities and other municipalities as well as those of utility and industrial companies. With its ratings, it was able to cover nearly 100 percent of the US bond market by 1924.

Moody's has been the leader in introducing rating and related practices to new markets: being the first to rate municipal bonds in 1919 and holding a monopoly for thirty years, first to charge issuers for corporate bonds ratings (followed by S&P in 1974) and rate a Eurobond in 1970, first to give ratings to bonds issued by finance companies in 1973, and bonds by bank holding companies in 1974 (followed by S&P in 1975). S&P, however, was the first to charge issuers for municipal bonds ratings in 1968 (followed by Moody's in 1970), the first to rate commercial paper in 1969, to assign ratings to insurance companies in 1971, and to issue a rating in the structured finance market for mortgage-based securities in 1975 (followed by Moody's in the 1980s). Fitch has been a marginal player in the rating business (Sinclair 2014), mainly a follower that drew attention only during controversies involving the oldest major players in the industry - Moody's and S&P. S&P bought Fitch Publishing, including its rating system, in 1960 - becoming the largest publisher of financial advisory and statistical services. Dun and Bradstreet Corporation (D&B, created by the merging of two credit reporting firms - R.G. Dun and Company and Bradstreet in 1933) acquired Moody's in 1962. In 1966, McGrew-Hill, Inc. acquired S&P—making it the second major rating agency to be acquired by a large business information and publishing company.

There were two major phases of legal incorporation that changed the meaning of rating and rating agencies. The first phase in the 1930s transformed the product of rating by mentioning it in banking regulation. The U.S. Office of the Comptroller of the Currency (OCC)—a department of the US Treasury in charge of supervising nationally chartered banks at the time[21]—issued the first rating-based regulation in 1931 requiring banks to carry at cost on their balance only bonds rated in a Baa/BBB or higher rating category. Banks had to keep bonds at lower rating categories at market value. In 1936, the OCC prohibited banks altogether from purchasing securities considered speculative by recognized rating manuals, generally securities rating categories below Baa/BBB. Such regulations made ratings a symbol of regulatory compliance, rather than just evaluations of bond quality. The second phase in the 1970s drew lines around the producers of rating—the specialized, for-profit agencies—with the creation of the NRSRO status in securities regulation. The Securities and Exchange Commission (SEC) amendment of the Exchange Act Rule 15c3-1—known as the 'net capital rule'—introduced in 1973 and finally published in 1975, directed broker-dealers[22] to certain rating agencies—NRSROs—for establishing which securities they held to consider investment grade and which non-investment grade. Broker-dealers would have to set aside as reserve a lower percentage of their holdings' worth—a lower 'haircut'—for their securities qualifying as investment grade, as they were regarded less volatile and more secure. A lower haircut meant higher net capital for broker-dealers and more ability to deal in securities. Rating agencies gained a new kind of authority and position as legitimate providers of standards for evaluating the market volatility of securities. Their regulatory power grew with such legal incorporation, as rating-dependent regulations proliferated afterwards (Partnoy 2002, Cantor and Packer 1994).

[21] The US had a fragmented banking system at the time, as national banks, state banks, and banks that became members of the Federal Reserve System had all different supervisory organizations: the Office of the Comptroller of the Currency (OCC) - an independent agency under the formal authority of the Federal Treasury, State authorities, and the Federal Reserve Banks.

[22] A dealer or broker-dealer is somebody in the business of buying and selling securities for their own account whether through a broker or otherwise. While dealers trade for their own accounts, brokers buy and sell securities for clients. The size of dealers can be small independent houses or subsidiaries of large banks. Dealers make markets in securities, underwrite, and provide investment services to investors and most of them also act as brokers (see Mishkin and Eakins 2014 for detailed explanation).

What made possible such legal incorporation through regulation and defined our current understanding of rating and ratings agencies was a process of cultural institutionalization whose success resulted from rating agencies' organizational identity formation practices. The innovation of rating and rating agencies became successful and got institutionalized as a result of agencies' approach to constructing their organizational identity—creating a positive identity that did not attempt to deinstitutionalize available options but presented themselves as complementary and supplementary alternatives or just another tool in the repertoire of market participants.

Therefore, the emergence of rating agencies and their ratings' regulatory power through legal recognition needs to be examined in the broader context of transforming technologies and institutions involved in gathering, processing, and presenting information, opinions and judgments about business. Scholars generally mention credit reporting agencies, specialized business and financial publications, and investment bankers as the predecessor institutions to rating agencies (Alcubilla and del Pozo 2012; Langohr and Langohr 2010; Sylla 2002; Sinclair 2014). However, such representations tend to hide the kind of relationships rating agencies had with these institutions and how those relationships shaped their development and meaning of rating.

Credit reporting agencies: commodifying information and fighting for a culture of (business) transparency. Among today's mechanisms that facilitate the sharing of credit information—credit rating agencies, credit information bureaus, and trade associations—the credit reporting firm was the earliest mechanism to appear in the United States (Miller 2003; Sylla 2002). In 1841, Lewis Tappan established the first firm to specialize in providing information about businesses involved in commerce—the Mercantile Agency, so that it aided the use of credit among merchants. Eight years later, John Bradstreet formed a similar firm, that ended up not only gathering commercial information but also publishing it in the form of a book in 1857. In 1859 the Mercantile Agency became R.G. Dun and Company. After dominating the field of *national* credit reporting for more than half a century, these two companies merged in 1933 to form Dun&Bradstreet (D&B).

Credit-reporting agencies gathered information about US businesses—their performance, standing, and other indicators—through a network of agents, and sold this compiled information to subscribers to help them determine whether the business they were going to deal with was worth their credit -its creditworthiness. First, they evaluated whether merchants were able to meet their financial obligations, as most trade in the US happened through the use of credit -mercantile credit (Olegario 2006). Latter they adopted a subscription-based business model: interested parties would subscribe to the service of reporting agencies—the gathering, compiling, and processing of information about businesses. Credit reporting agencies contributed to the commodification of information, the spread of which was underway with the development of the news and publishing industry in the US (more on this in the next section) (Asadoorian 2007).

The main source of information for early credit reporting firms were local attorneys, though the network of correspondents providing information included sheriffs, merchants, postmasters, and bank correspondents.[23] They generally relied on local knowledge to establish the trustworthiness and creditworthiness of an individual and its business (Cohen 2012). The reporting agencies also asked for subscribers to comment on attorney's provided information. So, attorneys were interested in working with these agencies because they provided an opportunity

[23] Attorneys that worked with agencies formed their own networks of exchanging information (among counterparts in other towns) (Olegario 2006, 52-3).

for them to build reputation (Olegario 2006, 52-3). Correspondents recorded information about as many businesses and businesspeople in a particular region as possible and evaluated their creditworthiness based on a narrow, specific set of "character" traits—honesty, punctuality, sobriety, and thrift being the most important. Credit applicants provided to their creditors only information about their financial worth: a vague figure including their 'unencumbered' real estate, cash, personal property, and owned merchandise. Checking their accuracy was too costly and time consuming for creditors. So, credit reporting agencies were also involved in checking for the accuracy of information provided by relying on different sources.

Credit reporting agencies offered detailed descriptive reports on businesses as well as a reference book containing the ratings of businesses. The detailed descriptive reports were compilations of information gathered and verified with the help of different sources. They involved challenging work because the gathering effort required cooperation from businesses in sharing information about customers. Credit reporting agencies tried to defend their activities as necessary solutions to the problem of closed networks of information and business secrecy, in order to support their information gathering activity. They encouraged sharing of information among businesses and contributed to developing among creditors the desire for more transparency (Olegario 2006). In the 1870s and 1880s, the number of subscribers to their reports increased and many court decisions favored their activity. Reporting agencies showed the importance of information in establishing trust and assessing risk. Creditors organized and professionalized the credit-granting function by creating in 1896 the National Association of Credit Men (NACM). The birth of these 'credit men' contributed to subduing the concerns of businesses about the strict accuracy of credit reports (Olegario 2003; 2006).

The reference books were syntheses or summaries of collected information organized according to a particular system—a rating system. The rating key—first introduced with Bradstreet's reference books[24]—included information on character and past behavior as well as the agency's evaluation of the subject's creditworthiness. For example, the Bradstreet's estimation of creditworthiness in a reference book from 1860 was expressed in letters: using Aa for 'Good for any amount required', A for 'Best of credit', B for 'Very good credit', C for 'Good credit', D for 'Good for smaller credit' and E for 'Fair for small lines' (See Olegario 2006, 66-67 for the whole key). The production of the reference books involved the processing of gathered information as well as a particular presentation of the resulting processed information. The processing of information required establishment of a fixed set of criteria and standards for evaluating information as relevant or not to determining creditworthiness. It involved a selective presentation and analysis of information. In the absence of criteria for valuing different kinds of selected information relevant to determining creditworthiness, presenting information in a simple symbolic form—as letter grades—meant exercising judgment or expressing an opinion about how to ultimately interpret the gathered and processed information.

Reporting agencies always urged subscribers not to fully rely on their published reference books that presented information in the form of ratings, but acquire the full detailed reports especially for smaller firms and ambiguous cases (See Madison 1974, 174; Olegario 2006, Chapter 2, Footnote 117; Cohen 2012). Nevertheless, the use of reference books was so widespread and visible, that it seemed like they had replaced descriptive reports as a useful source of information on businesses[25]. The spread of reference books meant also the spread of

[24] Initially, Bradstreet did not use a rating system, just a coded system. The decision to provide symbolic ratings may have been due to fear of libel suits - suits that argued agency's credit report defamed the evaluated subject's character (Norris 1978, pp. 298, 366, 368; Olegario 2006, Chapter 2, Footnote 113)

[25] See how Norris (1978, pp. 53-4. 68-73, 84-94, 111-3, 142-7) talks about this replacement.

rating and the implicit acceptance of judgment on creditworthiness. However, these firms continued to be seen as credit reporting agencies rather than rating agencies, even though they fought hard to defend the rating form of information they offered (Cohen 2012). Some scholars would argue that this was due to the fact that they viewed their main contribution and had their greatest struggle in transforming business culture—from one based on personal ties to one relying on widely held norms and rules, and valuing the principle of transparency[26]—willingness to make information widely available (Olegario 2006). Others would argue that it was part of broader corporate strategies that credit reporting agencies used to shape their image and reputation for independence and usefulness (Flandreau and Mesevage 2014a; 2014b).

Today credit reporting agencies offer ratings, though they are different from those of rating agencies. Reporting agencies give ratings just to businesses, even though they still use letters and/or numbers to express them. D&B, for example, explains their Rating as "a system that measures a firm's size and composite credit appraisal, based upon information from a company's interim or fiscal balance sheet and an overall evaluation of the firm's creditworthiness." (see Dun and Bradstreet 2017). A company's rating has two parts: a rating classification ranging from 5A to HH that determines a company's size in terms of D&B's calculation of the net-worth or equity of the company (reflecting credit capacity), and the rating system from 1 to 4 that reflects D&B's overall assessment (high, good, fair, limited) of a firm's creditworthiness. The first part of the rating is given for businesses that supply D&B with their current financial statements. The second part is based on D&B's analysis of "company payments, financial information, public records, business age and other important factors (when available). For companies that do not

[26] The term 'transparency' is used to mean different things in the financial and the political context. In finance, transparency exists when information about markets and corporation is available and accessible. In politics and government, transparency means accountability in public institutions and minimized opportunities for corruptive practices.

supply D&B with current financial information, company size is reflected by a different classification based on the number of employees they have—1R for businesses with more than 9 employees and 2R for companies with 1 to 9 employees—and their highest creditworthiness rating they can get 2. For lines of businesses not covered by the its rating system, D&B provides a classification by the number of employees the company has ranging from ER1 (1,000 or more employees), ER2 (500 to 999 employees) to ER8 (1 to 4 employees), and ERN (meaning that information is not available). They caution credit suppliers to not interpret negatively cases when businesses do not have a rating from D&B or D&B lacks information required for a rating.

Specialized Business and Financial Publications: the need for information and news. In the early part of the 19th century, dozens of newspapers catered to specific business audiences such as farmers and merchants. However, railroads business captured most of the media attention during the 19th century. Among "the first real business publications" in the United States were: *The Railway Express, The Railway Examiner, The Railway Globe, The Railway Standard, The American Railroad Journal,* and *The Railway Mail* (Roush 2011, Chapter 2). They provided detailed information on the railroad industry, ranging from the engineering of steam engines to the amount of shipped freight for each individual railroad.

As railroad corporations grew into multidivisional enterprises employing professional managers and operating across large diverse geographies in the late 1820s, they became more attractive to investors. By 1832, *The American Railroad Journal* appeared as one of the first specialized publications to provide extensive information about the railroad industry. From 1849 to 1862, under the editorship of Henry Varnum Poor (1812-1905), it presented itself as a publication directed at investors, offering carefully gathered and systematized information about railroads—some of the biggest businesses in America and perhaps the world. The journal provided information on the property, ownership, assets, liabilities and earnings of railroads throughout the country, including their stock offerings and overall financial conditions. Poor - a former lawyer and lumber merchant- is considered retrospectively not only as the first business journalist to use statistical analysis for assessing a company's performance but also a founder of business journalism for his arguments that companies disclosed detailed financial information—a radical notion for the 19th century (Roush 2011, Chapter 2; Bizjournalismhistory 2017). Poor started a separate firm with his son in 1868 to publish extensive historical and updated financial and operating statistics for most of the major American railroads compiled in a yearly volume called *Poor's Manual of the Railroads of the United States*. For several decades, this manual remained the authoritative guide for investors and others interested in the state of railroad finances (Chandler 1956).

Specialty business news publications as well as the coverage of business in mainstream newspapers also increased by the end of the 19th century. A mainstream newspaper—the *New York Herald*—began to cover business and economic issues for the first time and even hired its first financial editor—Thomas Prentice Kettell—in 1835[27]. The *Herald*'s founder—James Bennett—explained his view of business journalism "The spirit, pith and philosophy of commercial affairs is what men of business want. Dull records of facts, without condensation, analysis, or deduction, are utterly useless. The philosophy of commerce is what we aim at, combined with accuracy, brevity, and spirit." (Bizjournalismhistory 2017). In 1882, Charles

[27] The *New York Herald* was founded on Wall Street by James Gordon Bennett - a former economics teacher. It was the first daily newspaper to have a separate page on business issues. Bennet started writing what was called the 'money page' and later developed it into "the best financial section of any mainstream newspaper". Other newspapers at the time did not provide extensive analysis of the business community as the *Herald* (See Bizjournalismhistory 2017).

Dow, Edward Jones and Charles Bergstresser—former news reporters—started their own news service—Dow, Jones & Company—designated only to providing financial information—initially in the form of hand-written news bulletins delivered by messengers to subscribers in the Wall Street area[28]. Their service led to the publication of a business newspaper—*Customers' Afternoon Letter*—a year later, which circulated widely and became popular after they purchased a printing press. Dow Jones published its first stock average in 1884 including nine railroad companies and two industrial stocks. After receiving complaints that the average did not represent the overall market, they refined the list and gradually developed the first industrial stock average in 1896 out of 12 stocks[29]. One of the most well-known media for business news and information in the US—*The Wall Street Journal*—was founded by Dow and Jones and began publishing in 1889, as the first daily newspaper devoted exclusively to covering the business world (Roush 2011, Chapter 2).

The beginning of the 20th century brought changes in printing technologies and how newspapers operated as a business, with an increasing role for advertising revenues, and affected the spread of specialized business publications. In 1900, the recently founded John Moody & Company released a new specialized publication—*Moody's Manual of Industrial and Miscellaneous Securities*—that offered information and statistics on the shares and bonds of several financial institutions, government agencies, manufacturing, mining, utilities and food companies[30]. The Standard Statistics Bureau was another company—founded by Luther Lee Blake in 1904—that published an annual volume of compiled corporate news items on railroads

[28] They started their activities in the basement of 15 Wall Street, next to the New York Stock Exchange. (See Bizjournalismhistory 2017)

[29] The list was later expanded to 20 stocks in 1916 and 30 stocks in 1928. Since then the Dow Jones Industrial Average (DIJA) remained an established barometer of the market's performance, today including also non-industrial companies (Bizjournalismhistory 2017).

[30] John Moody called his manual the Red Book to distinguish it from Poor's manual known as the Green Book.

and other industries since 1906. The Fitch Publishing Company—founded by John Knowles in 1913—also offered financial statistics through specialized publications like the *Fitch Bond Book* and the *Fitch Stock and Bond Manual.*

Specialized business publications generally gathered information from multiple sources through reporters employed to cover a particular section or topic. They made use of already existing local publications as well as special inquiries conducted in magazines by some investigative journalist. The processing of the gathered information consisted in creating a story—a task which was mostly in the hands of writers and editors. The presentation of processed information was in form determined by the writer or the editor. The specialized publications did not offer mere numbers, statistics, objective 'facts', or sensational news. They were inspired by Progressive Era[31] journalists called muckrakers[32] which aimed at assisting society by being truthful and bring social change through their stories that uncovered and brought to light problems actively hidden from public knowledge (Roush 2011, Chapter 3). The information processed was presented in a narrative form, containing only enough information to support an argument and give a message. They varied in their business model—either distributing copies only to subscribers or making this service 'free of charge' by making it public through newspapers. Business journalism and specialized business publications provide

[31] The Progressive Era generally spans historically from the 1890s to the 1920s. This period in American history is characterized by widespread social activism and political reform aimed at addressing problems resulting from industrialization, urbanization, immigration, and corruption in government. The main logics behind the Progressive Movement were progress through modernization, efficiency, competition, innovation, design, and science. Progressives supported government involvement in the advancement of scientific methods in nearly all spheres of life and encouraged the professionalization of researchers in the social sciences, especially in history, economics, and political science (Jaycox 2005)

[32] American journalists that were reform-minded and exposed corruption in the established institutions and leaders through their investigative writings were called 'muckrakers'. The term was first used by President Roosevelt in a 1906 speech that praised 'the men with the muck-rakes'—muckrakers—as indispensable to society's wellbeing, but also cautioned that they needed to know the limits. The kind of reporting called 'muckraking' began to appear around 1900, generally with pieces in magazines such as *McClure's Magazine* and *Collier's Weekly,* that had wide circulation among a growing middle class. The muckrakers' writings played a very important role in putting pressure for reform (Gallagher 2006).

important information to businesses and investors. Their coverage and specialization has increased with time in the US.

Investment bankers: the power of reputation, judgment, and opinion. Investment bankers are individuals who are involved in activities of raising capital for companies, government and other entities. They may also offer advisory services to their clients on issues such as mergers, acquisitions, reorganizations and other financial transactions. They often work for an investment bank or other kinds of financial institutions. Investment banker's role is to identify risks of a company pursuing any particular project, given their expertise and ability to understand economic conditions and the investing climate. She serves as an intermediary between issuers of securities—generally companies who want to issue stocks or bonds—and investors—those interested in buying such issues. They help the issuer price financial instruments with the aim of maximizing their revenue and navigating regulatory requirements. Investment banks often serve as a proxy of a company by buying that company's shares and selling them in the market. The role of analysts at investment banks then is crucial in this respect as they have to use expertise in accurately evaluating the value of stocks purchased and whether the amount of risk involved in the purchase is worth taking. In smaller organizations the investment banker duties are fulfilled by corporate finance staff (Mishkin and Eakins 2014).[33]

Investment banking in the US emerged in the 1800s as financial markets changed to support the growing manufacturing-based economy (Ramirez and de Long 2001, 95). The industry brought together many financial services available in the early 1800s. In the early nineteenth century, government officials and commercial bankers learned about loan contracting

[33] For details see Mishkin and Eakins 2014.

and securities issues from their London counterparts while they tried to fund the public debt (Hayes, Spence, and Marks 1988, 15). The European experiences and investment houses influenced the working knowledge of certain financial practices and dominated the refunding of Civil War loans in the US. However, they did not have great impact on the structure and dynamics of US investment banking. The post-Civil War decade was marked by expanded activity and increasing influence of bankers through membership on corporate boards or finance committees. They started to give technical assistance to issuers regarding new offerings, extensive financial advice, as well as supporting services (Carosso 1970a). The variety and extensiveness of bankers' involvement in companies' activities made their services, general financial advice, and reputation, develop into highly valued assets for companies in attracting investors (Ramirez and de Long 2001, 98; Hayes et al. 1988, 16). Companies and the investment houses that financed them entered into "close, continuous relationships" that benefited both parties as "…banker's presence on the board facilitated sales of …securities; it gave investors the confidence that their interests were being better served; and it appeared to constitute either an endorsement of the issue's "investment quality" or "practically guaranteed" it" (Carosso 1970b). For bankers, this relationship meant secured access to substantial income, and ability to better compensate their analysts (Hayes et al. 1988, 17).

Railroad corporations used investment bankers to underwrite[34], purchase and sell their securities. These financial intermediaries were able to attract investors and also gather large sums

[34] Underwriting refers to the process through which investment bankers raise capital from investors on behalf of issuers of securities—generally companies and governments. The word originated from the practice of having each risk-taker write their name under the total amount of risk they were willing to accept at a specified premium. An example of underwriting can be found in insurance: when an insurance company find an underwriter for a particular policy, the amount of capital the underwriter puts up at the time of investment serves as a guarantee that the claim can be paid. The underwriter then helps the insurance company manage the risk of offering services to many applicants/customers. The underwriter serves as a guarantee because of their expertise in researching and assessing risk and a belief in their evaluation and final judgment (see Mishkin and Eakins 2014).

of capital through an extensive, often international, network for American securities and their issuers. Some banking houses had affiliated counterparts, others had family and personal connections in European financial centers like London and Paris (Sylla 2002). An investment banker's reputation was at stake when they got involved in the transaction of securities by offering them to investors and striking a deal (Carosso 1970). Thus, the interest of the banker in not tarnishing their built reputation served as the indicator for investors to put money in particular financial instruments. In exchange for the reputational capital[35] they put in line during these securities deals—certifying investment quality—investment bankers asked for extensive information on the company, its operation, and its finances, to be provided in an ongoing basis, and even insisted on having seats on the company's board of directors.

However, the growth of the US investing class led to a lot of resentment over investment bankers' insider position that made possible privileged access to extensive confidential, classified, and off the record information. Investment bankers organized into underwriting syndicates[36] whose operation and rules were mostly informal and not transparent to outside observers. They were led generally by apex investment houses and operated as a closed club for banks and bankers. Such view of investment banking, as an oligopolistic industry with and a few powerful houses secretly controlling the fate of US business instigated public suspicion, which peaked in the 1930s and resulted in major regulations for the industry (Hayes et al. 1988, 19-22).

Investment banks gathered information about businesses and their financial situation as part of their relationship with them. In order to raise capital for their clients and better position

[35] Reputational capital refers to the accumulated reputation of individuals or other entities acquired overt time based on their behavior that leads to others holding them in high esteem and trusting them. It is a reserve of good will that reduces the cost of transactions among parties.

[36] An underwriting syndicate refers to an informal organization of underwriters for buying and selling of a particular set of securities.

them in the market for capital, investment bankers needed to learn a lot of about them. Establishing long-term relationships with clients meant that they were regarded trustworthy and respectful of the highly confidential information they came through in the course of their duties.[37] Information then was gathered and flew through private closed channels. The argument that all potential investors should have access to the same information as the investment bankers led to the legislation asking for mandatory disclosure by issuers of securities to investors and the establishment of a regulatory body for securities—the Securities and Exchange Commission (SEC)—in the 1930s.

The processing of information gathered was initially done by the investment bankers themselves and later by junior level investment bankers called analysts. Analysts had training in the fundamentals of accounting and financial statement analysis as well as modeling and corporate valuation. In their beginnings they would typically help on certain projects, with development and preparation of marketing presentations, analysis of client equity and fixed income portfolios, research of current trends, support with trading and general client service.[38] The investment banker would present the processed information in meetings with clients and in the form of written reports as well as oral presentations during meetings. Their evaluation and judgment of securities was expressed in their actions: if they were underwriting and selling certain securities it meant that they had decided those were worth investing in after having carefully researched and assessed the risk they involved. Given their established relationships

[37] The investment banker had to follow the code of conduct of their firm and generally sign a confidentiality agreement. However, there was a potential conflict of interest in cases when the advisory and trading divisions of the investment bank or financial institution interacted.

[38] These are general terms used to describe the job of a new analyst by a major investment bank Goldman Sachs (see http://www.goldmansachs.com/careers/why-goldman-sachs/our-divisions/investment-banking/positions/analyst.html).

with businesses i.e. issuers of securities and their position as an intermediary, investors saw their behavior as an attempt to maintain reputational capital.

Thus, the judgment and opinion of investment bankers regarding the investment quality of securities was implied in their actions (underwriting, buying and selling) and it was not shared publicly with anyone but their clients ideally. Investment bankers in some sense were involved in rating as they processed the gathered information and presented it in a condensed symbolic form to their clients and even investors - in the form of behavior. Their behavior was a symbol similar to the letter grades of credit reporting agencies as the methods through which they were reached at remained opaque and not disclosed. They were symbols in that they left room for extensive interpretation.

Rating agencies and their ratings: reputation and the commodification of judgment or opinion. What we recognize today as rating agencies in finance are a set of for-profit organizations that evaluate different kinds of financial instruments as well as institutions. In 1909, Moody's company started adding an analysis of security values to the standard collection of information on the property, capitalization, and management of companies offered by other publications. Different from reporting agencies that evaluate businesses and the risks of extending commercial credit, and similar to investment bankers, rating agencies started by evaluating financial instruments and the risk of extending investment credit. Rating agencies adopted the rating system used by credit reporting agencies, processing information into different formats but offering also condensed versions of that same information as ratings too. Even though similar to investment bankers rating agencies became a kind of intermediary between the issuer of a security and investors, they differed in their claim for being 'independent' evaluators of investment quality as they were not themselves involved in the business of purchasing and selling securities. They offered a more democratic way of getting information and judgment on investment quality of financial instruments: paying a price for them. In their claim of independence, they resembled credit reporting agencies as well as specialized business publications—both of which based their reliability to a large extent on being impartial and objective.

Rating agencies gathered information from different sources, initially already available publications and documents. Similar to reporting agencies, they relied on businesses or other organizations sharing their information and making it available to them. Credit reporting firms made information gathering easier for credit rating agencies as they had worked hard to make information disclosure and sharing in the name of transparency more acceptable for businesses. Not only did they help foster a particular business culture they also had made the idea of collecting information through extensive networks of correspondents in order to sell it -the commodification of information- unquestionable. in contrast to investment bankers, and similar to specialized business publishers, they did not have direct relationships with businesses - they were not involved in the trading of financial instruments themselves and could not claim access to privileged unique information. As they started to offer other services different from ratings like specialized business publications and investment advice, their position resembled more investment banks though as they did not themselves purchase or sell securities they could keep a claim of independence.

As rating agencies specialized in the evaluation of financial instruments, they put most of their efforts into processing information in a particular way. Similar to investment bankers, they had analysts that organized the gathered information into reports, using statistical modeling as well as a synthesizing narrative of the analysis. Their methods of analysis and the process through which information is transformed into a rating or a summary evaluation remains opaque. Part of the reason for this lack of transparency has to do with the fact that the process of drawing conclusions about the overall quality of financial instruments (and investments broadly) and assigning a rating involves a lot of subjectivity. Initially when Moody's first offered ratings as part of a summary analysis of railroad investments, he set out to systematically devise standards and principles for processing gathered information over which anyone could build their evaluation of the quality of financial instruments and their creditworthiness (whether they were worth investing in). These explicit standards of evaluation resembled those of reporting agencies in the field of extending merchant credit but they were an innovation regarding the field of offering investment credit.

The way in which rating agencies presented the processed information—in the form of a symbol made of letters and/or numbers—resembles the one introduced by reporting agencies. Similar to reporting agencies, rating agencies presented information into different forms with different degrees of condensation and brevity (Cohen 2012). They offered manuals, reports, and summary analysis in narrative form that resembled the forms of specialized business publications as well as investment bankers' products. Ratings were generally provided in conjunction to these other less condensed forms of information, and rarely given separately by themselves. First, rating agencies offered their different products to interested parties through subscription. This model of financing their operation was similar to that used by reporting agencies and specialized business publications. The interested party in receiving the processed information payed for it—so businesses, organizations or individuals subscribed to get information regarding other businesses and organizations that would theoretically help them make decisions on whether to enter a particular relationship with them. Rating agencies changed their business model into an issuer-pays one: making the issuers of the evaluated financial instruments—the subject of the processed information rather than their audience—pay for ratings.

The idea of a 'independent' private agency as an intermediary collecting and selling information was familiar in the context in which credit rating agencies began. The rating form of presenting information was also widespread and more accepted - though not problematic and contested - thanks again to the experience of reporting agencies with such condensed form of presenting processed information (Cohen 2012). The greatest challenge for credit rating agencies was to be recognized as independent and trustworthy evaluators and consequently have their subjective evaluation of securities and their issuers accepted as useful and necessary for investors and other interested organizations. They could claim independence by the fact that they were specialized (i.e. experts) in a particular task—evaluation—and were doing it separate from financial institutions involved directly in the trading of financial instruments. However, when they started to offer advisory and consulting services and introduced the issuer-pays business model, it was more difficult for them to defend their claim of independence.

Rating agencies advanced the enterprise of commodifying opinion and judgement that previous institutions were involved in. They used the logic underlying the work of journalists and reporters who wrote news and opinion pieces—the provision of information as an expression of the freedom to speech and opinion—to present themselves—private for-profit organizations—as as individuals having the right to speech and opinion and not responsible (i.e. not to be penalized) for its consequences. Rating agencies, similar to reporting agencies, accepted the subjectivity of rating in this context. They were able to build legitimacy and authority behind this practice of presenting processed information by creating an organizational identity that embraced rating's subjectivity and emphasized it as a practice supplementary and complementarity to other existing practices in the field. Clearly, rating agencies were supporting investment bankers by evaluating risk - which was part of that they did in addition to take risks in place of others for a fee. Rating agencies' function could also be said to be supplementary to the work of reporting agencies by adding to their evaluation of businesses an evaluation of their financial products as participants in financial markets. While reporting agencies looked at businesses and organizations as participants in commerce, rating agencies looked at them as participants in financial markets.

Cultural Institutionalization through Building Organizational Identity

The emergence of rating agencies and their ratings owes a lot to this institutional background. However, rating agencies did not substitute these institutions but were able to grow in parallel with them. Rating agencies weaved together several of the 'logics' or 'innovations' regarding the gathering, processing, and presentation of information introduced by existing institutions in the financial field. They built an organizational identity that led their ratings and their kind of organization to be culturally institutionalized and then legally incorporated within regulations. As scholars note and many historians of credit rating agencies show, credit ratings were used widely despite absence of evidence for their performance before the 1930s (Carruthers 2013; Sylla 2002).

I argue that ratings and their agencies became institutionalized partly because of the way in which they build their organizational identity given the institutional, political and economic context in which they emerged. I want to highlight not only the conditions that contributed to the cultural institutionalization of ratings that existing literature emphasizes. but also the actors that perceived, seized and shaped the contextual opportunities through their actions. Looking at the organizational history of these rating firms and the way in which they presented their product and themselves will help reveal the mechanisms through which cultural institutionalization became possible and laid the ground for political institutionalization to follow from the 1930s to the late 1970s. I distinguish two paths of building organizational identity—what I call the path of doing product work and the path of doing producer work. Doing product work means engaging in activities that introduce the organization's product to the pool of existing products in an organizational field and make it meaningful, acceptable, useful, demanded and purchasable. Doing producer work means engaging in activities that shape the organizations reputation and performance as a producer of a particular product by making use of (or in relationship to) other producer organizations' reputations and performances.

Rating agencies emerged within the context of the Progressive Era generally spanning historically from the 1890s to the 1920s. This period in American history was characterized by widespread social activism and political reform aimed at addressing problems resulting from industrialization, urbanization, immigration, and corruption in government. The main logics behind the Progressive Movement were progress through modernization, efficiency, competition, innovation, design, and science. The movement began focusing on the political system: it took down corrupt government representatives, regulated monopolies and corporations (through Trust busting and antitrust laws) and made many constitutional changes. During this era, reform was introduced in many areas: local government, medicine, finance, insurance, industry, railroads, ect. The emphasis of the movement was on finding and building the "one best system" (Gould 2000; Tyack 1974, 39). Progressives supported government involvement in the advancement of scientific methods in nearly all spheres of life and encouraged the professionalization of researchers in the social sciences, especially in history, economics, and political science (Jaycox 2005).

Many long-lasting institutions that influence economic policy today originated in this era: the Federal Reserve System, the Interstate Commerce Commission, the Federal Trade Commission, the Food and Drug Administration. These organizations were aimed at advancing administrative efficiency through the scientific enterprise and standards setting, among others. During the depression of the 1890s, small business, farm, and labor movements demanded more extensive involvement of the federal government into the private sector, a position that went against the concept of laissez-faire—a doctrine opposing government involvement in the economy except for maintaining law and order (Faulkner 1951). The Interstate Commerce Act—regulating railroads, and the Sherman Antitrust Act—preventing large firms from controlling a single industry, that Congress enacted in 1887 and 1890 respectively, were enforced rigorously when presidents sympathetic to the Progressives' position came to power, like Republican President Theodore Roosevelt (1901-1909) and Democratic President Woodrow Wilson (1913-1921). Wilson, for example, ratified the Sixteenth Amendment that enabled the federal government to levy an income tax, required a small income tax on high incomes, lowered tariffs, and concluded long battles over trusts (Link 1954, 25-80).

Product Work: Differentiation and Complementarity

Before giving ratings, rating agencies had offered other products similar to specialized business publications—for example, *Poor's Manual of the Railroads of the United States, Moody's Manual of Industrial and Miscellaneous Securities,* and *Fitch Stock and Bond Manual*—that compiled and presented information on financial instruments and their issuers.

The kind of information offered by these specialized publications changed and it led to creating a new line of business for these organizations—ratings. In 1909, Moody's company started adding an analysis of security values to the standard collection of information on the property, capitalization, and management of companies offered by other publications. *Moody's Analyses of Railroad Investments* included a brief but comprehensive conclusion—also expressed with letter rating symbols used by credit-reporting firms since the late 1800s—stating the extent to which the railroad company and its outstanding securities where worth investing in—their investment quality. It also included for readers a description of the analytical principles used to assess these companies' operations, management, and finance. Given its experience with compiling and selling financial and statistical information, the Poor company entered the bond rating business in 1916. Fitch followed by introducing in 1924 the AAA to D rating scale appearing with an in-depth analysis by investment experts. The merger of Standard Statistics and the Poor company in 1941 formed the Standard and Poor's (S&P) company, which together with Moody's remain the world's largest credit rating firms by far. The trio—Moody's, S&P, and Fitch—still dominates the credit rating industry today (Cantor and Packer 1994).

John Moody and his company published the first security ratings for US railroads as part of *Moody's Analyses of Railroad Investments* in 1909. The publication was presented as offering 'an expert comparative analysis' that would enable bankers and investors establish 'the true values of securities' because it followed 'a method based on scientific principles properly applied to facts' (Moody 1909, 3). Before merging in 1941 as Standard and Poor's, Poor's Publishing Company and Standard Statistics Company published their ratings in 1916 and 1922 respectively. These first ratings were in the field of corporate securities. Poor's Publishing followed the same scale as Moody's, with asterisks to distinguish the grades within the letter rating categories A through D.[39] Standard Statistics started rating bonds and stocks in 1922 using a similar scale with number one and plus signs to distinguish letter grades[40]. Fitch Publishing Company was the latest entry to the rating business. The company was founded in 1913 as a publisher of financial statistics, mainly for the New York Stock Exchange, and later expanded reaching a range of customers in the investment world with the publication of *The Fitch Bond Book.* Fitch started ratings for corporate debt in 1922, but it published them formally in the 1924 issue of *The Fitch Bond Rating Book*. It introduced the AAA-through-D scale that Standard & Poor's adopted when it purchased Fitch's publishing business in 1960. Fitch remained a marginal player in the rating business, gaining publicity only after the 1930s.

Credit rating agencies employed similar rating schemas: using ordinal (e.g. A, B, C, D) and cardinal elements (e.g. AAA, AA, A), having three subcategories under each main rating category (e.g. A+, A, A- were three levels in the A category, similar B+, B, B- were the levels in the B category). From the beginning, the four rating scales of Fitch had several 'sub-categories' and went down to the D level which meant "practically valueless". Standard used E and F ratings and Poor's scale went down to H, as the lowest. Moody's lower rating was first E, then F was added in 1914 and both were dropped in 1923 when D remained as the lowest category. In 1930, Moody's also dropped the Daa, Da, and D categories imputing greater risk to the remaining lowest categories (Stimpson 2008, 49). However, as Poor's acknowledged, these lower categories were rarely used. For some time, different from others, Poor's had three "super-ratings" -an A with five stars (A*****) for US government bonds, an A with four stars (A****) for other "impregnable" obligations, and an A with three stars (A***) indicating the "Very

[39] Poor's put Freeman Putney, one of the young fellows that had discussed the idea of rating securities with Roger Babson, in charge of its ratings (Harold 1938).

[40] Luther Blake - the founder of Standard Statistics - placed Harold G. Parker in charge of the firm's rating department (Stimpton 2008).

Highest" investment quality (see table of Symbols of the Principal Rating Agencies in Harold 1938).

Rating symbols were different, but scholars claimed that they could match one agency's ratings to another because of their similarities. As at the time most rating agencies issued bond ratings in the A category and very few in the C or lower categories scholars argued that they were not using very different methods of evaluation for bonds (Harold 1938). Flandreau and Mesevage (2014b) however argue that it was not easy to match these agencies' rating scales and the similarities were an artifact created by different agents, scholars included.

Rating agencies did not claim to have unique sources of information, when it came to their product of rating, and they seemed to generally be transparent about where they got their information from. They definitely relied partly on publicly available investment news to generate their own, as scholars have noted (Partnoy 2002, 69). In his initial publication of ratings John Moody acknowledges that the analysis is based almost exclusively on the annual reports of the railroads for previous years but it continues to thank railroad officials and departments of federal government -the Interstate Commerce Commission[41] and the Department of Commerce—for their willingness to supply all necessary requested information (Moody 1909, 3). Poor's ratings publication in 1922 also explained where their information came from (Poor's 1922, x).

When talking about ratings, agencies emphasized more the process through which they analyzed information and the standards used in this process rather than sources. Moody (1909), for example, saw his enterprise as an attempt to establish a standard in the business of buying and selling investment securities, as different from many other trades and professions,

[41] Moody (1909) included in this publication/book a condensed version of the uniform accounting requirements for steam railroads prescribed by the Interstate Commerce Commission (133-192). These statements required by the Interstate Commerce Commission served as one important data source for Moody's work.

investment, banking and bond business lacked—in his view—widely accepted and used technical and scientifically-derived standards (126). Moody's first ratings publication had two main sections. Section 1 provided the principles used to determine railroad security values - physical factors, income factors, capitalization factors—a general key to all ratings, stock records and ratings, and a list of definitions and abbreviations. Section II presented individual analyses for every major railroad system in the US. Poor's Rating Service also followed those two principles—its ratings included *salability* numbers (1-4) given when explaining the meaning of bonds and stocks evaluations (Poor's 1922, xxxviii). In presenting its rating service in 1922, Poor's noted that their sources of information were diverse but not as extensive as those of investment houses. They reassured readers that this was not an issue to be concerned about because of their method: "Whilst our sources of information are more varied than those of any Investment House, we cannot claim that these…are in all cases as exhaustive as theirs… In the main, however, the ratings of such a House will be found to harmonize with Poor's, inasmuch as the Banking Affiliations of every security have received careful consideration by our analysts, and these affiliations are reflected in the ratings assigned." (Poor's 1922, vi).

Rating agencies presented their product of rating as opinion - subjective, relative and not completely accurate or factual. Moody's first ratings publication described the product as 'an analytical commentary' from the standpoint of the owners of the securities, aimed to help the banker and investor (these last words are capitalized in the text explaining the scope of the book) (Moody 1909, 14). He adds a note in smaller font stating that he cannot guarantee the absolute accuracy of statements and even welcomed suggestions for correcting any minor error users could identify (Moody 1909, 5). After giving the definitions of the rating key and before presenting the tables with records and ratings, John Moody reminds the reader once again of the subjectivity and arbitrariness involved in producing these ratings—for example, factors such as the character of management and of traffic, and the general position of the railroad system—and reminds users to treat ratings as indicators of value, and mere opinions (Moody 1909, 194). Poor's (1922, v) also emphasized that ratings could not be factual as long as they were a product of the organization itself. In the 1922 publication, they presented ratings as "an unbiased opinion on the investment value of securities" (Poor's 1922, viii) and a supplementary tool for clients—a check to their own judgment (Poor's 1922, ix). Because they saw ratings similar to a personal opinion, agencies did not hold themselves responsible "for the accuracy of any of these ratings or of the figures and information upon which they are based" (Poor's 1922, ix).

When agencies introduced the new product of rating they tried to differentiate it from other services and products that they offered or that were already available. Similar to reporting agencies which distinguished reference books (containing ratings) from reports, rating agencies distinguished the rating service from the manual service. In the Preface to the *Analysis*, John Moody emphasized that his book was different from a "Manual" and it could not supplant the Manuals which provided statistical records and comprehensive information. He explained that the *Analysis* included only enough statistical information to make understandable its conclusions and simply the evaluation of securities in relation to each other (Moody 1909, 16). The first clarification in the publisher's notice section in Poor's Rating Service publication for 1922 was also on how "Rating Service differs from Manuals Service" (Poor's 1922, V).

However, more important than differentiating securities rating as a product was presenting it as a familiar tool—supplementary and complementary to those already available and in use by the credit community. John Moody (1909, 5) attributed the inspiration for his work to the interest and support of Bankers and Investors as well as his many Wall Street friends. He saw the

Analysis as an attempt to establish a standard in the business of buying and selling investment securities, as different from many other trades and professions, investment, banking and bond business lacked—in his view—widely accepted and used technical and scientifically-derived standards (Moody 1909, 126). Ads focusing only on "John Moody's Investment Ratings," presented ratings as "Symbols of Safety for the Investor" that reflected "years of painstaking study and research" and drew parallels between the use of Moody's Rating of bonds and stocks by investors and the use of credit rating of loan applicants by bankers as well as the credit rating of subjects purchasing goods on credit by business men (Stimpson 2008). When Poor's Publishing advertised its rating service in *The Wall Street Journal* (May 12, 1922) they offered a detailed booklet mailed free of charge to those wanting to learn what Poor's Rating Service was and did and why they should use it. The Fitch Publishing Company announced its new rating service in June 13, 1924 at the same journal emphasizing how it was based on other Fitch services—similarly "the product of the most exacting statistical research" (Stimpson 2008, 67).

Even though scholars call them 'credit rating agencies' and 'bond rating agencies', initially rating agencies published ratings of both bonds and stocks (except for Fitch Publishing Company that offered only bond ratings), and evaluated investment quality rather than credit quality[42]. Before describing in detail the process and principles used to determine the value of securities, John Moody pointed out that he used the same method of analysis for both bond and stock issues—technically two distinct classes of obligations—because he saw them blend and interlace

[42] Credit quality is one aspect of investment quality. It is an evaluation of the issuer of a financial instrument (security): it indicates whether the institution or person issuing the instrument is able to meet its obligations. Credit ratings are evaluations of credit quality. For example, a credit rating of a corporate bond indicates the creditworthiness of the issuing corporation—whether it is able to repay its debt. Investment quality is an evaluation of the financial instrument as a product of the issuing entity: it indicates whether the purchase of the financial instrument is profitable in the long run. Investment ratings are then evaluations of investment quality. For example, the investment rating of a corporate bond indicates whether the investor is able to trade it without much loss or better with profit in the future. While credit ratings prioritize only the principle of security, investment ratings also consider the principle of salability.

in modern corporate finance and they could both be evaluated in terms of how secure investments they were (Moody's 1909, 122). Moody argued that in order to measure the value of securities they had to be evaluated and classified in terms of two principles: security and salability. The first and most important principle—*security*—meant evaluating the earning capacity or income-producing power of organizations (railroads at that time). Thus, the securities whose value was affected by factors beyond or above that of the fluctuating earning power—affected by money market conditions—were regarded as 'high-grade' issues. Those whose value was almost exclusively affected by changes in earning power—affected by specific conditions of the properties themselves—were regarded as more 'speculative-grade' issues (Moody 1909, 122). To evaluate the worth of investing in each security, Moody's defended looking at the average conditions of the property plus its average earning capacity for a considerable length of time—initially 10 years (1887-1897). The second principle used in evaluating securities—*salability*—meant evaluating how easily a security could be sold by the investor purchasing it—the more salable ones being rated higher (Moody 1909, 128-9). Poor's also offered ratings for both bonds and stocks, and considered in their evaluation both the security and salability principles (Poor's 1922, xxxviii).

Agencies presented their ratings as a conservative option and method for evaluating securities. John Moody in the *Analysis* argued that the application of the security and salability principles resulted in ratings that represented a very conservative judgment on the strength and value of a given security, but recognized that critiques could emerge regarding the positioning of speculative and lower quality security issues (Moody 1909, 193). Poor's (1922, V) also noted that "ratings must be conservative…lower in all probability than the ratings of this or that Investment House handling any given security. Furthermore, the 1922 publication clarified that these were “not credit ratings” in the sense that they did not offer opinions about the commercial or mercantile credit (Poor’s 1922, viii).

The focus on bonds and the security principle for evaluating investment quality developed in the 1930s and was emphasized more after the 1970s. Rating agencies followed the demands of the time, which focused on the security aspect of investments and emphasized credit risk and quick evaluations of financial products in fast changing times and uncertain markets. Moody’s, for example, decided to drop the Daa, Da, and D rating categories—building more risk in the remaining lower categories—in 1930 and to discontinue rating stocks, focusing on bond rating since 1934. These moves started the process of transforming agency ratings more into ratings of credit quality rather than investment quality (Stimpson 2008, 49).

Though securities rating was a new product offered by rating agencies in the first and second decade of the twentieth century, it was not the most important one and was generally offered in conjunction with other products and services especially manuals. When the new product of rating was introduced in 1909, Moody had already done work on publicizing his Manuals and made his name and his enterprise known (Stimpson 2008, 74). Poor’s also presented its rating service as an extension of the manual service not a supplement to it (Poor’s 1922, vii). Both rating agencies at the time insisted that ratings were never used apart from manuals or instead of them (viii). Similar to the credit reporting agencies’ efforts in connecting the reference book service to the report one, the effort of keeping them connected was partially successful. Most references to rating are in the context of manuals, which ended up being called ‘rating manuals’. Subscribing to the rating service itself was for a long time possible only if one subscribed to the manual service.

Ratings as a product partly spread as a result of the expansion of the statistical organizations' business and the introduction of new products, especially the increase in their advisory services. For example, Moody's—the leader of the ratings industry, in this period was making most of its revenues from the investment consulting part of its business not the ratings one (*Forbes* 1924). After the first edition of the rating book in 1909, John Moody introduced a new service—what he advertised as his "Real Investment Service"—*Moody's Weekly Review of Financial Conditions* (for short "Moody's Weekly Letters"). He had nearly no competition in this field and he expanded the service in 1912 to include also a weekly special analysis on a particular property or timely financial subject, a monthly trade barometer, an investment valuation record, a personal correspondence system, and a "Security Record System" which enabled subscribers to file a confidential list of one's holdings and receive regular personalized advice in managing them (Stimpson 2008, 52-4). Moody's Investment Service was founded sometime in 1913 as a result but the confusion between Moody's *Analyses* and Babson's *Moody's Manuals* went on till when Moody's bought the right to the "Moody's" name in 1924 from Poor's - the owner of Moody's Manuals at the time (69). Even then, though, a major article on Moody by B.C. Forbes in 1924 gave only passing mention of the rating books, and emphasized the other services offered by his firm. An advertising campaign started by Moody's in the late 20s presented themselves as offering two main investment services: the Manuals which made them "the chief recognized source for investment statistics and information" and their rating system with its revolutionizing investment methods (see ads samples in Stimpson 2008, 75).

There were different forms of ratings that investors could use as indicators or measures of bond quality. Hickman's (1958) study of corporate bond quality in the US for the period between 1900-1943 identified three forms of ratings: the *independent agency ratings*—a composite average of the ratings of Moody's, S&P (or its predecessor organizations), and Fitch, the *legal lists ratings*—implied by lists of legal investments for savings banks used by regulatory officials in the states of Maine, Massachusetts, and New York, and the *market ratings*—obtained from dividing the yield spread of a particular bond issue by the lowest yield of a corporate bond of the same maturity[43]. Agency ratings were not necessarily better at evaluating investment or credit quality. Rating firms saw themselves as supplementing or complementing the existing options and tools, rather than replacing them. Slowly, however, their role and importance increased, leading finally to their regard as better than other alternatives.

Producer Work: Reputation and Performance

The existing accounts and histories of credit rating agencies seem to emphasize contextual factors. Rating agencies are seen as finding themselves in the right conditions -with alternatives decreasing in importance and uncertainty increasing. However, this is only part of the story. The 1920s were characterized by growth in the US and a general feeling of optimism about the economy. This context did not give reasons for raising voices and complaining about rating agencies. There seemed to be little contestation also because they seemed to perform well till early 1930s. They were able to increase their reputational capital. However, establishing reputation meant actively showcasing the work of the organization, its products and its people.

Rating agencies created their identities as producers of ratings through the management of reputation and performance. They did not only have to build reputation and give evidence of performance but also had to harness existing reputational capital and external sources to support the image of performance out in the field. In their early years, the industry looked like a

[43] The maturity of a financial instrument—generally more applicable to bonds and deposits—refers to the time after which the financial instrument ceases to exist as its issuer has to pay back the original sum loaned from the buyer of the instrument—the principal—with interest. For bonds, this time is set at the time the instrument is issued.

competitive market. In the period till 1930s, credit rating agencies competed to secure a reputation for being independent, fair, and trustworthy. They were financed exclusively from subscription fees. These firms were small and with limited profitability. Issuing ratings meant putting under scrutiny the firm's name, integrity, and credibility. Inaccurate ratings could damage their reputation among the investment community and even put in danger their existence, as there were not high barriers for new entrants (Flandreau, Gaillard, and Packer 2011; Partnoy 2002).

Individual entrepreneurship was important in starting to build the identity of the rating agency as an organization. John Moody was not the first to have the idea of rating securities. Roger Baboon and Freeman Putney had discussed the possibility in 1901 when they rode the train to and from Boston, as reported by Harold in his 1938 book. Floyd Mundy published *The Power of Railroads* around 1903 which included the basic railroad operating and financial statistics and showed how to judge the investment value of bonds and stocks, without including any ratings. Moody's acted on the idea of rating securities after understanding the long standing practices of large institutions, especially insurance companies, of classifying bonds into groups, getting asked by users of Moody's Manuals for an opinion on the issue as early as 1906, and having discussed it with Carl Snyder whose book *American Railways as Investments,* The Moody Corporation published in early 1907 (Stimpson 2008, 43).

The struggle for John Moody was to make his firm and its products well known. His efforts at building reputation around himself and his enterprise start in the very early 1900s and involved traveling, giving workshops and speeches in different venues -mainly men's clubs and bankers' gatherings, - advertising intensively his firm's services, and publishing under his name books as well as articles in newspapers and magazines (Stimpson 2008, 31, 69). When the new product of rating was introduced in 1909, he had already done work on publicizing his Manuals and made his name and his enterprise known. John Moody, however, lost the Moody Manuals to Roger Babson who bought them in 1908, when Moody's company went bankrupt affected by the 1907 panic and John Moody was fired from the firm. He started the rating business in this context.

Moody's put time and money into publicizing his efforts and the products and services of his firm overall. He advertised extensively from 1900 on—almost every year except for some years after 1907—more than any of his competitors at the time (Stimpson 2008, 74).[44] In his beginnings, he used his ads to promote his company and its outputs—manuals, books, and special reports—most of them appearing in New York dailies such as the *Wall Street Journal* and the *New York Times,* many in newspapers like the *Los Angeles Times,* the *Chicago Tribune, and* the *Boston Herald* as well as in magazines like *Financial World* and *Forbes*. By the 1920s the company grew and the nature of its ads became more corporate in nature and targeted the fast emerging 'individual investor' that needed education and help with investing.

The reputation of Moody's—the leader rating agency—initially was closely tied to that of John Moody's reputation as an individual. A booklet titled "The Story of an Institution" that described the firm's position in 1915 and its associated advertising stated that "The Institution known as 'Moody's Investors Service' is John Moody" (Stimpson 2008, 60). It changed later as the firm expanded in the mid 1920s with greater revenues coming from its investment advisory service. Moody's public visibility through his writings always contributed to the prestige of the firm. Among the first publications was the best-seller *The Truth about The Trusts: A Description*

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[44] Moody's first serious competitor was Roger W. Babson whose company operated in Wellesley, MA and entered the New York market with his publication of *Bond and Stock Statistical Card Service* in 1903. However, John Moody saw Poor's Railroad Manual company as his major rival (Stimpton 2008, 28).

and Analysis of the American Trust Movement in 1904 based on information compiled by his company's Bureau of Corporation Statistics (Stimpson 2008, 31-33), Moody's series in *McClure's Magazine* on Wall Street and the "money power" titled *Masters of Capital in America - The Seven Men* written with George Kibbe Turner (November 1910) which John Moody used as a basis for a book titled *The Masters of Capital: A Chronicle of Wall Street* published in 1919 as volume 41 in the Yale University Press series "The Chronicles of America", a textbook in 1912 on the analytical method on *How to Analyze Railroad Reports*, and a history of American railroads published in 1919 as Volume 38 in the Yale University Press series entitled "The Chronicles of America" titled *The Railroad Builders: A Chronicle of the Welding of the States*. These publications reflected the spirit of the Progressive era that emphasized scientific inquiry as well as investigative journalism that threw light into secret issues and injustices—similar to those practiced by muckrakers.

One of the publications that created great sensation and a lot of publicity for John Moody was a forecasting piece he wrote on economic conditions in 1915 after the beginning of WWI which he actively mailed to every corporate official, every member of Congress, own subscribers and leading newspapers. He correctly predicted that the market would soar and not crash after the opening of the NYSE in December 1914 and this helped increase the sales of his firms' services and publications. Another one was a series of 21 articles in *Forbes* magazine where Moody offered "the cream of his investment advice". For his first article titled "Modern Investor Has the Nation-the Whole World-at His Feet" published in October 15, 1924, B.C. Forbes introduced Moody's as "Grand Marshall of the Army of Investors" having "a larger following than any other man in America". In 1925 B.C. Forbes Publishing Company presented the series in a book titled *Profitable Investing: Fundamentals of the Science of Investing,* introducing him, his services and in particular his ratings as representing "the supreme authority on the merit of an investment" (Stimpson 2008, 70).

The emphasis of rating agencies' ads was on their expertise and organizational history. For example, in 1923 John Moody used the Moody's Investment Letters to explain the 'Meaning of Moody's Bond Ratings' with a graphic illustration for his readers. At the same time Moody's announced its Rating Council—a special group of experts including "more than a dozen thoroughly qualified students of investment values" covering railroads, public utilities, foreign governments, and American municipalities, where each expert had his own research assistants (Stimpson 2008, 68). An advertising campaign started in 1924, for example, included ads calling attention to common investing mistakes and offering Moody's Supervisory Service to help avoid those pitfalls. It offered the "constant and experienced consideration" that "the ever-changing tide of business and finance demands" and special business and financial information obtained through their extensive facilities and organizational experience in "recognizing danger signals and anticipating their effect upon individual securities" (See ad sample in Stimpson 2008, 74). With another ads series in the end of 1920s, Moody's Investors Service (the name since 1914) featured itself as "an organization of experts", that for 19 years—from 1909 to 1927—had been "growing with the Country", becoming "quite indispensable to bankers, dealers, investors and corporate heads" with their investment services, "the chief recognized source for investment statistics and information" with their Manuals, and revolutionizing investment methods with their Rating System (See ads samples in Stimpson 2008, 75).

However, the claims of rating agencies for expertise were always presented carefully and with consideration for other institutions involved in the evaluation of securities, investment bankers in particular. An investment banker's reputation was at stake when he got involved in the transaction of securities by offering them to investors and striking a deal. Thus the interest of the banker in not tarnishing his built reputation served as the indicator for investors to put money in particular financial instruments. In exchange for the reputational capital[45] they put in line during these securities deals—certifying the quality of securities, initially bonds—investment bankers asked for extensive information on the company, its business and operations, and its finances to be provided in an ongoing basis and even insisted on having seats on the company's board of directors. The publisher's notes for Poor's Rating Service advised users not to see agency ratings as competing or substituting or better than the ratings of investment banks: "The high-class Investment House underwriting an issue of securities has undoubtably made an exhaustive private investigation, both financial and technical, into the merits of the particular issue, and its ratings should in consequence receive respectful consideration even when they differ from Poor's*"* (Poor's 1922, vi).

The positioning of themselves as organizations of experts that complemented existing institutions and even intended to support their work, helped rating agencies build their own reputation by borrowing from investment bankers' reputational capital. Once resentment increased among investors and the broader public about the means of gathering and distributing information used by investment bankers—their dealing with privileged information—rating agencies could inherit some of their reputational capital (Sylla 2002; Alcubilla and del Pozzo 2012). They were in the same intermediary position but represented a more 'democratic' kind of distributing information: they made available information to any paying investor and emphasized 'investor's right to know' (cited in Langohr and Langohr 2008). The reputation built up by

[45] Reputational capital refers to the accumulated reputation of individuals or other entities acquired overt time based on their behavior that leads to others holding them in high esteem and trusting them. It is a reserve of good will that reduces the cost of transactions among parties.

investment bankers and their investment houses as certifiers of quality for securities was seized by credit rating agencies due to their similar position as evaluators of securities as well as due to the way they built their organizational identity.

The growth of the US investing class led to a lot of resentment over investment bankers' insider position that made possible privileged access to extensive confidential, classified, and off the record information. Rating agencies provided an alternative intermediary to investment bankers as they provided the processing of information through a scientific method and offered a new form of information for a fee. Consequently, investors could access the rating-form of information more easily and make decisions for themselves in dealing with securities. The position credit rating agencies took within the existing flow of information led to a transfer of the reputational capital investment bankers had as certifiers of quality for bonds and other securities (Sylla 2002, 25; Alcubilla and del Pozzo 2012). When in their ads and introductions of the rating service Moody's and Poor's mentioned banks and credit reporting firms they were not just differentiating their product but drawing from the reputational capital these different institutions had accumulated. As Lipartito (2013) shows credit reporting also involved some reputational capital: their work did not eliminate reputation—it mediated reputation and changed the way reputation was conveyed in markets. Therefore, similar to reports, ratings had reputational effects which were subject to political and legal debate. Under conditions of increasing uncertainty, there is a sense of having less control on reputation—therefore the use of symbols such as ratings might help with gaining a sense of being more in control of one's reputation.

The legacy and fate of existing institutions involved in rating was partly responsible for the emergence of rating agencies' as contributors to the field of information provision and necessities for the investment community. As investment banking transitioned from wholesale to retail behavior—offering securities to individuals not only organizations—it experienced many more instances of questionable practices and speculative excesses that led to public debates about their responsibility for the Great Depression and their unethical behavior (Carosso 1970). This harm to investment bankers and their reputation helped credit rating agencies strengthen their own reputational capital—as an alternative accurate and trustworthy source of evaluation for securities. The use of agency ratings silently became part of practices used in many professions—bankers, insurance companies, consultants and other actors in the securities market (Caruthers 2013; Cohen 2012). Agency ratings gained visibility through time as their judgments expressed in summary form were more amenable to spread than lengthy information compilations from other specialized publications or the cryptic private evaluations of investment bankers.

Scholars note that ratings spread and became part of investors practices even though there was not enough evidence of their performance (Carruthers 2013; Partnoy 2002). After being incorporated in 1914, Moody's started to expand its ratings coverage to bonds issues of US cities and other municipalities as well as those of utility and industrial companies. Moody was the first to start rating US state and local government bonds in 1919—entering a market that was nearly a century old, with S&P following only in the early 1950s (Sylla 2002, 31). By 1924, Moody's was able to cover nearly 100 percent of the US bond market with its ratings. The performance of their ratings was tested with the Great Depression: bond defaults rose but many of Moody's highly rated ones continued to pay as scheduled (Langohr and Langohr 2008, 394). Their performance though is still debated and their necessity too, compared to existing alternatives (Flandreau, Gaillard, and Packer 2009; 2010).

Some of the first studies to examine the performance of agency ratings emerged after the end of 1930s. Harold (1938) produced a major study of rating agencies and their bond ratings where he argued that thought the rating agencies' record was not perfect, their performance in effectively protecting investors against loss was "certainly beyond reasonable criticisms". Two other major publications were Hickman's (1958) work of corporate bond quality in the US for the period between 1900-1943 and Hempel's (1971) study of the state and local bond market for nearly the same period. Hickman (1958) identified three potential forms of ratings that investors could use to make in their investment decisions: the independent agency ratings, the legal lists ratings, and the market ratings. Hickman found that these rating systems performed quite well over the time he examined them -they could predict both lesser and greater default rates and the risk-return trade-off (the greater the risk of default, the greater the return earned). He concluded that these different rating systems were equally effective in predicting bond quality—most probably because they used the same information to produce their ratings. Hempel (1971) also pointed out alternative ways of measuring credit quality and noted that rating agencies' method tended to favor large governmental units giving them higher ratings: 'Nearly 98 per cent of the 310 cities with populations over 30,000 were rated Aa or better' (108).

While in this period ratings seemed to perform well, there were certain biases and surprising findings of these studies. One of the most surprising findings of Hickman's (1958) study was that agency ratings for corporate bonds were more sensitive to business cycles than market ratings. Rating agencies upgraded their ratings in good times and downgraded them in bad times. This instability was in contrast with the frequent statements of rating agencies about how their ratings measured the 'intrinsic quality' of securities (23-24). Hickman also noted that all these different forms of ratings were more successful at evaluating issues within industries, and less efficient in detecting risk of default between major industrial groups (12-13). They privileged bonds from the railroad industry, as they rated them higher than public utility and industrial bonds, despite the greater rate of default in that sector. Hempel (1971) noted that rating agencies tended to favor large governmental units giving them higher ratings: ‘Nearly 98 per cent of the 310 cities with populations over 30,000 were rated Aa or better’ (108). Hempel (1971), on the other side, was disturbed to find that a very high proportion of the 264 defaulting issues of municipal and government bond examined in the study had received an Aa or better agency rating in 1929 - before the Great Depression of the 1930s. The ratings were downgraded as the Depression progressed.

Flandreau and Mesevage (2014b) found that reporting agencies were active participants into building an image of performance and a good track record through the use of their lawyers who managed court cases. Looking at both litigated and settled cases, they show that the emerge of mercantile agencies resulted from a farsighted corporate strategy operating in a legal environment that was not ready to permit the commodification of credit. Similar to credit reporting agencies who faced the challenge of libel suits and strategically addressed it through handling of court cases, rating agencies were not passive receivers of neither reputation nor performance. Their organizational identity was not only a consequence of contextual developments but also a result of organizations’ identity building efforts. An important characteristic of these efforts was their emphasis on presenting themselves and their ratings as an option and a supplementary complementary tool for market actors not a competitive alternative to existing practices and institutions in these markets. This embracing of uncertainty through a less competitive approach to organizational identity building helped them become culturally institutionalized.

The reception of rating agencies and their ratings: Evidence of successful institutionalization

The initial reception of agency ratings for securities was overall positive, though mixed with confusion. There was praise for the new publication of *Moody's Analyses of the Railroad Investments* which contained the securities ratings. Many financial publications praised the rating book, generally John Moody's new analytic methods, but none of the reviews quoted by Moody in his 1910 edition mentioned the securities ratings per se (Stimpton 2008, 50). Despite the clarification given in the *Analysis,* people thought this was a new manual and saw the publication as another part of Babson's work—the Moody's Manuals. The confusion resulted in partly from lack of appropriate differentiation: for example, in 1909 Moody did not have money for advertising the rating book and was not able to differentiate his product enough, whereas Babson publicized Moody's Manual heavily. John Moody in his memoir noted that, despite the initial 'storm of opposition' among the rated companies and on Wall Street and 'ridicule from some quarters', ratings began to have an effect with dealers and investment houses.

The use of agency ratings was limited in this period, though the use of other products of rating agencies such as manuals had given their name wide recognition and considerable authority as valuable providers of information. Institutions like banks and insurance companies relied first and foremost on their own analysts and considered agency ratings as a means of confirming their own conclusions. Industrial firms looked at ratings for their "recognized publicity value" (Harold 1938, 22). So, agency ratings were seen more valuable in the secondary market, rather than in the primary market[46] for new issues (where one would expect agency's

[46] The primary market refers to the market for newly issued financial instruments.

information to be more valuable given their claim of exclusive sources and processes for producing ratings) (Harold 1938, 21).

The evidence presented by these and other scholars emphasizes how agencies had acquired a reputation for being valuable providers of information and were widely used by individuals and organizations participating in the financial system. Examining court records before the 1930s, Flandreau and Sławatyniec (2013) note that courts used the output of rating agencies at the time—mostly their manuals and ratings—as norms of prudence produced and widely accepted by the professional financial community. Giving a long list of supporting statements from federal court cases from early 1920s to late 1930s, they argue that courts' early reliance on rating agencies and their products was not a direct endorsement but an indirect one. Courts relied on the endorsement of the banking and securities trading profession which conventionally accepted the agencies' output as a kind of benchmark within the financial industry (10). Courts decided to trust the word of "financiers and investors" and experts working in the sector like dealers in stocks, considering them to be the only ones who could accredit market reports as trustworthy or not, rather than define themselves what really was industry-wide practice. According to Frandreau and Sławatyniec (2013) it would have been very difficult for judges and the courts to gauge the actual industry practice given the absence of professional handbooks produced by the financial community itself. Authors attribute the courts' attempt to validate ratings as a form of self-regulation and part of the financial industry's own recognized standards, to the Harvard College v. Amory (1983) case which equated standard prudent investing to the standard of industry practice (citing Langbein 1996)[47].

[47] This contrasts with the case of Britain where the legal lists of proper trust investments were produced by Chancellors (Fandreau and Sławatyniec 2013).

The silent spread of agency ratings and their extensive use in the 1930s indicated that they had become institutionalized as acceptable useful evaluations of financial instruments. By the Crash of 1929, the practice of using ratings had spread widely. Rating agencies were able to maintain their reputation as respected valuable contributors in the securities market, most specifically in the bond market. The demand for credit ratings increased dramatically during the 1930s as the Great Depression fueled investors' concern about high bond default rates and credit risk. Getting rated also became more important for issuers, bond issuers more specifically, as they helped bring in financing for projects and could keep them operating in difficult times. During the 1930s, rating agencies were advertising more their services as protectors of investors from further losses, offering sound advice on managing their investments and identifying investment opportunities based on accurate data and statistical information (Stimpton 2008).

The absence of a vigorous long-lasting debate around the use of ratings and rating agencies in regulation was another indicator that their cultural institutionalization was successful. Researchers at the Federal Reserve of New York had already developed a system that reflected the "safety" and "desirability" of a bank's portfolio in a single number produced by weighting the bank's entire portfolio based on credit ratings (Osterhus 1931; Harold 1938, 160-1). As Flandreau et al. (2009, 38) notice, bankers themselves would mention rating agencies to prove their sincerity in court cases. When banking regulators incorporated agency ratings in their regulations initially in 1931, market participants supported it. However, in 1936 when another ruling by the OCC formally requiring nearly all banks to use them, the banking and finance industry voiced strong opposition (Partnoy 2002, 70; Harold 1938; Flandreu, Gaillard and Packer 2009).

The opposition to the 1930s legal incorporation of ratings, however, was mostly because of its implications, not because of a particular view of rating agencies and their product. At the time, more than half of the 2,000 listed and publicly traded bond issues failed to be classified as 'investment securities' by the OCC definition offered in the 1936 decision (Harold 1938, 31; Partnoy 2002, 71). Looking at foreign securities, Flandreau et al. (2009, 10) calculated that the percentage of those in the top four categories of rating agencies fell from on average 85.4 in September 1931 to 47.2 by February 1936[48]. Cantor and Packer (1994, 6) indicated that most of the NYSE-listed bonds (891 out of 1,975) did not meet the test in 1936. Banks noted that with these rulings, rating agencies were "superseding the opinion of banks' statistical experts" (especially those in investment banks) which were "equally competent", and in fact they doubted that rating firms themselves were "desirous of accepting such a responsibility" (*New York Times,* March 22, 1936, "Banks Deplore Bond-Rating Rule"). The *New York Times* article argued that rating agencies had started acknowledging their quasi-regulatory responsibilities a month after the 1931 ruling by the OCC when they started adopting a policy of rating new bonds before they were issued, using the information on securities filed with the SEC a ruling) (Stimpson 2008, 92). The criticisms of the legal recognition of ratings as legitimate evaluations of credit risk pointed out that rating agencies did not outperform markets and the holding of highly rated securities would provide a false sense of security to banks, because they reflected only the past performance of securities and their issuers (*Wall Street Journal,* June 25, 1936, "Security regulations opposed by bankers").

[48] Authors calculate it for each rating agency at the time based on date in their manuals. The percentage of foreign securities in the top four notches in September were 95.0 (Fitch), 90.1 (Moody's), 81.2 (Poor's) and 75.2 (Standard Statistics) and in February 1936 were 45.4 (Fitch), 50.5 (Moody's), 49.5 (Poor's) and 43.3 (Standard Statistics).

Most scholars view the 1930s legal incorporations of ratings as critical to the rise of rating agencies and the credit rating industry (Cantor and Packer 1994; Partnoy 2002; Sylla 2001). However, secondary sources indicate that these decisions did not require ratings from any specific agency, and the press generally talked about 'statistical corporations' rather than rating agencies. This was clear in 1938 when in response to banks' opposition, banking regulators reached an agreement about not mentioning ratings directly in the ruling and clarifying through an OCC statement that the judgment on whether the level of risk or impairment was low enough to place a security in the top category and consider it investment grade was left to the bank examiner[49] (Carruthers 20014, 12-3). According to Harold (1938), however, banking regulators generally agreed that the top category or 'investment grade' securities went no lower than the Baa/BBB rating—practically still relying on agencies' judgments.

Conclusion

This chapter argued that agency ratings in finance became regulatory thanks to a successful cultural institutionalization process preceding their legal incorporation. These private agencies were able to make their product of rating and themselves as organizations, an accepted unquestioned part of the financial system. Their ratings became part of everyday practices of different organizations and individuals in finance and ended up being seen as natural and irreplaceable solutions to the problem of evaluating financial instruments and their issuers. I traced this process of cultural institutionalization and highlighted how rating agencies as organizations adapted to the changing context and actively and creatively make use of the

[49] The position of the bank examiner started with the National Bank Act in 1935 which the OCC to conduct examinations of every national bank and prepare detailed reports for each of them that presented their condition (For details see Office of the Comptroller of Currency 2017).

opportunities context offered. They crafted the form and identity of their organization and products in a dynamic, emergent, and fragmented financial field such that it supported their institutionalization—silently but successfully.

First, I presented a brief history of the emergence of agency ratings in finance, with the purpose of clarifying terms and highlighting the organizational and institutional context within which the organizational identity work of rating agencies took place. Second, I noted how rating agencies were able to become accepted as part of the field and its actors' practices by building a positive organizational identity, that is, presenting themselves not as a competitive alternative to existing practices but as a complementary or supplementary one. I delineated two paths through such identity building proceeded for rating agencies: through shaping the meaning of their product - ratings- and through building a particular view of themselves as producers of ratings. Lastly, I provided evidence on the reception of rating agencies' organizational identity work and the success of the cultural institutionalization process.

The process through which ratings and rating agencies became institutionalized lays the ground for the following chapter which will examine the legal incorporation of rating and their agencies through regulation. Understanding the nature of cultural institutionalization of ratings and their producers is crucial to evaluate the role of different actors—government agencies, industry representatives, and other market actors—who contributed to their role in the regulatory framework through the 1930s and 1970s phases of legal incorporation. Among others, this chapter has created an awareness of how the meaning of ratings and their agencies changes in interaction with their environment, but is not strictly determined by context and circumstances. It has also exposed some of the myths surrounding rating agencies, like that they claimed exclusive sources of information and that their most important activity and product was rating.

CHAPTER 5

Legal Incorporation and the Political Institutionalization of Rating in Finance

Rating—as a process of collecting, processing and presenting information in a particular summary condensed form—has a long history in finance. However, it has become a regulatory mechanism for the field—its markets and organizations—only as a product of certain specialized organizations - what we refer today as 'rating agencies'. It is the ratings given by Moody's, Standard and Poor's (S&P since 1941), and Fitch that carry the power to regulate the behavior of organizations and other market participants in finance. As the previous chapter showed, initially these organizations entered the field by presenting themselves as supportive and supplementary components of already existing institutions, building a positive organizational identity that allowed them to institutionalize their products overall as well as themselves as producers of a variety of products. They tried to offer ratings only in conjunction to other services like manuals and analytical reports. Rating agencies built their reputation as a viable and useful organizational form by borrowing from existing institutions' reputational capital and making use of their legacy - successes as well as failures. They were able to successfully institutionalize themselves and their products, as a natural and necessary solution to investors' and bankers' problem of evaluating financial instruments and their issuers. Agency ratings became gradually an important unquestioned tool in the repertoire of capital market participants.

While some scholars view agency ratings in finance as a form of private regulation, many acknowledge that their regulatory power owes a lot to their legal incorporation in government regulations (Partnoy 2002; Sinclair 2008). This chapter will examine why exactly ratings and rating agencies became part of government regulations and how legal incorporation shaped their meaning and identity. I argue that the successful cultural institutionalization of ratings and their agencies was a necessary though not sufficient condition for their legal incorporation through regulation. Cultural institutionalization enabled the incorporation of rating as a product into regulation, by making it a process involving less contestation and conflict. However, it did not provide enough ground for the inclusion of rating agencies as producers into public regulation. A process of political institutionalization—that involved making accepted the political significance and implications of agency ratings—was necessary, to incorporate rating agencies as the producers of rating in government regulation. As in the previous chapter, I highlight how rating agencies adapted and made use of the contextual opportunities for doing organizational work—a crafting the form and identity of their organization and products—in a way that supported existing institutional arrangements but also advanced their position as source of regulation in the dynamic, emergent and divided field of finance.

First, I provide a brief history of the legal incorporation of rating and rating agencies through regulation. Second, I delineate the processes through which the legal incorporation became possible, focusing on how rating agencies worked on their organizational identity and navigated their context before and after major instance of regulatory incorporation. This section examines their role in advancing the cultural and political institutionalization of ratings as a product and themselves as the producers. Lastly, I present evidence on the reception of the legal incorporation of rating and rating agencies and the success of political institutionalization. This section traces the role government and industry actors affected the meaning of rating and rating agencies, and the way in which alternatives to rating and rating agencies as regulatory mechanisms faded through time. I highlight the implicit negotiation among different actors involved in the outcome of giving regulatory power to agency ratings. I note how the legal incorporation of rating and rating agencies through regulation contributed to furthering their cultural and political institutionalization and to silencing alternatives. In conclusion, I summarize important arguments and reflect on how the political institutionalization process at the same time offered opportunities for the beginning of a process of deinstitutionalization.

The legal incorporation of rating and rating agencies: a brief history of two phases

The regulatory incorporation of rating in finance happened in two phases: in the 1930s and in the 1970s. The first phase of legal incorporation involved the recognition of rating as a product, whereas the second phase resulted in the recognition of rating agencies as the producers of the rating product. Rating-based regulations were first introduced in the banking industry in the early 1930s and later spread into the insurance industry in the 1950s and the securities industry in the mid 1970s. These incorporations happened over a background of major political and economic events and broader regulatory changes.

The legal incorporation of the 1930s: recognizing rating as the product

Historical Context. The 1930s were defined by the deepest and longest-lasting economic downturn in the history of the Western industrialized world—the Great Depression. The Great Depression started with the stock market crash[50] in October 1929, which created panic in Wall Street and hit hard millions of investors. Millions of shares became worthless, and investors that bought stocks with borrowed many ("on margin") disappeared completely. In the following

[50] The American economy suffered a recession since the summer of 1929, as consumer spending fell and production slowed. Stock prices however continued to rise, reaching levels unjustifiable by the anticipation of future earnings. The stock market bubble burst when investors starting selling shares en masse: on October 24, 1929, also known as "Black Thursday", a record of 12.9 million shares were traded, and five days later on a "Black Tuesday" nearly 16 million shares were traded. (see History for details http://www.history.com/topics/great-depression)

years, investment as well as consumer spending levels fell, resulting into sharp declines in industrial output and increasing unemployment as failing companies laid off workers. The Depression deepened with four waves of banking panics (in the fall of 1930, in the spring and fall of 1931, and the fall of 1932), as many investors lost confidence in the solvency of their banks and demanded deposits in cash from them, forcing banks to liquidate many loans, to the point of closing their doors and failing. President Herbert Hoover—a Republican and former Secretary of Commerce, who believed government should not directly intervene in the economy—tried supporting failing institutions through government loans. However, banks did not use this loans to help businesses and increase employment. The Democrat President Franklin D. Roosevelt—who won overwhelmingly the presidential election in 1932—addressed these conditions by putting in place many relief and reform measures known as the New Deal[51]. An example of such reforms as the passing of the Social Security Act in 1935 that provided Americans for the first time with unemployment benefits, disability benefits and pensions for old age. Nevertheless, the Depression continued till late 1939, when the economy could slowly recover with bust American industry got with the beginning of World War II.

The Great Depression and the 1930s brought major changes for the US financial system. As the economy crashed, bank assets lost value and many US banks collapsed. From 1928 to 1933—in five years—the total number of banks in the Federal Reserve System decreased by 3,322 institutions. Only in the third quarter of 1933, 3460 banks were suspended (Carruthers 2014, 10). A substantial portion of their assets at the time were corporate bonds, and bond market prices dropped at the beginning of the Depression. Regulators and politicians overseeing the system were able to overlook the implications of the bond market for banks and the value of

[51] The New Deal refers to a series of experimental projects and programs President Roosevelt and his administration put in place from early 1930s to early 1940s to deal with problems of the Great Depression period.

their assets, by putting in place new ways for examining banks and establishing their value, introducing changes in the standards of the banking as well as insurance sectors.

The federal government changed the structure of financial regulation in order to tackle the Great Depression problems. It put in place the New Deal set of rules and regulations and its associated body of new government agencies and regulatory institutions. The Banking Act of 1933 known as the Glass-Stegall Act was one of the most important pieces of legislation whose implementation shaped the financial landscape in the United States for decades. It created the Federal Deposit Insurance Corporation (FDIC) to protect depositors' accounts, separated commercial from investment banking, and imposed stricter regulations on financial institutions, among others. Other regulations at the time attempted to change conditions that led to bank failures, especially among small banks: for example, the increase in the minimum capital requirement of banks, the limitation on the use of bank credit for speculation, and the increasing authority given to bank examiners (Komai and Richardson 2011, 14). In 1934, non-bank deposit-taking institutions were also covered by federal regulation: the National Housing Act established the Federal Savings and Loan Insurance Corporation (FSLIC) and the Federal Credit Union Act created the Bureau of Federal Credit Unions, both organizations that insured and regulated the savings and loans, and member-owned credit cooperatives respectively. The Banking Act of 1935 made minor changes to the deposit insurance system—decreasing the amount of the deposit that FDIC insured—but major changes to the structure of the Federal Reserve System—centralizing the control over money and credit supply in the hands of the Federal Reserve Board of Governors. Among others, the Banking Act of 1935 permitted the Fed to purchase securities issued and guaranteed by the US government and established the Federal Reserve Open Market

Committee with the authority to establish policy regarding securities trading in the open market (Komai and Richardson 2011, 16).

In the Great Depression years, Congress also passed a series of acts that regulated stock exchanges and securities markets. The Securities Act of 1933 regulated the issuing of securities, and the Securities Exchange Act of 1934 established the Securities and Exchange Commission (SEC) to regulate the issuance, purchase and sale of securities, equities and debt instruments in particular and prevent abuses of the kind that led to the 1929 crash by requiring the submission of periodic financial statements from all public companies. The Commodities Exchange Act passed in 1936 organized exchanges for trading commodities futures and options and established the Grain Futures Administration (GFA) to regulate those exchanges (Komai and Richardson 2011, 17; Carruthers 2014, 14-15) (Figure #. List of legislation and regulatory agencies in finance till the end of the Great Depression, based on Figure 1 in Komai and Richardson 2011, 32).

In the 1930s, rating agencies were trying to survive the Great Depression all means: especially by shaping their products and services to the new economic and political context. Moody's survived the 1929 Crash and the Great Depression by starting new services advising investors—the Investment Management Services—cutting drastically the salaries of managers and passing common stock dividends. Poor's Publishing Company fell into bankruptcy and was saved by Roger Babson's financing. Fitch had a difficult time too (Stimpton 2008).

Moments of legal incorporation. The banking community was the first to adopt ratings-based regulations. The Office of the Comptroller of the Currency—a department of the US Treasury in charge of supervising nationally chartered banks at the time[52]—issued the first ratings-based

[52] The US had a fragmented banking system at the time, as national banks, state banks, and banks that became members of the Federal Reserve System had all different supervisory organizations: the Office of the Comptroller of

regulation on September 11, 1931, requiring banks to carry at cost on their balance sheets only bonds rated in a Baa/BBB or higher rating category and keep bonds at lower rating categories at market value. The Federal Reserve Board, which at the time had almost unrestricted power to shape the nature of member banks' bond holdings, had started to use bond ratings in the assessment of the portfolios of member banks in 1930 (Partnoy 2002, 70; Harold 1938). Researchers at the Federal Reserve of New York had developed a system that would reflect the "safety" and "desirability" of the portfolio of a bank in a single number produced by weighting a bank's entire portfolio based on credit ratings (Osterhus 1931; Harold 1938, 160-1).

The reliance on ratings to establish the investment quality of securities and other bank holdings increased after the 1931 ruling. In 1933, the Federal Reserve Board began to publish tables highlighting the variation of bond yields across different rating categories, using Moody's system of Aaa, Aa, A and Baa for "investment grade" securities (Federal Reserve Board 1933, 483; Carruthers 2014, 11). State banking superintendents—in Montana, Mississippi, Alabama, Oregon, Ohio, and New York—began relying more and more on ratings, followed by authorities supervising insurance companies (Harold 1938, 27-29). The Banking Act of 1935 allowed national banks to buy only 'investment securities' as defined by the Comptroller of the Currency and Section 9 of the Federal Reserve Act required the same from state member banks.

Regulations began to explicitly refer to ratings as a basis for evaluating securities and their issuers. In its February 15, 1936 ruling, the Comptroller prohibited banks' purchase of "distinctly and predominantly speculative… "investment securities"" and in a footnote to its ruling directed them to a rating product to understand the terms it employed. The OCC ruling footnote stated that "the terms employed herein may be found in recognized rating manuals, and where there is

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the Currency (OCC) - an independent agency under the formal authority of the Federal Treasury, State authorities, and the Federal Reserve Banks (see Komai and Richardson 2011).

doubt as to the eligibility of a security for purchase, such eligibility must be supported by not less than two rating manuals" (Harold 1938, 30; Partnoy 2002, 71)[53].

These ratings-based regulations were adopted quickly, even though sometimes only symbolically. Bank examiners applied ratings to bond portfolios mechanically as they were not experienced in comprehensively assessing financial securities (Atkins 1938, 14 cited in Carruthers 2014, 10). State bank regulators followed similar guidelines and extended the ruling to nearly all commercial banks (Palyi 1938, 37 cited in Carruthers 2014, 10). Many state insurance regulators (including those in New York) began using rating in their activities, though they did not mandate any particular rating levels until the early 1950s (Stimpton 2008, 92).

However, the direct reference to ratings was removed from banking regulations in 1938. In a revised set of regulations introduced by the Uniform Agreement on Bank Supervisory Procedures, the Secretary of the Treasury, the Federal Reserve Board, directors of the Federal Deposit Insurance Corporation (FDIC), and the Comptroller of Currency agreed on applying a new common standard for examining banks: they classified bank assets into categories, with the top category securities—being considered again those "in which investment characteristics are no distinctly or predominantly speculative grade" (Stimpton 2008, 93)—to be kept at cost or book value, without adjusting for market changes (Simonson and Hempel 1993, 255 cited in Carruthers 2014, 12). This 1938 agreement did not mention ratings directly and the judgment on whether the level of risk or impairment was low enough to place a security in the top category and consider it investment grade was left to the bank examiner (Carruthers 20014, 12-3). According to Harold (1938), however, banking regulators generally agreed that the top category

[53] Regulations governing the Purchase of Investment Securities, and Further Defining the Term "Investment Securities: as Used in Section 5136 of the Revised Statutes as Amended by the "Banking Act of 1935," Sec. II, issued by the United States Comptroller of the Currency, Washington, February 15, 1936.

or 'investment grade' securities went no lower than the Baa/BBB rating, therefore, practically still relying on rating agencies' judgments.

Reception and aftermath. The support of bankers and other capital market participants for the incorporation of ratings in regulations was ambiguous and changed through time. Articles that covered the 1931 decision of the OCC mentioned the support and endorsement of market participants (New York Sun, September 11, 1931; Wall Street Journal, September 12, 1931; Wall Street Journal, December 31, 1931).

However, the banking and finance industry voiced strong opposition to the 1936 ruling, though their major concern was not the reference to ratings per se but its implications. At the time, more than half of the 2,000 listed and publicly traded bond issues failed to be classified as 'investment securities' by the OCC definition offered in the 1936 decision (Harold 1938, 31; Partnoy 2002, 71). Cantor and Packer (1994, 6) indicated that most of the NYSE-listed bonds (891 out of 1,975) did not meet the test in 1936. Looking at foreign securities, Flandreau et al. (2009, 10) calculated that the percentage of those in the top four categories of rating agencies fell from on average 85.4 in September 1931 to 47.2 by February 1936[54].

Banks offered the most vocal opposition to the 1936 ruling. They argued that the ruling excluded them from taking advantage of the rise in bond prices at the time, and was going to limit the issuance of new bonds and employment in the US (*Wall Street Journal,* March 13, 1936, "Banks oppose eligibility rules for investments"). They also noted that with this ruling agencies were "superseding the opinion of banks' statistical experts" (especially those in investment banks) which were "equally competent", and in fact they doubted that rating firms

[54] Authors calculate it for each rating agency at the time based on date in their manuals. The percentage of foreign securities in the top four notches in September were 95.0 (Fitch), 90.1 (Moody's), 81.2 (Poor's) and 75.2 (Standard Statistics) and in February 1936 were 45.4 (Fitch), 50.5 (Moody's), 49.5 (Poor's) and 43.3 (Standard Statistics).

themselves were "desirous of accepting such a responsibility" (*New York Times,* March 22, 1936, "Banks Deplore Bond-Rating Rule").

The revised regulations of 1938 that removed reference to ratings were an attempt by federal authorities to address the banking and finance industry's concerns officially and formally. Federal authorities began to change the interpretation of the issued 1936 regulations through speech since the first criticisms emerged (*Wall Street Journal*, April 29, 1936, "Comptroller Unlikely to Officially Define "Speculative" Securities"; *New York Times*, May 23, 1936, "Topics in Wall Street"; *Wall Street Journal*, May 23, 1936, "Text of Comptroller's Remarks on Bank Investments").

Rating agencies did not respond publicly or directly to these legal incorporations. However, a month after the 1936 ruling, agencies started adopting a policy of rating new bonds prior to their offering dates, using the information contained in each security's prospectus filed with the SEC (Stimpton 2008, 92). According to the New York Times article about the 1936 ruling, this was an indication that rating agencies had started to acknowledge their quasi-regulatory responsibilities (*New York Times*, March 22, 1936, "Banks Deplore Bond-Rating Rule").

The demand for ratings increased dramatically during the 1930s as the Great Depression created a sense of uncertainty and crisis and fueled investors' concern about high bond default rates and credit risk. Getting rated became more important for issuers, bond issuers more specifically, as they helped bring in financing for projects and could keep them operating in these difficult times. However, ratings were not the most demanded product from agencies. Most of rating agency revenues came from offering advisory and supervisory services to investors, as this period was characterized by a lack of confidence in the banking and finance industry overall. The increasing consolidation in the credit reporting industry also indicated the need to fill the void in trust in the existing system, as in 1933 the two largest firms merged to form Dun and Bradstreet (D&B).

Years of stability, consolidation, and visibility. Scholars see the role of rating agencies and the use of ratings decrease during the 1940 to 1960 period. They argue that after the second World War ended in 1945, the US entered a period of overall stability and prosperity, reflected also in its economic and bond environment too (Sylla 2002, 30-31)[55]. According to Atkinson's (1967) National Bureau of Economic Research (NBER) study *Trends in Corporate Bond Quality* examining the period from 1944 to 1965, most bonds fell into the top four categories of agency ratings and were considered investment grade: 93.5 percent of bonds (excluding real estate and finance bonds) (52).[56] Defaults were rare: only 0.1 percent of the volume of corporate bonds outstanding (compared to 1.7 percent in the 1900-1941 period) and they were mainly in the railroad industry (Atkinson 1967, 2; Hickman 1958). State and local bonds followed the same trend: Hempel (1971) in his NBER study *The Postwar Quality of State and Local Debt* identified only six defaults, all of them involving revenue bonds[57], of which three Moody's rated only after their default (Sylla 2002, 33). Bond quality was so high in this quarter century after World War II, that studies could not examine the relationship between agency ratings and default, or evaluate agencies' performance (Atkinson 1967l; Hempel 1971). Because of the impression that the quality problem did not exist during this period, Atkinson (1967) mentions ratings in passing.

[55] According to Sylla (2002, 30), the bond market grew in absolute terms, but corporate bonds contributed less to this growth. He mentioned two reasons for the decrease of corporate financing through bonds: higher and more stable corporate earnings that enabled financing through internal funds/means, and the development of term loans by commercial banks as an alternative to bond financing.

[56] Atkinson's study was a kind of update to Hickman's (1958) study on the corporate bond markets for the 1909-1944 period. More on this latter in this chapter.

[57] A revenue bond is a kind of municipal bond. Different from a general obligation (GO) bond that is backed by dedicated property taxes and other general funds, a revenue bond is issued by governmental entities and backed by revenues coming from a specific project and its implementation. The default risk for municipal bonds is generally lower than that of corporate bonds, but the revenue kind of municipal bond can be more vulnerable to changes in consumer tastes or economic downturns than GO kind (See Mishkin and Eakins 2014).

Partnoy (1999) saw the fact that leading agencies employed fewer analysts and gained most of their revenues from selling research reports, an indicator of the decreasing importance of agency ratings.

However, rating agencies continued their efforts to consolidate and maintain their relevance for the financial sector as reliable processors and supplier of valuable information for investors. In 1941, Standard Statistics and Poor's Publishing combined to form Standard & Poor's (S&P). The *New York Times* article titled 'Publishers Plan Merger Next Week' (March 1, 1941) emphasized how this merger would contribute to the US economy by adding more jobs. The S&P began rating US municipal bonds eight years later, interrupting Moody's 30-year monopoly in this field. There were no major rating-dependent regulations issued from 1940 to 1960. The only regulatory development was in the early 1950s when the National Association of Insurance Commissioners released numerical grading guidelines that required insurance firms to hold only investment-grade bonds. State insurance regulators mandated holding bonds in particular rating levels (Partnoy 2002, 73).

The legal incorporation of the 1970s: recognizing rating agencies as the producer

Historical Context. In order to understand the 1970s legal incorporation of rating agencies one must examine the processes and developments in the 1960s that built into such decision. Instability increased during the 1960s, leading finally to the recession of the early 1970s[58] and its aftermath. Kennedy was elected president in 1960. Even though the US had the largest growth during the 1960s (as a result of post-war reconstruction efforts), it faced problems with unrest and violent conflicts both within and outside its borders. Its most important involvement

[58] The Recession of the 1970s or the 1973-1975 recession refers to a period of stagflation high unemployment and also high inflation.

internationally was in Cuba—breaking diplomatic relationships in 1960, failing the "Bay of Pigs" invasion of its territory in 1961, and experiencing a missile crisis in 1962—and in Vietnam—increasing involvement, supporting a coup in 1962, and escalating situation to a full-blown war in 1967 and 1968. Internally this period was marked by the beginning of 'the Civil Rights Movement" with the lunch counter sit ins in the South in 1960, the assassination of president Kennedy in 1963, the shooting of Malcom X in 1965, the spread of race riots into many major cities in the 1966 and 1967. The spread of new technologies like the color TV (nearly 5 million sold by 1965) and the increased TV coverage of US military efforts during this time helped increase awareness of the public and opposition about war. The economy and financial markets were not at the center of attention during these times, and there was also no major change in the regulatory infrastructure.

The 1960s were an important time for the rating business: there were major acquisitions and increasing publicity for rating agencies and their evaluations. S&P bought Fitch Publishing and the rights to use its rating system—the AAA-D notation for fixed-income debt—in 1960.[59] The purchase was made in cash and the amount was not disclosed, but it made S&P the largest publisher of financial advisory and statistical services at the time (*New York Times,* September 24, 1960, "Standard & Poor's Buys Publications of Fitch Company"). Dun & Bradstreet completed the acquisition of Moody's on March 30, 1962[60]. McGraw-Hill, Inc.—a large information and publishing company—acquired S&P in January 1966. Agencies' rating decisions from 1964 to 1966 to downgrade municipal bonds—New York State and City general obligation bonds—got extensive media coverage. The controversy around the quality of their

[59] Moody's maintained the Aaa-C notation for his ratings of fixed-income debt.

[60] Moody's managers were able to fund the retirement of long-time executives (as Louis Holschuh and John Sherman Poter) as well as meet operational costs. That same year S&P became a public company listed on the NYSE.

ratings and their independence grew and led to a broad governmental investigation of rating agencies work, with congressional hearings that lasted from the end of 1967 to the end of 1968 and several studies examining their performance. These debates also led to the reexamination of the subscriber-pays business model for ratings: in early 1968 S&P introduced fees for giving municipal ratings, that is, starting to apply an issuer-pays model that charged issuers for the rating of their securities and became the norm for major rating agencies by the end of the 1970s.

The 1970s themselves were eventful for the US and their financial markets. They marked the demise of the 'Golden Age' of US capitalism, as the US faced multiple challenges to their position as a world power: increasing international competition, spiking energy prices, falling productivity and profits, and rising inflation and unemployment. The crisis resulting from the 1973-1974 stock market crash[61] and the credit crunch at the beginning of the decade raised questions about the governance of securities markets overall and their role in the financial system. The Bretton Woods agreement[62] on a fixed exchange rate system established at the end of the WWII and the Vietnam War which had been going on since 1954 came to an end in 1973, having started to unravel with Nixon's New Economic Policy—a program "to create a new prosperity without war" known as "Nixon shock" announced in August 15, 1971. Nixon resigned in August 1974 and Ford was president till January 1977. Though conflict within and abroad that directly affected the US dissipated, international developments like the Arab-Israeli

[61] The 1973-1974 stock market crash refers to the 1973-1974 bear market—a general decline in the stock market over a long period of time—that affected major stock markets, especially the one in the United Kingdom. It was one of the major events of the 1970s recession and one of the worst stock market downturns in modern history.

[62] The Bretton Woods agreement was signed on July 22, 1944 in Bretton Woods, New Hampshire, Unites States as the result of the United Nations Monetary and Financial Conference. It established a system of rules, institutions, and procedures that regulated the international monetary system. The United States played a key role in making the gold and the US dollar the basis of the system. The organizations it put in place to govern the system - the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD) later to become the World Bank - began operating in 1945 when a sufficient number of countries ratified the agreement (for details see "Bretton Woods System" prepared by Dr. B. Cohen for the Routledge Encyclopedia of International Political Economy: http://www.polsci.ucsb.edu/faculty/cohen/inpress/bretton.html)

conflict and the oil crisis in the period between 1973 and 1975 and the continuing detente and arms control efforts till the end of the decade demanded US involvement and attention.

The regulatory environment in the 1970s changed: with amendments to some existing regulations and regulatory agencies, and new additions to the regulatory framework. When it came the oversight of the securities markets, the SEC favored industry self-regulation: for example, it deferred to private accounting standards boards, such as the Financial Accounting Standards Board (FASB)[63] and its predecessors, even though as an organization it had the authority to create its own standards. The FDIC had a great influence on bank behavior, as it made sure that insured banks used Federal Financial Institutions Examination Council (FFEIC) and FASB rules in their quarterly reports on their condition and income[64] to the FDIC. The Common Futures Trading Commission (CFTC) was created in 1974 as a result of an amendment to the Commodities Exchange Act. It was granted extended authority in regulating futures trading in all goods, articles, services, rights, and interests traded for future delivery and pursuing its own matters. In 1974, Congress also passed the Employment Retirement Income Security Act (ERISA) that aimed to protect retirees, especially retired workers, by requiring their retirement plans to disclose to them information such as audited annual reports and summaries of plan descriptions, and by providing a system of filing grievances and appeals for retirees. It established minimum standards regarding retirement and made disputes and standards on

[63] In 1972, the American Institute of Certified Public Accountants (AICPA) released a report that called for the elimination of the Accounting Principles Board (APB)—which relied on part-time, unpaid member accountants for devising standards—and the creation of a fully-independent FASB—that would have paid staff that worked full-time on creating standards. Though FASB was created in the name of independence, it did not break the industry- and national-level influences it meant to overcome (Seidler 1972). Since then it is the FASB that sets the Generally Accepted Accounting Principles (GAAP)—a five-tiered hierarchy of rulings and opinions—in the US (for details see Moehrle, Reynolds-Moehrle, and Tomlinson 2002). Since 2002, FASB has tried to align US GAAP with international standards set by the International Accounting Standards Board (IASB).

[64] There are referred as Call Reports and FDIC has the responsibility of maintaining and correcting this data and making it available to the public. This data from insured nation and state nonmember commercial banks and state-chartered savings banks made up the main source of information about the banking system that was publicly available.

employee benefits a federal issue.[65] In 1975, the Home Mortgage Disclosure Act (HMDA) and the Securities Acts Amendments (SAAs) became law. The HMDA required institutions to report the amount of dollars invested and their locations, as first it aimed to discern whether depository institutions were discriminating in their investing, prioritizing certain communities and geographies over others.[66] The SAAs of 1975 made the SEC responsible from creating a National Market System that would help improve competition, liquidity, efficiency and stability in securities markets. By 1975, the SEC ended anti-competitive fixed minimum commission rates[67], but it failed to follow Congress' orders and materialize the National Market System[68] (Komai and Richardson, 17-23).

Rating agencies expanded their activities during the 1970s, changed their business model by charging issuers for ratings, and became well-known for their rating product. Debt markets had developed into an alternative to banks as a favorite source of capital, which led to a surge in the issuance of bonds - corporate and municipal. In 1970 the issuance of corporate bonds rose to a record of $22.4 billion from $13 billion a year earlier. In the municipal market, bonds issued rose to nearly $18 billion from $8 billion in 1960 (see chart in Stimpton 2008, 135). Rating agencies became increasingly involved in rating new issues, and their rating actions—especially downgrades of municipal bonds—continued to attract more publicity and controversy, especially

[65] There have been many amendments to ERISA, the earliest being the Omnibus Budget Reconciliation Act of 1974 (COBRA) and the Health Insurance Portability and Accountability Act (HIPAA).

[66] There were many amendments to HMDA and the kind of data required changed - asking more detail on race and the pricing of loans. These amendments were done through regulations rather than laws.

[67] Fixed minimum commission rates are one source of income for broker-dealers. They refer to how commissions on stock exchange transactions are based on schedules of minimum commissions established by national exchanges, NYSE being the most important one. A broker and dealers who is member of a particular exchange needs to charge the same minimum commission to its customer for a particular transaction irrespective of which exchange the transaction was made in. This was because commission rates schedules of different exchanges were substantially identical. However, as these are schedules of minimum commissions they do not pose any legal restriction on members who can charge very high the commission (Ratner 1970, 350).

[68] Macey and Haddock (1985) argue that there are no valid reasons that explain why SEC failed enacting a National Market System.

after the Penn Central crisis in 1970. Following S&P's move to start charging issuers for rating their municipal bonds, Moody's announced also that a fee[69] would apply to all new issues, corporate bonds included, effective May 15, 1971. Moody's and S&P remained the dominant players in the rating business, as those few new entrants at the time focused on rating a particular kind of financial institution or instrument (Stimpton 2008, 1945). The controversy and debate over rating agencies and their rating decisions intensified, but at the same time it ended up being secondary to other ongoing major regulatory transformations mentioned above.

Moment of legal incorporation. The transformation and regulatory power of rating and rating agencies became unquestioned with a seemingly unimportant rule adopted by SEC in November 1973 as part of the broader changes for securities market participants introduced with the Securities Act Amendments of 1975. In amending Rule 15c3-1 under the Securities and Exchange Act of 1934, the SEC recognized certain Nationally Recognized Statistical Rating Organizations (NRSROs) as legitimate providers of standards for evaluating the market volatility of securities. The Exchange Act Rule 15c3-1—known as the 'net capital rule'—established a formula for broker-dealers to calculate their net capital: the broker-dealer would have to deduct from its net worth a percentage of the market value of its proprietary securities positions—a 'haircut' (SEC 2005; SEC OGI 2009, 2). The haircuts, however, varied by the kind of securities broker-dealers worked with: lower for securities considered investment grade and higher for those considered non-investment grade as the former holdings were regarded more liquid and less volatile than the latter ones. The rule specified that broker-dealers would have to rely on ratings as indicator of whether each security fell into the investment or non-investment grade

[69] The fee for ratings of municipal bonds would be between $600 and $1,350 for general obligation bonds (depending on the size of the community) and between $850 and $2,500 for revenue bonds (depending on the work involved).

category. The SEC released notice stated that "The Commission to a limited extent has also recognized the usefulness of the nationally recognized statistical rating organizations as a basis for establishing a dividing line for securities with a greater or lesser degree of market volatility" (see *Notice of Revision Proposed Amendments to Rule 15c3-1 under the Securities Exchange Act of 1934,* Release No. 34-10, 525, 1973 SEC LEXIS 2309, November 29, 1973[70]). Debt instruments rated within the three or four highest categories of the rating scale from at least two of the NRSROs were considered investment grade (SEC OGI 2009, 2).

This legal incorporation, however, recognized rating agencies—private specialized for-profit organizations—as the exclusive legitimate producers of ratings, even though these firms engaged much more in activities other than rating. The reliance on ratings for distinguishing between investment grade and non-investment grade paper and determining capital charges for different grades of debt securities held by broker-dealers was seen as "a reasonable objective" move (SEC 2005, 6).

The Commission did not define the term NRSRO in its rules and regulation. At the time, it did not specify what a rating agency could do to get the NRSRO status. The main criterion for identifying NRSROs was actual use of these agencies' ratings by markets nation-wide (SEC OGI 2009, 3), and the recognition "by the predominant users of securities ratings" that they were credible and reliable (SEC 2005, 10). In 1975, the SEC recognized Moody's, Standard &Poor's, and Fitch credit rating agencies as NRSROs through no-action letters – letters that reassure the applying entity it will not be persecuted by the SEC for the activities it has explained in its application. The SEC staff agreed to raise no questions on the matter of their incorporation into the net capital rule (SEC 2005, 9), not challenging in this way the judgment of the markets. The

[70] This is mentioned in endnote 38 of Partnoy's (2002) article.

Commission, thus, took a "know-it-when-we-see-it" approach, deciding to recognize a rating agency as NRSRO on a case-by-case basis (Shipe and Freeman 2008, 2).

Reception and aftermath. This instance of legal incorporation happened silently. No article on any major financial press publication mentioned or covered this change in the net capital rule and the designation of rating agencies as NRSROs. However, its effect in enhancing rating agencies' regulatory power and role in the field was visible in the extent to which their rating actions - more downgrades that upgrades - were discussed and reflected in the major financial publications like the New York Times and the Wall Street Journal. Nearly none of the more-than-fifty news articles I gathered for the period between 1973 and 1975—covering the 1970s incorporation—mentioned or discussed the amendment of the net capital rule, the emergence of the NRSRO status, or the explicit recognition of Moody's, S&P, and Fitch as NRSROs. This lack of contestation could be an indication of the successful institutionalization of ratings, and also the underestimation of legal changes that happen through rules rather than regulations and laws.

Rating dependent regulations increased exponentially after the 1970s legal incorporation. The term "NRSRO" mentioned in the net capital rule for broker-dealers spread widely in many other regulations, even though the SEC had not provided any definition or specified any conditions for getting this status (Partnoy 1999; Partnoy 2002, 74-8)[71]. Other regulations just referred back to the original rule: for example, Rule2a-7 defined the term "as that term is used in Rule 15c3-1" (see 17 C.F.R. 270.2a-7). The earliest incorporations of the term NRSRO into congressional legislation, and federal, state, and foreign laws were in the early 1980s, with a

[71] Partnoy (2002) documents the increase in NRSRO-based rules, regulations, and decisions since 1973 (to 2000) in three figures: Figure 1. Federal Banking Agencies References to NRSRO, Figure 2. Securities references to NRSRO (Cumulative), and Figure 3. Securities References to NRSRO (references per year) (76-7)

widespread use from the early 90s on. [72]The term diffused quickly partly because of the already-widespread use of ratings by dealers and other actors in the securities industry. However, now their meaning had changed becoming a proxy for "regulatory determinations of liquidity and creditworthiness" (SEC 2005, 6).

Organizational Identity For Regulatory Incorporation and Political Institutionalization

The above mentioned historical context and instances of legal incorporation contributed to the emergence of rating agencies and their ratings as regulatory mechanisms in finance. However, rating agencies not only adapted to but also were receptive and made use of contextual opportunities. The way in which they built their organizational identity - their product and producer work - advanced not only their cultural institutionalization - being used in different actors' practices as inevitable, natural, and unquestionable ways of evaluating financial instruments and their issuers--but also their political institutionalization--being seen as politically acceptable, useful, relevant, and effective means of addressing politically-charged issues that have public repercussions. Rating agencies' organizational identity work contributed to these two processes of institutionalization and supported their consideration for a position of regulatory power.

I argue that ratings and their agencies became legally incorporated and politically institutionalized partly because of the way in which they build their organizational identity given

[72] For example, Congress initially used the term in Rule 2a-7 under the Investment Company Act of 1940 the Second Mortgage Market Enhancement Act of 1984. In section 3(a)41 of the Exchange Act, a security was required to have ratings in the top two rating categories by at least one NRSRO to be considered a "mortgage related security". In 1989, the U.S. Department of Education began using ratings from NRSROs to decide which institutions were financially responsible enough to participate in student financial assistance programs. The California Insurance Code uses NRSRO ratings to determine which insurance companies can invest their excess funds in certain kinds of investments. Canada references NRSROs in its National Instrument 71-101 on its Multijurisdictional Disclosure System (SEC_2005, 8).

the institutional, political and economic context in which they operated. I want to highlight not only the conditions that contributed to the regulatory incorporation and institutionalization of ratings that existing literature emphasizes, but also the actors that perceived, seized and shaped the contextual opportunities through their actions. Looking at the organizational history of these rating firms and the way in which they presented their product and themselves will help reveal the mechanisms through which legal incorporation and institutionalization of rating and rating agencies became possible and laid the ground for the increasing regulatory role of ratings and rating agencies after the 1970s on.

Similar to the previous chapter, I distinguish two paths of building organizational identity - what I call the path of doing product work and the path of doing producer work. Doing product work means engaging in activities that introduce the organization's product to the pool of existing products in an organizational field and make it meaningful, acceptable, useful, demanded and purchasable. Doing producer work means engaging in activities that shape the organizations reputation and performance as a producer of a particular product by making use of (or in relationship to) other producer organizations' reputations and performances.

Product Work: Marginality and Complementarity

The 1930s phase of legal incorporation (1930-1960). Rating agencies continued their strategy of not focusing exclusively on the rating product but offering it as part of a bundle of other products. An article about Standard Statistics Company in *TIME* magazine presented their service as 'financial wisdom' which was equated to 'correct and timely figures' (February 9, 1931). Moody's ads in 1931, for example, offered help to investors on profiting from "the unusual promises" of the time (*Wall Street Journal,* March 17, 1931), defining the service they offered as 'VISION…and Supervision'—an opportunity for investors to gain the agency's supervision by stepping out of the "bedlam of the money markets" and retreat in Moody's "quiet watchtower" (*TIME*, April 1931). Clearly, they were promoting more their advising and supervisory services as the solution or what was needed to survive in highly uncertain times like those of the Depression. These services increased and provided most of the business revenue. For example, Moody's revenues dropped drastically in 1931 and started a continuous upward trend afterwards, related to the growth of its investor advisory services—not subscription fees for manuals or the rating books (Stimpson 2008, 112-3). The increased visibility and use of these agencies' supervisory services, however, must have affected also the spread of ratings and their use by actors in the financial markets. The reference to 'rating manuals' in the 1930s legal incorporations also indicates that ratings were given as part of manuals, not offered as stand-alone products.

The form in which the product of rating was presented experienced many changes in this period. Moody's focused attention on bond ratings - discontinuing the rating of stocks - taking advantage of the dramatic rise in bond defaults between 1931 and 1933. A booklet titled *Moody's Bond Ratings* published in 1933—a precursor to *Moody's Bond Record*—is indicative of this move: it provided simply a list of ratings for bonds, without the broader analysis included in the Moody's Rating Books. The Rating Books became more valuable when Moody's started issuing weekly updates on the securities and rating changes, and additionally offered two new services: provision of timely data on dividend announcements and daily bulletins on sinking fund notices and bond and stocks called for redemption (Stimpton 2008, 88). In 1935, Moody's Weekly Letter also split into two publications: *Moody's Bond Survey* and *Moody's Stock Survey*. After the 1936 ruling, where the OCC in a footnote explicitly delegated its vested power in identifying ‘investment securities’ to rating agencies, agencies started adopting a policy of rating new bonds prior to their offering dates, using the information contained in each security’s prospectus filed with the SEC (Stimpton 2008, 92). This was another form of the rating product—one that used publicly available information as the source, but also emphasized and recognized the increasing view of ratings as a necessary useful signal of creditworthiness. This was partly because of the new regulations that made bond issuers more interested in obtaining ratings of their bonds *before* they issued them rather than *after,* as was rating agencies recorded practice.

The product work during the 1930s phase of legal incorporation shows that agencies treated ratings as marginal to their main work, and they did not do much directly to promote it as a product. Two articles in the *Christian Science Monitor* series on Moody’s—the industry leader, one by Alan W. Wallace—vice president and treasurer—and the other by Russell Leavitt—vice president and economist of Moody’s—talked in length on the consulting services offered to clients in managing their investment portfolios and on a new service offered quarterly to the subscribers of Moody’s Stock Survey since 1955—Moody’s Handbook of Widely Held Common Stocks, respectively. As Leavitt stated in his article, the agency offered the handbook quarterly with key statistics, summary analysis, and Moody’s Ranking Scores on around 600 common stocks as a way of informing the subscribers of Moody’s opinion on ‘where the market was’ as well as providing them with “do-it-yourself” investment management tools (“Stock Survey Data Guide Investor Managing Own Portfolio”; Stimpton 2008, 99).

The 1970s phase of legal incorporation (1960-1980). The agencies’ advertising efforts in the 1960s show that the rating services were not a major concern for them: they did not need advertise or even mention ratings. They focused on advertising their investing and consulting services overall, targeted especially towards individual investors. S&P offered “investment counsel” and Moody’s offered help with stocks than broader investing[73] (Stimpton 2008, 125). Rating agencies continued expanding their services and doing work beyond rating. They tried to gain legitimacy and recognition for a broader range of services and products that they developed independently of the rating work. By the end of June 1965, S&P’s revenues from non-printing sources like financial publishing and investment consulting were around $19 million and a year earlier Moody’s were around $7.5 million. By the end of 1960s Moody’s overall revenues reached the $12 million amount. As financial markets expanded and bond issuance increased, Moody’s manuals, weekly surveys, and especially its stock handbooks and personalized advisory services—which where frequently advertised in *The New York Times*- were in high demand (see Stimpton 2008, 124-6 for examples of ads). This indicated that ratings as a product were institutionalized.

However, agencies mentioned ratings in the context of other products ratings were generally associated with—manuals, as a way of maintaining the status of ratings and justifying their subjectivity through an emphasis on expertise, factualness, commitment to individual investors, and implied impartiality. An article at the *New York Times* (May 6, 1956, “Personality: Boswell of U.S. Corporations”) praised above all Moody’s Manuals which were popularly known as “Moody’s Encyclopedia of Investment and Finance” and regarded as “Next to to the Bible”. John Sherman Poter—the editor-in-chief for the Manuals from 1924 to 1962—emphasized how Manuals’ subscribers were to be found in “every field of commercial endeavor’ and unlike the first rating books, they were strictly factual, with Moody’s Ratings being the only ‘matters of

[73] One of Moody’s ads framed investment as "a 24-hour-a-day, virtually sleepless job, that generally requires around-the-clock attention of professional investment counsel" and their role as helping individual investors with such enterprise ('How to Sleep Soundly While Your Investments Work for You' ad in the *New York Times* - see Stimpton 2008, 125).

judgment' in corporate descriptions (Stimpton 2008, 101). In a series of articles in the *Christian Science Monitor* published in December 1957, Moody's continued to showcase its recent work, emphasizing its commitment to serve investors with a diverse integrated set of services. Moody's president at the time Donald B. McCruden noted that the main source of their revenues come from consulting and advisory services, as after the panic people had turned to investing in contrast to speculating and gambling (December 10, 1957, "Moody's Seeks to Provide Integrated Service to Investor"). Edmund Vogelius—the vice president and head of corporate bond ratings in the 1950s and mid 1960s—argued that ratings were used as "a means of distinguishing investment quality" - not just to meet regulatory demands—as banks were not the major bond holders, and individuals were increasingly involved in investment. He tried to justify their customer's trust in them when asking for consulting and advisory services, with the work that went into producing the Manuals and Ratings, highlight where the "unusual advantages for obtaining important and valuable information" came from. In August 1970, Moody's successfully introduced a new manual *Moody's Over-The-Counter Industrial Manual*—part of the expanded Moody's Industrial Manual, that covered smaller companies whose securities were issued over-the-counter, not in any of the New York or other American stock exchanges. An ad on this new publication stated that the two giant works covered 7,000 companies and these manuals told you 'where the money is' (Stimpton 2008, 143).

There was an increasing emphasis on the informational value of ratings during the 1970s phase of legal incorporation. This was reflected in the changes that happened to ratings' presentation—their structure and categories. In a press conference Moody's president John C. Weiner, Jr., announced the refinement of the A and Baa municipal rating categories by adding A1 and Baa1 to distinguish better credits (so the order of ratings would be A1, A, Baa1, Baa)

(*New York Times,* March 26, 1968, “Moody’s Broadens Bond Ratings - Two Classes Added - Free Service to Continue”). In September 1968, S&P followed Moody’s adding similar refinements to its rating system. It also started efforts to upgrade and mechanize rating procedures, especially through the use of computer applications.[74] Moody’s also introduced a new set of symbols and analytics for all forms of short-term corporate debt, commercial paper included, in 1972, after hearings that identified a rating company as responsible for the Penn Central crisis.[75] The new system had 4 categories: the ‘prime’ category was broken into ‘prime-1’, ‘prime-2’, ‘prime-3’ - these three expressing the ability of the issuer to finance short-term debt repayment under conditions of financial stress with the ‘prime-1’ category being the safest- and the ‘not prime’ category meaning that the issuers were unlikely to have available cash or other financing strategies to meet all their short term debt obligations (Stimpton 2008, 135; *Wall Street Journal,* August 31, 1971, “Dun & Bradstreet to Revise Commercial Paper Ratings”).

In 1974 rating agencies expanded their rating activity: partly because of the boost in revenues that the new issuer-pays (rather than investor-pays) model generated, and partly because of the absence of realistic alternatives to these private firms as sources of ratings. A year after beginning to rate bonds of financial institutions in 1973, Moody’s introduced preferred stock ratings with a new set of symbols parallel to the long-term bond rating one, using all lowercase

[74] These changes in presentation were the result of demands from investment bankers like George E. Barrett, Jr., a vice-president at New York’s First National City Bank who expressed bankers’ increasing view that the existing rating system was not very helpful to municipal bond buyers and sellers who wanted to know how far was each issue from a potential downgrade to below investment grade status. He called for finer gradations in the A and Baa range of rating systems, as at the time nearly 85 percent of municipal bonds were rated in those categories, and an increase in the number of analysts rating agencies - Moody’s and S&P -employed (*Wall Street Journal,* January 2, 1968). A study on municipal ratings published in December 1968 by The Investment Bankers Association asked agencies to clarify their methodologies and standards used for assigning ratings, but these and other similar demands were not directly addressed (Stimpton 2008, 124).

[75] Congressional hearings on the quality of credit ratings had found NCO incompetent as ratings were assigned by a single analyst who worked out of his home because of disability and it charged issuers $100 dollars annually for each rating (Stimpton 2008, 134). Keefe brought together a new team of analysts, most of them from the commercial credit division of D&B, to improve Moody’s commercial paper and corporate bond rating activities.

letters in quotation marks "aaa" through "c" to acknowledge different characteristics of preferred stock. Moody's also became the first agency to rate bonds issued by bank holding companies (only those that had subsidiaries). Only holding companies with equity of at least $150 million would qualify for Aaa ratings (Stimpton 2008, 145; Moody's Bond Survey, January 10, 1974).[76]

Rating agencies continued to present that ratings as 'opinion' and 'judgment', but increasingly used their reputation and work on their other products, especially their manuals, to justify and somehow sidetrack and devalue concerns with rating's subjectivity. They emphasized ratings as the result of the 'objective' process of collecting and processing data with statistics and expertise. Rating agencies engaged in a transfer of reputational capital or status from the advisory and manual products to the rating product. Instead of borrowing reputation from other existing institutions like the investment banks and reporting agencies, now they borrowed the reputation they built as providers of their other products to maintain their reputation and status as providers of ratings. In this context, ratings ended up being presented simultaneously as subjective advice, opinion, judgment as well as objective information, fact, and truth.

Producer Work: Professionalism and Structural Reform

The 1930s phase of legal incorporation (1930-1960). Rating agencies presented themselves as supervisors and visionaries of capital markets in service of individual investors and as statistical organizations of experts and professionals, not rating firms. During the 1930s, rating agencies were advertising more their services as protectors of investors from further losses, offering sound advice on managing their investments and identifying investment opportunities

[76] Moody's gave the first ratings—an 'Aaa' and 'Aa' respectively- for $200 million worth of debentures to be offered on Jan. 15 by Bankers Trust New York Corporation, and $40 million of debentures to be offered the same day by Mercantile Bancorporation (Stimpton 2008, 145).

based on accurate data and statistical information. Starting in 1931, there was a dramatic rise in bond defaults—corporate bonds default rate, for example, rose by around 5 percent in 2 years, reaching a century high default rate by 1933 (Stimpton 2008).[77] Furthermore, a banking crisis forced banks to sell securities to meet depositors demands for currency. The increase in business for 'statistical organizations' was then attributed to fearful investors that wanted to avoid the turbulence of markets and 'needless risk' by getting more reliable information. An article about Standard Statistics Company in *TIME* magazine equated 'financial wisdom' to 'correct and timely figures' (February 9, 1931). Moody's ads in 1931, for example, offered help to investors on profiting from "the unusual promises" of the time (*The Wall Street Journal,* March 17, 1931), defining the service they offered as 'VISION…and Supervision' -an opportunity for investors to gain the agency's super-vision by stepping out of the "bedlam of the money markets" and retreat in Moody's "quiet watchtower" (*TIME*, April 1931).

The 1930s legal incorporation of ratings corresponded to changes in some of the practices of rating agencies. Moody's eliminated the Daa, Da, and D rating categories and built more risk in the remaining lower categories in the 1930, discontinued the rating of stocks and focused on bond rating, and prioritizing credit quality over investment quality. In 1936, they also began

[77] John Moody published his autobiography *The Long Road Home* in 1933. The book reveals that he did not expect the extent to which the Depression would affect investors and the American economy. In several occasions before the 1929 stock market crash, John Moody expressed his optimism about the bond market in 1930. In an article of the *Chicago Tribune* (December 27, 1928) he declared that the 1907 panic and the 1920-1 events would not be repeated and next years would bring a boom for the US economy. In *Moody's Weekly Newsletter* (October 28, 1929), in statements for the *Wall Street Journal* (November 13, 1929) and an interview for *New York World* he attributed the changes in liquidity to temporary changes in the technical conditions of the market, one who for driven by a speculative mania that did not affect much of the overall population, rather than substantial radical changes in the underlying conditions of the market. These public declarations failed to predict the difficult times for financial markets ahead and damaged Moody's reputation as a market observer. Roger Babson, the owner of Moody's Manual at the time, predicted the 1929 Crash and the enduring depression with his 'Babsonchart' - an application of Newton's theory of 'actions and reactions' to economic forecasting (Stimpson 2008; Moody 1933). John Moody retired as president in 1944, and as chairman in 1956, and shortly afterwards died in California at age 89 (on February 16, 1958). An article at *The New York Times* presented him as the one who wrote the history of US corporations and helped learn about them, not focusing on his innovative product of the securities rating (May 6, 1956, "Personality: Boswell of U.S. Corporations").

rating new bonds before they were issued using the information on securities filed with the SEC (*New York Times,* March 22, 1936, "Bankers Deplore Bond-Rating Rule"). They argued that this policy was about providing rating opinions to investors before they made securities purchase decisions and assisting them in their decision making. The rating of securities before they were issued became an important guiding principle in their operation, as a way of increasingly presenting themselves in service of a public made of individual investors rather than institutional ones.

Aware of the increasing distrust in markets and private financial institutions' price setting ability, rating agencies' efforts supported government's and regulators' consideration of them as a "valuable and politically acceptable tool" in governing finance. That is how rating agencies were able to come out of the Great Depression with a substantially higher status within the US financial system: compared to the alternative of investment bankers, they were seen as involving no conflict of interest (Flandreau et al. 2009, 5). However, again, they build a positive organizational identity, one that respected existing institutions. For example, in a series of articles in the *Christian Science Monitor* published in December 1957, Moody's continued to showcase their recent work, emphasizing their commitment to serve investors with a diverse integrated set of services. As an example of their efforts to provide reliable service Edmund Vogelius - the vice president and head of corporate bond ratings in the 1950s and mid 1960s - mentioned a recent policy that required bond issuers to come with their investment bankers "to help ensure the professionalism of the meeting" ("Moody's Airs Code for Measuring Investment Quality of Bonds"; Stimpton 2008, 96).

After the 1930s legal incorporation, most scholars saw rating agencies as "small and relatively moribund" (Sylla 2002, 34). Moody's story in the early 40s and early 60s seems to indicate a different situation: rating agencies were diversifying their products and services and trying to maintain and develop their existing reputational capital as impartial evaluators of securities and their issuers. It is in this period, with the increase in the increasing participation of municipalities and states in capital markets, that the political institutionalization of rating and rating agencies as producers of ratings begins. In 1957, Moody's had a staff of 300 of which 250 were exclusively involved with factual and analytical investment research (Stimpton 2008, 97). In 1958, an article on Moody's municipal bond ratings titled "When Moody's Comment is Baa, That is Merely a Passing Grade" (September 2, 1958) featured David M. Ellinwood -the head of the agency's municipal ratings section- who emphasized the increased quality of agency's municipal ratings after the mid-1930s reorganization of the department. According to Ellinwood, by 1958 Moody's had rated 4,618 municipal securities (publishing financial statistics on more than 6,000), of which only 129 fell in the Aaa category, and three quarters fell in the A or Baa grade categories. Paul Heffernan -the journalist who wrote the article- concluded by presenting Moody's Investors Service as an authority to be reckoned with by public administrators. In *Moody's - The First Hundred Years* Stimpton (2008, 104) writes that "It is not surprising, therefore, that as municipalities faced fast rising financing needs in the expanding US economy after World War II, municipal administrators began to recognize the added costs associated with lower ratings and the importance of putting their best foot forward in meetings with the rating agencies." Even though demand for agency ratings during this time was low, their reputation increased, especially because of their ability to evaluate state governments and municipalities as issuers of securities, and the realization that they could influence their behavior.

Rating agencies' efforts at being considered reliable and impartial were supported also by the increasing production of knowledge on their performance in rating bonds. At the end of the

1930s, a major study of rating agencies and their bond ratings came out arguing that thought the rating agencies' record was not perfect their performance in effectively protecting investors against loss was "certainly beyond reasonable criticisms" (Harold 1938). A new study *Corporate Bond Quality and Investor Experience* published in 1958 by W. Braddock Hickman in the context of the Corporate Bond Research Project at the NBER argued that overall bond ratings of the four agencies had a remarkably good record as reliable and dependable indicators of bond quality for the period 1909 to 1943. His study was one of the first major applications of computer technology to financial market research and was regarded as the only "statistically accurate assessment of rating performance" to that date (Stimpton 2008, 94). Hickman's team tabulated all ratings assigned by Moody's, Poor's, Standard, and Fitch for the 1909-1943 period using the IBM punch cards and calculated rating-specific default and loss statistics. The study found that "with great regularity issues rated as high grade at offering and at the beginning of assumed [four-year] chronological investment periods had lower default rates that those rated as low grade. In addition, capital losses, as measured by the difference between par value and market price at default, were consistently smaller for the high grades that went into default than for the low grades" (Stimpton 2008, 94). Different from Harold's (1938) study of the same period, Hickman's claimed that ratings were dependable evaluations of bond quality even for long periods of time. He was surprised to find that ratings assigned by the agencies in each of the four high-grade rating categories - Highest Quality (e.g. AAA), High Quality (e.g. AA), Sound (e.g. A), and Good (e.g. BBB) - had been good predictors of bond defaults over longer investment periods. He also indicated that rating performance had improved after 1931, supposedly because rating agencies tightened standards (example tables from Hickman's study and Moody's own bond default research for the 1920-1940 period in Stimpton 2008, 95).

The 1970s phase of legal incorporation (1960-1980). Rating agencies gained their visibility as providers of ratings and became the center of larger public debates during the mid 1960s and early 1970s, as the press publicized their rating actions regarding states and municipalities' issuance of bonds. The 1960s were an important time for the credit rating business: with major acquisitions and much publicity for rating agencies and their evaluations. After S&P's purchase of Fitch Publishing in 1960, Dun & Bradstreet completes acquisition of Moody's on March 30, 1962[78]. In 1964, Moody's decision to change the rating of New York State's general obligation bonds from Aaa to Aa became unexpectedly the most widely covered rating change in the news media, with coverage even outside the financial news columns. This downgrade was seen as the first action by a rating firm to generate controversy. It was a surprise for Moody's analysts as the action was disclosed in the October 19 issue of *Moody's Bond Survey*—a publication with little circulation outside Wall Street—and had not made any press announcements about it (Stimpton 2008, 117). The *New York Times* ran a front-page story on the downgrade of Moody's, even though it followed Dun & Bradstreet's rating change from 'prime' to 'better good grade', because Moody was seen as "the most influential bond rating service" (October 20, 1964, "Credit of State Loses Top Rating on Moody's List: Investors' Service Follows Dun & Bradstreet Step—Loan Costs Could Rise").

The news-making rating actions took place in the context of the growth of lending through capital markets. Moody's explained the 1964 downgrade as reflecting concern about how the

[78] Moody's managers are able to fund the retirement of long-time executives (as Louis Holschuh and John Sherman Poter) as well as meet operational costs. This acquisition was seen as a perfect fit - Moody's started to experiment with introducing new innovative services like *Moody's Insurance Stock Survey*—a complement to *Moody's Stock Survey*—in 1962, and *Moody's Creative Analysis*—a computerized service for investment research in 1963. Both services were discontinued quickly, within a year. It was not seen as a good time for introducing new services, most probably because of the eventful political years—with the assassination of president Kennedy, the loss of a U.S. nuclear submarine with 129 people aboard in the Atlantic in 1963, and the alleged attack on the Gulf of Tonkin which gave president Johnson the power to increase military involvement even without declaring war in Vietnam in 1964 (Stimpton 2008).

state of New York was not borrowing in its name but was using state agencies to borrow money. For example, empowered by the state, the New York Housing Finance Agency could issue more than $2 billion debt for construction of housing, university, and mental health facilities. Moody's saw these instances of growing state agency borrowing as a riskier situation because the state did not have a legal obligation to vote funds for serving debt, and they could not rely on the state's moral obligation to do so alone (Stimpton 2008, 120). S&P's bond rating committee decided to keep its AAA rating. Another downgrade followed from Moody's on the NYC general obligation bonds—from A to Baa—in July 1965 (following D&B lowering from "good grade" to "better medium grade" (*New York Times,* July 19, 1965, "Moody's Likely to Follow Dun-Bradstreet in Lowering New York City's Bond Rating"). S&P decided to keep its rating to a single-A till a year later -in July 1966, five months after it was acquired by McGraw-Hill, Inc—a large business information and publishing company. It downgraded the NYC general obligation bonds from A to BBB.

The downgrades were resisted by state officials but praised by the financial community overall—reflecting the successful cultural institutionalization of ratings and rating agencies and the beginning of a process of political institutionalization. NYC Governor Nelson Rockefeller first regarded the situation as temporary and the state comptroller Arthur Levitt latter complained that the downgrades increased substantially state's net interest costs. Bankers did not agree with state officials' assessment that the cost could be attributed to the downgrades (Stimpton 2008, 120-1). A *Wall Street Journal* editorial praised Moody's decision for bringing to light "what's wrong with government in that metropolis" and "a distilled example of political ills more generally besetting the nation" (Stimpton 2008, 121). The controversy about the effect and fairness of agency ratings increased public awareness about the power of ratings, as lower ones could mean higher financial costs.

The controversy surrounding the rating changes for municipal bonds led to a broader governmental investigation of rating agencies overall, which in a way represented an instance of negotiation over the regulatory power of rating agencies before the actual legal incorporation in the mid 1970s. In 1967, angry at the S&P and other downgrades, NYC finance administrator Roy M. Goodman asked the Federal Reserve Board (Fed) and the Federal Deposit Insurance Corporation (FDIC) to consider developing a new system for rating municipal bonds. His demand for government involvement in establishing new standards and practices regarding the evaluation of municipal bonds was based on the claim that the existing system was old and not-up-to-date with technological developments and the times—"a horse-and-buggy system in a jet age" as Goodman called it (Stimpton 2008, 121).The congressional hearings "to examine the rating agencies' methods and their impact" started at the end of 1967 with Goodman's call for an alternative to bond-rating by private for-profit firms: a private research organization financed by all interested parties—cities, banks, institutional investors, and securities dealers—that was "free from political interference and conflict of interest" and incorporated the latest technology—computers and other modern tools.

The way rating agencies presented themselves during these controversies and congressional hearings - as open to change and as independent impartial professionals just doing their job - was important in their battle for being politically institutionalized. Moody's and S&P—stated they would have welcomed any ideas for improving the bond rating or another agency offering such service (Stimpton 2008, 122). In his appearance before Congress' Joint Subcommittee on Economic Progress, NYC finance administrator Goodman claimed that 'inaccurate' ratings were burdening local governments with their 'chocking' interest rates on debt issues. Questioning the "almost Biblical authority" agency ratings had assumed "throughout the American investing economy, influencing banks, trustees, and individuals to an unwarranted degree", he called for a careful study of the quality and practices of agencies that produced these services by private research organizations (*Wall Street Journal,* December 6, 1967, "Congress Urged to Act on Bond-Rating Service Replacing Private Firms—New York City Finance Officer Suggests Systems Financed by Cities, Banks, Buyers, Dealers").

Rating agencies also made use of some frames that government and media used to make sense of them in the 1960s and early 1970s in formulating their justification for changes to their business model for financing ratings. Congressional hearings on this issue lasted for a year and triggered many observers—including a 20th Century Fund group—to examine the municipal rating business and consider the impact of the rating system on markets. Rating agencies themselves used the hearings to justify changes in their policies on giving ratings. Rating agencies took seriously Goodman's claim that rating agencies were unprofitable businesses and lacked the resources to modernize. They viewed congressional hearings diagnosing rating agencies with lack of adequate personnel and funding needed to properly cover small communities and do their job. Claire Cohen, a municipal bond analyst with D&B recalled in an interview that the only way for agencies to address the inadequacies determined by the congressional hearings and "do their job responsibly was by charging for the ratings" (Stimpton 2008, 122). S&P was the first to announce the introduction of fees for issuing municipal ratings (between $500 and $2,500 per bond). It stated that the fees were needed to meet costs - support more staff at a time of increasing issuance of municipal bonds. The procedure for giving ratings would remain the same but more time would be given to rate issues of high complexity—though not necessarily larger in size (*Wall Street Journal,* January 24, 1968, "Standard and Poor's Will Charge to Rate New Municipal Issues"). One of S&Ps full-page ads in financial news media stated "We will start to operate the way lawyers do and be paid for time spent on analysis" (Stimpton 2008, 123). Moody's continued to offer free of charge ratings for municipal bonds, keeping in line with the overall feeling that the agency provided ratings purely as a public service, not as the main source of making profits (Stimpton 200, 123). Both agencies however had long had the practice of charging for the rating of small private placement issues on request.

Rating agencies gradually changed their business model—charging issuers for ratings, not investors—and expanded their involvement into new markets as well as their revenues from issuing ratings during the 1970s phase of legal incorporation. Following S&P's move to start charging issuers for rating their municipal bonds, Moody's announced also that a fee—between $600 and $1,350 for general obligation bonds (depending on the size of the community) and between $850 and $2,500 for revenue bonds (depending on the work involved)—would apply to new issues effective May 15, 1971. Again this change was said to meet rising analytic costs as rating new municipal issues became more complex and time-consuming (*New York Times,* April 16, 1970, "Moody's Rating Fee on Tax-Exempts Set"). Again, this story-line of 'modernization in rating agencies so that they do their job better' was suggested by governmental actors in the 1960s congressional hearings following the downgrade of NYC municipal bonds. They were the ones that also highlighted the financial repercussions of rating decisions and their regulatory position.

Till the early 1970s, the status of rating agencies remained high and they were accepted as legitimate reliable providers of ratings, even though they were not transparent about the process through which those ratings were produced. A study on municipal ratings published in December

1968 by The Investment Bankers Association concluded that "the agencies have so conducted themselves that their rating systems as a whole have earned the respect accorded them" (Stimpton 2008, 124). Under the context of this overall support, the study asked agencies to clarify their methodologies and standards used for assigning ratings and expressed concerns about over-reliance on ratings that came out of a field lacking diversity of opinion[79]. Hempel (1971, 113) noted that agency ratings— "the consensus opinions of groups of sophisticated bond analysts"—continued to be seen as valuable indicators of future bond quality, despite lack of historical proof for their performance. Because of the impression that the bond quality problem did not exist during the 1940-1960 period, Atkinson (1967) mentioned them in passing. The rating agency's role was seen as that of an evaluator of the quality of issuers and their financial instruments (products). As an analyst commented after the assignment of the first rating to a Eurobond[80] by Moody's in December 1970, the Moody's system was seen as offering a reliable yardstick for measuring the quality of Eurobond issuers—useful to U.S. corporate borrowers and European investors (*Wall Street Journal,* December 10, 1970, "Moody's Begins Rating Some U.S. Issues Abroad").[81]

An important event that gave rating agencies the opportunity to strengthen their position as private regulators with no alternative and their arguments for the necessity of extending the issuer-pays model to corporate bonds rating was the Penn Central crisis. On June 21, 1970, the Penn Central Company—the holding company for Penn Central Transportation Company which operated the nation's largest railroad—filed for bankruptcy. Different from expectations, the

[79] There was a fear that S&P would not last in the business and Moody's would have a monopoly in municipal ratings again.
[80] A Eurobond is an international bond denominated in a currency different from the one of the country where it was issued.
[81] Moody's assigned its first ratings—a double-A rating—to a planned $20 million overseas offering of 15-year debentures by Richardson-Merrell Overseas Finance N.V., a foreign subsidiary of the New York based drug, chemicals, and toiletries manufacturer and also announced it could rate other Eurobonds of American firms.

government rejected the company's request for bailout (*Wall Street Journal,* June 22, 1970, "Penn Central Files Bankruptcy Petition for Rail Unit After U.S. Reneges on Aid"). Penn Central and its 28 affiliates defaulted on $2.6 billion of long-term debt and the operating company could not pay around $82 million commercial paper notes[82]. This impacted the default rate for corporate bonds which reached a 40 years high—at 2.6 percent from zero percent in 1969 (Stimpton 2008, 132). Moody's sister company D&B's National Credit Office (NCO) got most of the criticism during this event. It had kept the commercial paper issued by Penn Central Transportation Company at the highest 'prime' rating category till three weeks before Penn Central filed for bankruptcy. Two other companies it had rated 'prime' were at risk of default shortly after the Penn Central case.[83] S&P also lowered its rating of Penn Central's commercial paper below 'prime' only a few days before the crisis, however its actions did not get that much attention as it was seen as new to the business of commercial paper ratings—with only one year of experience and limited coverage. Moody's was not rating commercial paper at the time and it had downgraded Penn Central entities' bonds to the lower speculative level before the default happened. However, it felt the repercussions of the criticism directed to its parent company. Though D&B/NCO defended the accuracy of its ratings and emphasized that the problem was with how fast reports were produced, one would agree with a reporter's statement that "Second guessing investment advisors is an old game, but questioning the reliability of Dun & Bradstreet is something new" (*Wall Street Journal,* August 13, 1970, "The Credit Checkers—Critics Claim Ratings By Dun & Bradstreet Sometimes Are Faulty").

[82] Commercial paper notes are a form of short-term debt. They are unsecured, short-term debt instruments - with maturities equal or less than 270 days (9 months) - issued by a corporation to meet current assets, inventories, or short-term liabilities. Because of its unsecured nature it is issued by large highly-rated institutions. One of the advantages of commercial paper is that it may not be registered with the SEC if it matures before 9 months (See Mishkin and Eakins 2014)

[83] The other two companies whose commercial paper was rated 'prime' but came close to default were Four Seasons Nursing Centers of America and King Resources Company.

Even though there had been no criticism of corporate bond ratings, no public outcry for the agencies to improve the quality of analysis in the corporate sector, by mid-October 1970, Moody's had begun charging issuers for ratings of all taxable bonds, including corporates and U.S.-dollar denominated foreign obligations. Again, the justification given for this change was the increasing cost of evaluations "due to scientific advances, a large scale expansion of corporate debt, more complex corporate structures and rapidly changing industrial patterns" that made rating corporate work more complex and difficult (Stimpton 2008, 1939). Part of the argument was that this was to better serve issuers, as better credit research and wide distribution of ratings would help them move their paper (*Wall Street Journal,* October 1, 1970, "Moody's Change for Corporate Ratings, But Rival Standard & Poor's to Hold Off"). Recalling the decision to charge fees to issuers in an interview twenty years later, Keefe stated that the move was necessary to keep Moody's competitive (though the only possible realistic competition it had was from S&P, new entrants emerged only after 1973 and specialized in particular kind of issues and issuers).

New firms were entering the business of rating, but they were not challenging the existing players—Moody's and S&P—just working to take advantage of developments in the Eurobond market as well as other unexplored markets and sectors. In 1974, BankWatch was established by Keefe, Bruyetter & Woods a financial institution research firm to rate banks and bank holding companies. Moody's leader Keefe was involved in this organization and this effort was not seen in opposition to Moody's activities. Moody's continued to expand, as part of its power rested in extensive coverage of different objects and fields with its rating. In March 1974, Keefe and other key figures at Moody's traveled to Europe to meet with potential rating customers—three governments, several government organizations, three municipalities, eleven corporations, and six investment banking firms—and were able to get requests and interest for their ratings by European issuers. In June 1974, Moody's sent representatives to meet with local companies in Japan, a trip that would result in the agencies' assignment of an Aaa rating to a proposed $50 million Eurobond offered by the Japan Development Bank in March 1975, which became the first-ever rating on a Eurobond sold by a non-U.S. Issuer. The S&P began charging for corporate bond ratings in July 1974 and in 1975 began rating bank holding companies and also mortgage-backed securities, the latter marking the first rating in the structured finance market, which would end up making half of all revenue in the global rating business (Stimpton 2008, 145). The new entrants in 1975 included McCarthy, Crisanti & Maffie a company that rated bonds in the US markets and Mikuni & Company which rated bonds in the Japanese markets.

Rating agencies were receptive of the reputational damage the investigations and the questioning of their ratings quality could have for their overall activities. Therefore, they engaged in activities that seemed to reform the organization and address to some extent the structural and technological issues hearings identified. Congressional hearings on the quality of credit ratings had found NCO incompetent as ratings were assigned by a single analyst who worked out of his home because of disability and it charged issuers $100 dollars annually for each rating (Stimpton 2008, 134). Keefe brought together a new team of analysts, most of them from the commercial credit division of D&B, to improve Moody's commercial paper and corporate bond rating activities. This led to the introduction of new set of symbols and analytics for all forms of short-term corporate debt, commercial paper included, in 1972. In May 1972, Moody's also announced a reorganization of the municipal bond research division, into three departments - on new issues, on reviews and research, and on educational services (Stimpton 2008, 138). The introduction of the educational services was a telling move, in that the organization felt it needed to communicate better with its audiences - the users of ratings (the public—investors) and also their purchasers (the private sector—issuers evaluated)—the rating's meaning and limitations.

The business of rating agencies expanded especially after a report published by the Twentieth Century Fund on the rating agencies in April 1974. The report concluded that the agencies were doing "a credible job" given their resources. Ratings were portrayed as a useful service to the public given their use to enhance the marketability of municipal securities. The report argued that rating agencies had to be responsible for the great power that their ratings had in influencing market decisions. Rating agencies were criticized for not being transparent and clear about "what ratings actually measure" and were advised to regularly review and revise their ratings to reflect any material change. The continuing role of rating agencies was not questioned—it seemed to be accepted and necessary, taken-for-granted. Most of the recommendations offered were directed at changing the behavior of actors other than rating agencies: the report called states to improve reporting—making available timely, uniform, consolidates financial reports, warned regulators against over reliance on ratings, and asked the securities industry and municipal government to increase efforts at educating the public on how to use ratings. These suggestions made threats of being substituted with alternative regulatory sources less credible (Twentieth Century Fund and Petersen 1977).

Similar to the 1960s, rating agencies drew most attention and controversy with their rating of municipal bonds. However, this time events reflected the increased power, prestige, and confidence of rating agencies resulting from the 1970s legal incorporation. In April 1975, S&P suspended its double-A rating for NYC's debt securities stating that major underwriting banks were unable and unwilling to continue purchasing NYC's notes and bonds. The major of New

York Abraham Beame and the Controller Harrison J. Golden criticized the decision as ‘unfair’. Many others like the financial editor of the American Banker and a member of the 20th Century Fund Task Force that published the 1974 report on rating agencies Ben Weberman commented that the suspension “doesn’t do the rating agencies credit” (Cited in Stimpton 2008, 148). The *New York Times* ran a feature article on the increasing power of rating agencies a week after the S&P’s decision (April 9, 1975, “Rating Power: The Who and Why”). S&P’s head of municipal ratings John K. Pfeiffer stated the decision to suspend NY’s rating was taken unanimously by the rating committee’s eight analysts. “I don’t care about raising hell. That’s part of doing your job. I care about doing the right thing” he replied when asked about the furor regarding its decision (Cited in Stimpton 2008, 148). Moody’s kept its A rating of NYC’s bonds commenting that they had not found any deterioration in the city’s credit that was worth a change in rating. Though states and municipalities nationwide were dealing with problems stemming from inflation and growing financial needs, the financial issues of the New York State and NYC received most attention and led to intensifying debates on the role of ratings and their agencies. In summer 1975, NYC faced default. Moody’s lowered the ratings of the city’s bonds two letter grades to speculative grade Ba, downgraded the New York State bonds to the A1 category (below double-A) and withdrew its ratings of the state’s tax and revenue anticipation notes[84].

Rating agencies continued to build a positive organizational identity—emphasizing not what they were not but what they were—especially through their producer work. Their producer work focused on presenting themselves as professional organizations, whose reliability emerged from

[84] Anticipation notes are short-term obligations offered generally by states or local governments to meet temporary financing needs as a way to manage the mismatch between the timing of expenses and revenues. They promise to pay off the note principal either through future anticipated tax collections (tax anticipation notes), non-tax revenues like state aid (revenue anticipation notes), a combination of taxes and revenues (tax and revenue anticipation notes), or the proceedings from an expected future long-term bond issuance (bond anticipation notes). These notes generally have one year or less maturities and can be paid at maturity rather than semi-annually (see Mishkin and Eakins 2014).

their expertise and experience in processing information gathered from different sources. They did not see themselves as raters, but more as advisory and consulting organizations that offered their opinions and judgments based on statistical analysis. Through their work on presenting themselves as organizations that produced not only ratings but also other services, rating agencies could survive criticism directed at the quality of the rating product. They could claim that changes in their organizational structure and process would solve problems with ratings. The response of rating agencies to the controversies over municipal bond rating and the rating of commercial paper reflected these dynamics: they directed more attention to the change in organizational structure rather than the change in the process and product of rating, avoiding in this way the difficult questions and issues surrounding the nature of rating—its subjectivity, partiality and biases involved in the opaque process of producing ratings. Agencies' producer work, in the 1970s phase of legal incorporation, was key to presenting themselves to multiple actors as impartial and independent professional organizations, whose standards of evaluation and products were reliable. These efforts also aimed at sidelining any arguments about a conflict of interest involved in these organizations' activities.[85] After having presented themselves successfully as reliable options for evaluating investment quality, they presented themselves as impartial alternatives that were relatively free of any conflict of interest and politically acceptable solutions to the problem of evaluating certain financial products.

The reception of rating agencies and their ratings following legal incorporations and evidence of successful institutionalization

[85] For example, conflict of interest accentuated in the 1960s for Moody's not just because of the new issuer-pays financing model but also because it began involvement in the mutual fund business and the investment management business. In 1969, however, D&B decided that Moody's would leave these lines of activity (Stimpton 2008).

Many different actors contributed to the meaning of rating and rating agencies as regulatory mechanisms in finance: government actors, members of the finance industry, as well as the press. Government agencies and regulators delegated some of their regulatory power through the legal incorporations in the 1930s and 1970s, and also publicized agencies' rating work through the contestation of their rating actions, especially downgrades. Financial industry actors rarely contested ratings and rating agencies work, and supported the belief that rating agencies did not ask for their regulatory power but were forced into the regulatory position by government regulators. The press also increased the visibility of the debates over rating agencies, especially their rating activities, voicing concerns about their transparency and highlighting possible alternatives to ratings as well as their agencies for evaluating securities, judging credit quality, and drawing conclusions about issuers' creditworthiness. The interaction of these actors contributed to the two phases of legal incorporations—the regulatory incorporation of rating as a product and rating agencies as their producers—and shaped their regulatory power by supporting the political institutionalization of ratings.

Government actors during legal incorporations and downgrades of municipal securities

The 1930s moments of legal incorporation. Before the 1930s legal incorporations, several governmental agencies had started endorsing ratings as indicators of securities quality and important tools for regulators through their use in reports and studies. The Federal Reserve Board, which at the time had almost unrestricted power to shape the nature of member banks' bond holdings, started to use bond ratings in the assessment of the portfolios of member banks in 1930 (Partnoy 2002, 70; Harold 1938). Researchers at the Federal Reserve of New York even developed a system that would reflect the "safety" and "desirability" of the portfolio of a bank in a single number produced by weighting a bank's entire portfolio based on credit ratings (Osterhus 1931; Harold 1938, 160-1). In 1933, the Federal Reserve Board began to publish tables highlighting the variation of bond yields across different rating categories, using Moody's system of Aaa, Aa, A and Baa for "investment grade" securities (Federal Reserve Board 1933, 483; Carruthers 2014, 11).

When banking regulators incorporated agency ratings in their regulations - requiring nearly all banks to use them in the 1930s, they formally legitimated rating as a product and indirectly acknowledged the standards and evaluation process of rating agencies as the source of regulatory ratings. The acknowledgement of rating agencies role was indirect and generally implied - reflecting the successful cultural institutionalization of rating and their agencies preceding the 1930s legal incorporation. Though most scholars view the 1931 decision by the OCC as critical to the rise of rating agencies and the credit rating industry (Cantor and Packer 1994; Partnoy 2002; Sylla 2002), secondary sources do not indicate that the decision required ratings from any specific agency, and the press generally talked about 'statistical corporations' rather than rating agencies. According the *Wall Street Journal* on September 12, 1931, "high grade" securities would be those with ratings in the top four categories of any agency, and "low grade" ones for those in categories below. There is no indication of the 'investment grade' category mentioned by Harold (1938, 28). Furthermore, the 'top four categories' threshold in the ruling did not match the 'top three categories' threshold that agencies used to describe the very safe securities, and neglected the risks of the fourth category securities which agencies argued to "require close discrimination" by informed agents (Flandreau et al. 2009, 9)[86]. The 1931 ruling referred to specific rating categories (Baa/BBB) and the 1936 directed banks to 'rating manuals' - both

[86] See *Fitch Bond Book 1930, Moody's Manual of Investment 1929, Poor's Ratings 1925, Standard Bond Description 1924* for the language on securities in the fourth category.

reflecting the explicit recognition of the rating product. The OCC in its 1930s rulings only implicitly delegated its vested power of identifying 'investment securities' to rating agencies.

Though the source of rating was not mentioned in the 1930s regulatory incorporations, it was implied somehow in the terminology that they had to come from rating agencies at the time, as there seemed to be no alternative sources offering them. Institutions had long maintained internal guidelines that limited the purchase or holding of bonds rated below a certain level (Stimpson 2008, 91). They were free to set their own thresholds and determine on a case-by-case basis which bonds to hold and for what reasons. The official legal incorporation of ratings limited their choices and brought to the forefront rating agencies' products and services. The new regulations made bond issuers more interested in obtaining ratings of their bonds *before* they issued them rather than *after,* as was rating agencies recorded practice. They "forced" bond issuers to rely on rating agencies as authoritative sources of evaluation, regardless of the information value of these agencies products (Partnoy 2002, 71). A month after this ruling, agencies started adopting a policy of rating new bonds prior to their offering dates, using the information contained in each security's prospectus filed with the SEC (Stimpton 2008, 92). Even though federal authorities issued the revised set of regulations in 1938 that did not mention ratings directly and left the evaluation of securities' quality and the judgment on what was an 'investment grade' security to bank examiners (Carruthers 20014, 12-3), they could not eliminate the implied understanding that practically one would still rely on agencies' judgments and ratings. According to Harold (1938), banking regulators generally agreed that the top category or 'investment grade' securities went no lower than the Baa/BBB rating.

Downgrades of municipal securities. State officials resisted the downgrades of New York city and state bonds by Moody and S&P in the mid 1960s. NYC Governor Nelson Rockefeller first regarded the situation of Moody's downgrade in 1964, as temporary. The NY state comptroller Arthur Levitt latter complained that the downgrades increased substantially state's net interest costs. Congressional hearings on the rating agencies' methods and their impact started at the end of 1967 as a result of local government officials' reaction to the downgrades of municipal bonds. The NYC finance administrator Roy M. Goodman called for government involvement in establishing new standards and practices regarding the evaluation of municipal bonds and presented an alternative to bond-rating by private for-profit firms: a private research organization financed by all interested parties - cities, banks, institutional investors, and securities dealers—that would be "free from political interference and conflict of interest" and incorporate the latest technology. Goodman claimed that 'inaccurate' ratings burdened local governments with 'chocking' interest rates on debt issues (*Wall Street Journal,* December 6, 1967, "Congress Urged to Act on Bond-Rating Service Replacing Private Firms - New York City Finance Officer Suggests Systems Financed by Cities, Banks, Buyers, Dealers").

Congressional hearings on this issue lasted for a year—till the end of 1968—but they did not result in any legislation enacted or even specific recommendations for improvements to the existing bond-rating system. This represents one of the first victories of rating agencies and indicates the successful political institutionalization of rating and rating agencies. Still, congressional hearings drew public attention to the rating business and their study and even became a justificatory basis for rating agencies' decision to finance ratings through issuers' payments rather than investors' subscriptions. The change into the issuer-pays business model for ratings was said to be a solution to the rising analytic costs of rating new municipal issues, a task which was becoming more complex and time-consuming in agencies' view (*The New York Times* 'Moody's Rating Fee on Tax-Exempts Set', April 16, 1970). However, governmental actors were the ones to highlight the financial repercussions of rating decisions and also their regulatory position during the congressional 1967-1968 congressional hearings.

The 1970s moment of legal incorporation. The credit crunch and the crisis that ended in 1970 raised questions about the securities industry and its governance. Congressional hearings on the study of securities industry highlighted problems with the practices of brokers and dealers in securities markets but did not consider their use of ratings as problematic. These hearings, however, highlight the way in which ratings entered the SEC vocabulary-as a benchmarking mechanism in securities market, to regulate the behavior and practices of its professionals. From the late 1960s to the mid 1970s, the debate in Congress over rating agencies and their role in finance was weak[87]. Overall, no question was raised about credit ratings' use and their agencies. Their role in evaluating the liquidity and creditworthiness of securities was taken for granted, especially in the municipal securities industry. Major actors in the securities market were using them: for example, the New York Stock Exchange (NYSE) used ratings in its capital rule as it required different haircuts – a percentage of capital (market value or positions) to be set aside by a broker or dealer as a safety deposit for emergency situations – depending on the rating and maturity of municipal securities. The revised text of Rule 325 entitled *Capital Requirements for Member Organizations and Individual Members* presented in the House Hearings, showed clearly how NYSE required securities covered by lower ratings to have higher haircuts, i.e. the percentage of market value to be deducted got higher as a security's rating decreased. Furthermore, the NYSE rule also specified that the ratings had to come from "any nationally known statistical service which is recognized by the Exchange" (214). In the case of Commercial Paper the sources were even more specific: Standard and Poor's or the National Credit Office

[87] Among all the legislative history documents on the Securities Acts Amendments of 1975 (the amendments to the Securities Exchange Act of 1934), only eleven documents mentioned credit ratings and their agencies.

were considered valuable and legitimate sources of ratings. Securities not covered by ratings from the specified agencies or at all were required the highest deductions, ranging from 30 to 50 percent of their market value (House Hearing on Study of the Securities Industry Part I, July 16, 1971, 214-217). The SEC rules at the time were different as they did not require a discount for municipal bonds and charged a fixed percentage (5 percent) for commercial paper (House Hearing on Study of the Securities Industry Part II, November 10, 1971, 831).

The l970s legal incorporation explicitly delegated regulatory power to rating agencies as the producers of ratings. The SEC did not define the term Nationally Recognized Statistical Rating Organization (NRSRO) in its rules and regulation and did not specify a path for getting the NRSRO designation. The main criterion for identifying NRSROs at the time was actual use of these agencies' ratings by markets nation-wide (SEC OGI 2009, 3), and the recognition "by the predominant users of securities ratings" that they were credible and reliable (SEC 2005, 10). The SEC staff agreed to raise no questions on the matter of their incorporation into the net capital rule (SEC 2005, 9). Clearly SEC was affected by the practices of main industry leaders and did not challenge market judgment. The Commission would decide on a case-by-case basis, using no-action letters—letters that reassure the applying entity it will not be persecuted by the SEC for the activities it has explained in its application—to recognize rating agencies like Moody's, Standard &Poor's, and Fitch as NRSROs (Shipe and Freeman 2008, 2).

Some attributed the decision of the Commission to designate three credit rating agencies as NRSROs to its concern that new entrants into the rating business would not meet the minimum quality standards assumed to be in place for the existing rating agencies - Moody's, S&P and Fitch - whose ratings were used by companies to meet regulatory requirements (Stimpton 2008, 146; Keller and Stocker 2010). The SEC feared that rating agencies' new fee-for-service compensation structure would be abused by newcomers: this business model was biased towards producing higher ratings because those meant more business for them. Jiang et al. (2012, 4) demonstrate this phenomenon of inflated agency ratings following the adoption of the issuer-pays financing model instead of the investor-pays one by examining the effect of such change for S&P. They find that S&P ratings became higher after it began to charge for corporate bond ratings in July 1974. The conflict of interest associated with such change in compensation model increased especially after the S&P's formal recognition as a NRSRO in 1975. Using a sample of 797 corporate bonds issued between 1971 and 1978 and rated by both Moody's and S&P they also found that between 1971 and June 1974—when Moody's was charging issuers but S&P had not changed its business model yet—Moody's rated the same bonds higher than S&P (2). "In an effort to discourage the spread of unscrupulous agencies that might sell good credit ratings to the highest bidder, in 1975 Congress designated Moody's Investor Services, Standard & Poor's Ratings Services and Fitch Ratings, Ltd. as nationally recognized statistical rating organizations NRSROs" and make compliance with federal regulations relating to bank and broker capital dependent on getting these specific agencies' ratings (Keller and Stocker 2010, 1).

However, the legal incorporation of rating agencies and their ratings through the SEC rule change in 1975 was the result of the successful cultural and political institutionalization of ratings and their agencies. During the time of the SEC decision, the 93rd Congress was conducting hearings on the credit crunch. In these congressional hearings ratings were mentioned only in the context of regulation regarding municipal bonds. During debates over a bill that would permit commercial banks to underwrite state and local revenue bonds, several senators argued for the bill stating that revenue bonds were not much different from general obligations bonds in practice, because rating agencies used the same rating system for both.[88] Senator William Proxmire stated that the distinction between the two kind of municipal bonds was "of little practical significance, since no municipality can afford to permit a default on its revenue bond issues without seriously jeopardizing its general bond rating" (93d Congress Hearing on Credit Crunch Part 2, 920). Senator McLean reminded Senator Brock that "the theory of bond rating is to equate the two, so that a BAA should be equivalent whether it is a GO or a revenue bond" as a response to his concerns that the BAA rating was not an adequate indicator of quality (93d Congress Hearing on Municipal Securities Regulation unpublished, 20). "There is no suggestion that ratings are not given in the market" stated Michael S. Zarin, member of the Committee on Governmental Debt Administration, Municipal Finance Officers Association (Vol.2 Senate Hearing Part 3 93d Congress, 478) reflecting how the use of ratings and their "established rating agencies" was taken for granted especially for the evaluation of municipal bonds (Vol.6 Senate Hearing2 Part 1 and II October 1973 93d congress, 139).

Industry actors during legal incorporations, downgrades of municipal securities, and the introduction of the issuer-pays business model

Moments of legal incorporation. The finance industry generally supported rating agencies and their work and did not see them as problematic. They were seen as the victim of government actions for being selected somehow unwillingly to be incorporated in regulations. During the 1930s moments of legal incorporation, though market participants had supported the Comptroller's 1931 decision (*Wall Street Journal,* December 31, 1931 "New York Banks agree

[88] This bill would change the Glass-Steagall Act of 1933 that allowed banks to underwrite general obligation bonds but prohibited them from underwriting revenue bonds. "General obligations bonds are backed by the full faith and credit of the issuing municipality, whereas revenue bonds are secured by revenues from the project they finance." (93d Congress Hearing on Credit Crunch Part 2, 920)

on Values"), the banking and finance industry voiced strong opposition to the 1936 ruling. Banks argued that the ruling excluded them from taking advantage of the rise in bond prices at the time, and was going to limit the issuance of new bonds and employment in the US (*Wall Street Journal,* March 13, 1936, "Banks oppose eligibility rules for investments"). They also noted that with this ruling agencies were "superseding the opinion of banks' statistical experts" (especially those in investment banks) which were "equally competent", and in fact they doubted that rating firms themselves were "desirous of accepting such a responsibility" (*New York Times,* March 22, 1936, "Banks Deplore Bond-Rating Rule").

It was representatives of small and medium-size industry actors that criticized ratings and rating agencies and their legal incorporation, indicating the politics involved in their regulatory recognition. They pointed out the problem with trusting ratings of private specialized firms without evidence of their performance and without knowing the actual process and methods through which those ratings were produced. A resolution issued by the Missouri Bankers Association on May 5, 1936 during its annual convention in Kansas City emphasized how the ruling penalized medium-sized and smaller companies as ratings put a premium "upon size rather than merit" and "do not take into account the possibilities of the future". The association stated that "the delegation to these private rating agencies of the judgment as to what constitutes a sound investment is unprecedented in our history and wholly unwarranted by their records in the past." (Cited in Stimpton 2008, 93). These criticisms of the legal recognition of ratings as legitimate evaluations of credit risk continued and furthered the above arguments pointing out that rating agencies did not outperform markets and the holding of highly rated securities would provide a false sense of security to banks, because they reflected only the past performance of securities and their issuers (*Wall Street Journal,* June 25, 1936, "Security regulations opposed by bankers").

There was no reaction to the 1970s legal incorporation, reflecting the success of the political institutionalization process as rating agencies were considered as reliable impartial organizations and the emerging conflicts of interest as a result of the issuer-pays model of financing the provision of ratings. Before the SEC rule change that recognized NRSROs there is some indication that the logic of rating was well accepted (again an indication of the successful cultural institutionalization of the product) but the source of such ratings—private for-profit firms or the government or another not-for-profit body—was more contested among industry actors. In a statement before the SEC, Hans Rudolph Reinisch, President of the National Shareholders Association, suggested that new issues and underwritings had to be rated the way corporate bonds were rated, in order to clarify their quality and distinguish sound issues from highly speculative ones, even though by whom was a different issue as he questioned the independence of bond rating agencies (House Hearing on Study of the Securities Industry Part II, November 10, 1971, 1708).

Downgrades of municipal securities. The downgrades were praised by the financial community overall. Bankers did not agree with state officials' assessment that the cost could be attributed to the downgrades (Stimpton 2008, 120-1). A *Wall Street Journal* editorial praised Moody's decision for bringing to light "what's wrong with government in that metropolis" and "a distilled example of political ills more generally besetting the nation" (Stimpton 2008, 121). The controversy about the effect and fairness of agency ratings increased public awareness about the power of ratings, as lower ones could mean higher financial costs. However, industry actors did not want to make such argument, maybe in fear of attracting more governmental attention and being objected to more supervision by regulatory agencies, or just in support of rating agencies' established position as friendly supporters of bankers and investors.

The controversy surrounding the rating changes for municipal bonds led to a broader governmental investigation of rating agencies overall. The debate on rating agencies also shed light on the close relationship between investment bankers and rating agencies. Bankers supported the rating agencies work and were using their ratings. They saw their rating system as worthy of respect but also had suggestions for improvement. George E. Barrett, Jr., a vice-president at New York's First National City Bank expressed bankers' increasing view that the existing rating system was not very helpful to municipal bond buyers and sellers who wanted to know how far was each issue was from a potential downgrade to below investment grade status. He called for finer gradations in the A and Baa range of rating systems, as at the time nearly 85 percent of municipal bonds were rated in those categories, and an increase in the number of analysts rating agencies—Moody's and S&P—employed (*Wall Street Journal,* January 2, 1968). A study on municipal ratings published in December 1968 by The Investment Bankers Association concluded that "the agencies have so conducted themselves that their rating systems as a whole have earned the respect accorded them" (Stimpton 2008, 124). Under the context of this overall support, the study asked agencies to clarify their methodologies and standards used for assigning ratings and expressed concerns about over-reliance on ratings that came out of a field lacking diversity of opinion[89].

The issuer-pays business model. The financial markets were not surprised by the changes in the business model of rating agencies. It was considered a normal thing to do for a private firm - offering an investment service and wanting to be paid for it so that it could continue to do a good

[89] There was a fear that S&P would not last in the business and Moody's would have a monopoly in municipal ratings again.

job and even do it better. As Keefe stated in his 1989 interview "NCO started charging for ratings year ago and it was never seen as a conflict of interest…D&B had sold its credit ratings for nearly one hundred years and no stigma ever attached to them" (Stimpton 2008, 140). The rating agency's role was seen as that of an evaluator of the quality of issuers and their financial instruments (products). As an analyst commented after the assignment of the first rating to a Eurobond by Moody's in December 1970, the Moody's system was seen as offering a reliable yardstick for measuring the quality of Eurobond issuers - useful to U.S. corporate borrowers and European investors (*Wall Street Journal,* December 10, 1970, "Moody's Begins Rating Some U.S. Issues Abroad").[90] It was clear that rating agencies had begun to serve two different publics—the issuers and the investors—and that there was a potential conflict of interest involved in their position. The meaning of ratings also had changed with time: though once they were seen as being offered in service to the public (investors and other participants in financial markets), gradually this had shifted into seeing them as more of a product and service to private clients.

The media and the fate of alternatives to rating and rating agencies

Business publications shaped the debates on rating and rating agencies by giving publicity to rating agencies' actions and creating awareness about their existing and developing regulatory power. According to Moody's account of their own history, the controversy that followed their decision to change the rating of New York State's general obligation bonds from Aaa to Aa was unexpected, as they had not circulated the decision widely. The *New York Times* ran a front-page

[90] Moody's assigned its first ratings - a double-A rating - to a planned $20 million overseas offering of 15-year debentures by Richardson-Merrell Overseas Finance N.V., a foreign subsidiary of the New York based drug, chemicals, and toiletries manufacturer and also announced it could rate other Eurobonds of American firms.

story on the downgrade of Moody's, even though it followed Dun & Bradstreet's rating change from 'prime' to 'better good grade', because Moody was seen as "the most influential bond rating service" (October 20, 1964, "Credit of State Loses Top Rating on Moody's List: Investors' Service Follows Dun & Bradstreet Step -Loan Costs Could Rise"). The downgrade became the most widely covered rating change in the news media, with coverage even outside the financial news columns (Stimpton 2008, 117).

The press as well as other kinds of publications played another important role: reflecting presented and envisaged alternatives to rating as a product and rating agencies as producers of ratings. From an analysis of press coverage and other studies on rating agencies before the 1975 instance of legal incorporation, there was a limited set of envisaged alternatives and even those few ones could not survive or become a realistic challenge for rating agencies and their ratings.

The alternatives to ratings and their logic were less frequent, and nearly nonexistent. There were some contestations of the way in which agency ratings were produced—their form. Hickman's (1958) study, for example, compared agency ratings to other possible bond quality measures—a measure composed of market ratings and one derived from legal investment lists. His findings showed that overall all measures performed equally well over that same time period, but agency ratings tended to follow business cycles much more than other quality measures (cited in Sylla 2002, 28). Around the period of 1970s legal incorporation, another alternative system of rating securities was proposed and devised - first in the United States[91] and later in the UK[92]: what was called an 'objective' rating system that - in contrast to the 'subjective' rating

[91] Mr. T. F. Pogue and Mr. R. M. Soldofsky devised the 'objective' rating system in the US in the early 1970s but %95 of their ratings ended up tallying with Moody's (*The Economist* "Objective, but how effective" March 18, 1978).

[92] In the UK, the 'objective' rating system was initially devised by the statistical services firm Extel, in collaborating with the Institute of Actuaries and the Society of Investment Analysts (*The Economist*, July 31, 1976, "Un-American activity"). It was launched to rate debentures and loan stocks quoted on the London stock market in 1978 and it was rating only companies. The Extel system did not survive, but closed within twelve months of

system of Moody's and S&P—was based only on mechanistic formulas using only published financial information, , and gave separate ratings to the issuer of the security and to the security as a financial instruments. The objective system aimed to appeal to "a small and entirely professional market" (*The Economist,* March 18, 1978, "Objective, but how effective"). This alternative system, however, failed to challenge the established status of Moody's and S&P with Wall Street. Another alternative to ratings emerging in 1975 during debates on rating municipal bonds was The Bond Buyer Index—a measure of municipal bond yields widely used by municipal bond dealers (*New York Times,* September 12, 1975, "City's does Fan Bond Dealers' Problems").

The alternatives to rating agencies as sources of ratings were more frequent and got more attention. The first alternative to rating agencies in banking regulation were presented to be bank examiners in the opposition to the 1936 instance of legal incorporation that referred to rating manuals. In the speech following the ruling the Comptroller emphasized that bank examiner's judgment and their ability to evaluate credit files on investments were to be considered before referring to rating manuals (*New York Times,* May 23, 1936, "Topics in Wall Street"). The other alternative source of ratings or standards of evaluating financial instruments that appeared as early as the 1940s was the government. An article in the *New York Times* (January 2, 1940, "Rating for Bonds Scored") noted that agencies were not accountable, saw their own ratings as simply sign-posts, and were being used by bank examiners themselves, therefore, asking for government standards instead. This article noted how ratings were already culturally institutionalized and had affected the informal practices of bank examiners too, making this alternative not realistic. The call for the government as a source of ratings in the mid 1960s and

operation. However, it was revamped by another brokers firm called Simon & Coates in 1980 and offered for free to investors (*The Economist,* February 2, 1980, "Bond rating for free").

early 1970s together with debates on the rating of municipal bonds (resulting from the 60s downgrade of the NY state and city bonds by Moody's and S&P). The 20th Century Fund research report as well as other government organizations however did not ask the complete elimination of industry involvement in setting standards and a new system for rating municipal bonds. Industry and professional organizations were also presented as an alternative source of standards for evaluating securities and their issuers, only when talking about the evaluation of municipal bonds in the 1970s. They generally took the form of rules for increasing reporting and disclosure of information that emerged in response to attempts to legislate standards for state and city bonds evaluation. The S&P themselves in hearings a the House of Interstate and Foreign Commerce Committee argued that federal regulation on rating municipal bonds was not necessary and instead efforts had to be put into creating a uniform method to financial reporting (*New York Times,* March 28, 1972, "U.S. Bond-Rating Rules Urged").

In 1974 rating agencies expanded: partly because of the boost in revenues that the new issuer-pays (rather than investor-pays) model generated in the case of Moody's, and partly because of the absence of realistic envisageable alternatives to these private firms as sources of ratings. The report published by the Twentieth Century Fund on the rating agencies in April 1974 concluded that the agencies were doing "a credible job" given their resources. It acknowledged the regulatory power rating agencies had acquired and even mentioned the alternatives that could substitute them—a potential public ownership of rating agencies, varying degrees of regulation, surveillance of their ratings, and establishment of supplementary services—in case they did not meet their responsibility. The continuing role of rating agencies was not questioned—it seemed to be accepted and necessary, taken-for-granted as most of the recommendations offered were directed at changing the behavior of actors other than rating agencies (*New York Times* "Data

Bank Urged in Bond Rating Study" April 3, 1974). The report made threats of ratings agencies being substituted with alternative regulatory sources seem less credible. It stated clearly that "to most, public ownership or full regulation seems an extreme solution to an ill-defined problem" (Stimpton 2008, 147) and "any element of compulsion in the formulation of credit ratings would be unwise and unhealthy. It would needlessly taint, if not destroy, their acceptability as objective opinions of investment quality" (148). It was only after the 1975 legal incorporation recognizing NRSROs that government involvement was attempted in the field of rating municipal bonds, but these efforts also failed, indicating the successful political institutionalizaiton of rating agencies and their ratings.

The meaning of rating and rating agencies after legal incorporations. The 1930s ratings-dependent rules and regulations had important implications for the meaning of ratings as a legitimate and appropriate alternative method of evaluating investments quality and security, and a product of rating agencies. This first phase of legal incorporation made costlier for financial institutions to hold low rated or unrated bonds, but at the same time helped many banks survive for a longer time - protecting them from market fluctuations (Carruthers 2014). As Partnoy (2002, 70-71) argues, it increased the symbolic value of ratings as certification of institutions' adherence with government regulations. This 'regulatory license'—which helped institutions reduce costs associated with regulation—in his view, led markets to care less about the agencies' reputation or the informational value of their offered product (73). Another consequence of such incorporation was an assumption that ratings could be easily matched across agencies and there was an easy correspondence between their different granular categories (Flandreau, Gaillard, and Packer 2009, 20).

However, it was not very clear who rating agencies were serving—the public (customers) or the private sector (firms). In 1971, S&P started rating insurance companies—using the AAA-D bond rating symbols, it was the first to introduce a rating system that evaluated the claims-paying ability of insurance companies. In this case, it could be seen as a positive step for customers of insurance - as a way for them to evaluate these companies and discriminate in their decisions to purchase ones' services versus another—or it could be an initiative inspired by some professional organization or industry concern, by participants in the insurance markets as a way of dealing with members that were problematic to the industry or as part of a professionalization project. The summer of that same year, when NCO merged with Moody's to form NCO-Moody's commercial paper division of D&B, George Keefe—who became responsible for the new unit—stated that "there were to be no more "Penn Centrals"" and that profitability and market share were secondary concerns for D&B–the primary one being the quality of their evaluations helping the public (investors) to detect problems in time (Stimpton 2008).

White (2002; 44) notes that the 1970s legal incorporation of ratings was different from the first round in the 1930s as it introduced 'regulatory restrictions on supply' favoring incumbents over new entrants to the industry. These regulations assume that the major incumbents and suppliers of ratings recognized in 1970s legislation automatically will continue to meet the market test (i.e. do better than markets) for a long time. Jiang et al. (2012) give indication of the role NRSRO designation played in the decisions of rating agencies to change their financing model from an investor-pays to an issuer-pays model. They note that newcomers kept the investor-pays business model unchanged till they were recognized as NRSRO. They give the example of Duff & Phelps—a Chicago-based equity research firm that started to offer ratings for corporate bonds as part of its research services to private clients in 1976—which adopted the issuer-pays model only after its recognition as a NRSRO in 1982. I also argue that another reason why this incorporation was different and much more important is that it took place silently--without getting noticed-in the form of an unimportant rule adopted by a government agency. It was the time when the Securities Act Amendments of 1975 were being discussed—amendments that regarded the structure of the securities market itself. The credit crunch and stock market crash had raised major concerns about brokers and dealers' practices and other market participants like the exchanges. In the larger efforts to create a unified securities market and better delineate the regulatory configuration with SEC as a key actor, a simple rule mentioning a simple term that involved a simple assumption would not merit attention, debating, or major contestation.

Evidence of successful political and cultural institutionalization

The cultural institutionalization of ratings was evident in the arguments given for the new ratings-based regulations introduced by SEC as part of the broader Securities Act Amendments (SAA) of 1975. SAA aimed to reform the self-regulatory organizations and governance of the securities market. The specific rules that made reference to the necessity of agency ratings were SEC Rule 15c3-3 (the Net Capital rule)—which was first proposed in 1973, introduced the NRSRO designation, and regulated broker/dealers requiring them to calculate their capital based on the current ratings of the securities they held in their accounts, and SEC Rule 2a7—which applied minimum rating standards to money market funds' assets to ensure their safety and liquidity. SEC deemed Moody's, S&P and Fitch as "nationally recognized" early on with 'no action' letters—letters sent to these agencies stating that SEC would not take any enforcement action if these agencies' ratings were used by these companies to meet SEC rulings. At the time of the NRSRO designation there was no definition of the term or specific criteria for identifying such organizations given. New entrants lamented the process to be cumbersome, ill-defined and anti-competitive even though new no action letters were sent to other agencies in the 1980s (e.g. Duff & Phelps in 1982, McCarthy, Crisanti & Maffie in 1981, Dominion Bond Ratings Service in 2003 and A.M. Best in 2005). Stimpton (2008, 146) argue that with time the criteria used for being NRSRO became more clear including security of conflict of interest, adequate financial resources and staffing sufficient training, and appropriate methods of institutional separation to avoid mixing rating judgments with investment advice. Even assuming it was so, it would be difficult to access no action letters sent to these agencies and understand these emerging criteria. It was not a transparent process and many new entrants were frustrated with it (Partnoy 2002).

Similar to the 1960s, after the 1975 instance of legal incorporation, rating agencies drew most attention and controversy with their rating of municipal bonds. However, this time events reflected the increased power, prestige, and confidence of rating agencies resulting from the 1970s legal incorporation. In April 1975, S&P suspended its double-A rating for NYC's debt securities stating that major underwriting banks were unable and unwilling to continue purchasing NYC's notes and bonds. The major of New York Abraham Beame and the Controller Harrison J. Golden criticized the decision as 'unfair'. Many others like the financial editor of the American Banker and a member of the 20th Century Fund Task Force that published the 1974 report on rating agencies Ben Weberman commented that the suspension "doesn't do the rating agencies credit" (Cited in Stimpton 2008, 148). The *New York Times* ran a feature article on the increasing power of rating agencies a week after the S&P's decision (April 9, 1975, "Rating Power: The Who and Why"). S&P's head of municipal ratings John K. Pfeiffer stated the decision to suspend NY's rating was taken unanimously by the rating committee's eight analysts.

"I don't care about raising hell. That's part of doing your job. I care about doing the right thing" he replied when asked about the furor regarding its decision (Cited in Stimpton 2008, 148). Moody's kept its A rating of NYC's bonds commenting that they had not found any deterioration in the city's credit that was worth a change in rating.

Though states and municipalities nationwide were dealing with problems stemming from inflation and growing financial needs, the financial issues of the New York State and NYC received most attention and led to intensifying debates on the role of ratings and their agencies. In summer 1975, NYC faced default. Moody's lowered the ratings of the city's bonds two letter grades to speculative grade Ba, downgraded the New York State bonds to the A1 category (below double-A) and withdrew its ratings of the state's tax and revenue anticipation notes. State Comptroller Arthur Levitt called the downgrades 'outrageous'. In October 1975, however, then President of the United States Gerald Ford vetoed a plan to provide Federal assistance to NY and the state's financial problems deepened (*New York Daily News,* October 30, 1975, "Ford to City: Drop Dead"). After the vows of president Ford to veto any bail-out, New York stated that there would be a postponement of repayments related to $1.2 billion short-term notes and established the Municipal Assistance Corporation (MAC) to address the city's financial distress. Rating agencies were being criticized for not voicing concerns about the city's financial troubles earlier and not moving fast enough (*Wall Street Journal,* November 28, 1975, "Credit-Rating Firms Did Inadequate Job, Sen. Eagleton Claims"). In a speech at Rutgers University campus in Camden, New Jersey Senator Thomas Eagleton (D., Mo.) argued that Moody's and S&P were party to blame for the city's financial crisis as with overly optimistic ratings of NYC's bonds, they signaled all was well, and made possible for New York "to sell itself to an unsuspecting public as a worthy credit risk and also market its bonds" even given its badly administered and shaky finances (Stimpton 2008).

Rating agencies' confidence and the indication of the successful political institutionalization of their ratings after the mid 1970s legal incorporation with the NRSRO status became more clear in 1976. Rating agencies rating decisions were publicized more and more; downgrades increased for cities like Boston and Philadelphia (*Wall Street Journal,* January 28, 1976, "Moody's Downgrades Ratings for Boston And for Philadelphia") and states like Connecticut (*New York Times,* March 14, 1976, "The Rating Agencies Get Tough"). The most dramatic of the downgrades was given by Moody's on May 26, 1976 for MAC bonds. Moody's downgrade from A to speculative-grade B happened without warning and took Wall Street and bond markets by surprise, following MAC's disclosure that it was going to sell $25 million small-denomination bonds nicknamed "mini-MACs". The rating agency stated that MAC revenues were too vulnerable given NYC's precarious finances and that "bondholders' legal rights to security have been recently and repeatedly abrogated by the State legislature" (*New York Times,* May 27, 1976, "Moody's Slashes M.A.C. Bond Rating From an 'A' to a 'B'"; Stimpton 2008, 149). MAC top officials—especially its finance committee chairman Felix Rohatyn—threatened to sue Moody's for negligence and incompetence as its action was said to mark "the most serious setback in the last year for New York City's carefully constructed financial effort" and had caused many market losses for bondholders (*New York Times,* May 29, 1976, "M.A.C. Bond Move Termed Setback"; *Wall Street Journal,* June 1, 1976, "MAC Set to Sue Moody's in Bid to Regain Investor Faith After Bond Downgrading").[93] The head of municipal ratings at

[93] In the WSJ article, Mr. Rifkind, a partner in the law firm of Paul, Weiss, Rifkind, Wharton & Garrison, compared that the tort action and the case against Moody's (and rating firms/agencies broadly) to a case that might be taken against an accounting firm that issued inaccurate financial material. 'A tort is a wrongful act to which the inquired party may seek remedies in a civil court.' (also in Stimpton 2008, 151)

Moody's—Jackson Phillips—considered NY officials' reactions a normal expression of strong displeasure for a downgrade and commented: "There's no threat that can make me change my mind on the MAC downgrading". MAC, however, did not sue Moody's immediately in the hope that a bill introduced by Representative John M. Murphy of New York City—House Resolution 675 (H.R. 675)—giving the SEC authority to reverse rating agency opinions would gain traction.

The fate of the bill involving the SEC in the regulation of municipal bond rating business as well as the testimonies given by rating agency representatives in congressional hearings on this topic also indicate the successful political institutionalization of ratings and their agencies. The House Resolution 675 would require the SEC to set standards for making "accurate" ratings of municipal bonds. The proposed legislation would allow SEC to take the objections of aggrieved issuers for the ratings they were given, and order a revision of the rating decisions if it saw appropriate after considering them in a hearing. This bill died in committee and no legislation followed (*Los AngelesTimes* "Proposed Bill on U.S. Rating for Bonds Hit"; *New York Times* "S.E.C. and Standard &Poor's Score Bill to Curb Bond Rating", *Wall Street Journal* "SEC Opposes Bill to Tighten Its Control Over Municipal Bond-Rating Agencies"). In his testimony before a Congressional subcommittee on H.R. 675 in June 24, 1976 Phillips argued that putting the SEC in the rating business meant that it would have to do all the research firms did and would represent an interference of the government with an individual's freedom of opinion. He called such initiative "repugnant to the commonly held view of government authority" considering it a case of "the government ordering a person to change his opinions and judgments, however honestly held" (Stimpton 2008, 151; Congressional Subcommittee Hearing…). The claim was that the firm's ratings were opinions similar to the opinions of an individual—not to be interfered with, though they had broader societal implications. To conclude his comments, Phillips cited parts of the testimony of New York State Comptroller Arthur Levitt during similar hearings held in 1972: “To regulate ratings would eventually mean Federal control of public borrowing. The implications are frightening” (Stimpton 2008, 152).

The rating agencies came out somehow unaffected by these developments, as no legislation resulted from the 1976 hearings and MAC did not follow with its threat of legal action. The controversy and hearings seemed to characterize rating agencies as having ‘life or death power’ - in the words of New York City Comptroller Harrison J. Goldin (*Los Angeles Times,* June 25, 1976, “Life or Death Power”; *New York Times,* 1976, “Goldin Backs Bond-Rating Legislation”). In late September, Rohatyn and George D. Gould -two top MAC officers- wrote Moody's a letter stating they considered the firm ‘unfit’ to rate MAC bonds and requested that it discontinued rating their securities (*Wall Street Journal,* October 1, 1976, “MAC Debt Doth Murder Sleep”; *Wall Street Journal,* October 7, 1976, “MAC Asks Moody's To Stop Bond Rating, But Says It Won't Sue”). They argued Moody's ratings were political motivated citing a letter signed by then Moody's president John D. Lockton Jr. that called New York State culpable of committing "one of the biggest fraudulent acts ever recorded" in managing the city's financial crisis. Moody’s did not stop rating MAC’s securities (*Wall Street Journal,* October 8, 1976, “Moody's Rejects Request To End Ratings of MAC”). Jackson Phillips' handling of the MAC ratings controversy was applauded and even called 'courageous' and 'heroic' by many within the industry. An editorial in *Barron’s* was titled ‘Emperor’s New Clothes: the Naked Truth Finally Emerges About MAC” and a feature article in the *Wall Street Journal* titled ‘Rating Game: Credit-Rating Firms Wield Greater Power in Public Debt Market” summed up developments with the New York ratings stating that “the credit-rating business has come out of the closet, into the spotlight- and sometimes into battle" (Stimpton 2008, 152).

It was clear that they had won the battles till now and local governments were the losers. A sharp drop in the prices of bonds of the Municipal Assistance Corporation followed news of the New York State Court of Appeals decision to invalidate the moratorium on repayment of New York City Notes in late November (*New York Times,* November 20, 1976, “Reaction One of Dismay, Not Panic; M.A.C. Bonds Fall After Decision”). In the summer of 1977 SEC also releases its massive investigative report into the city’s financial troubles accusing the city and banks for hiding NY’s real financial plight (*Wall Street Journal,* August 29, 1977, “SEC Weighs Action After its Staff Accuses City, Banks of Hiding New York’s Plight”). SEC had also critical words for Moody’s and S&P—the nation’s two largest bond rating agencies—but they managed to be not at the forefront of criticism (*New York Times,* August 30, 1977, “Taxes Accounting”). One and a half months later there is news of public relations efforts from rating agencies explaining the process through which they give their bond ratings (*Los Angeles Times,* October 10, 1977, “Moody's Explains how it Plays Bond Rating Game”). Partnoy (1999; 2002, 78-80) examined suing of rating agencies after 1970s and the common element of all of the cases was that at the end agencies won.

Rating agencies, however, navigated the post-incorporation environment by re-emphasizing the judgmental nature of their ratings and supporting government efforts for more disclosure in finance. An article in the *New York Times* (March 14, 1976, “The Rating Agencies Get Tough”) mentioned rating agencies cautioning about their ratings by saying they were not auditors therefore could not know whether the reported information to the SEC and themselves by issuers of securities was accurate and comprehensive. In 1976 the proposed bill for bond rating would require agencies to register with the SEC as ‘investment advisors’ (*Los Angeles Times,* June 14, 1976, “Proposed Bill on U.S. Rating for Bonds Hit”). Rating agencies worked with the SEC to oppose the regulation of municipal bond rating agencies with an alternative bill aimed at regulating persons who rated—analysts. Fitch especially emphasized how it supported SEC's disclosure requirements, making information available to everybody (*New York Times,* June 24, 1976, "S.E.C and Standard & Poor's Score Bill to Curb Bond Rating"; *Wall Street Journal,* June 24, 1976, "SEC Opposes Bill to Tighten its Control Over Municipal Bond-Rating Agencies"). The debate on rating and rating agencies became an issue about information—its availability, accuracy, and comprehensiveness—in the years to follow. Because the Penn Central crisis was seen as the Enron of 1970s i.e. as a problem with the behavior and regulation of dealers, from 1977 on the performance of rating agencies and their reliability was made dependent on the good use of certain accounting methods and principles (*Wall Street Journal,* June 30, 1977, "Tell and Sell"). Ratings were also seen as one form of information, while more calls were made for more information and disclosure (*New York Times,* November 5, 1977, "People and Business: Federal Rules for Municipals Seen").

Conclusion

This chapter highlighted the process through which the cultural institutionalization of credit ratings gave way to their political institutionalization and advanced their regulatory power. It did so by emphasizing the way in which demand for ratings was created through different venues and different actors: the financial press, the credit agencies themselves, other segments of the financial market - the banking and insurance sectors- and the government agencies. I focused on the decisions to incorporate credit ratings in substantive regulations for the financial sector and recognize credit rating agencies as legitimate evaluators of the quality of bonds and their issuers. The legal incorporation of ratings and their agencies happened in two stages: the first one during the early1930s and the second one in the mid 1970s. I argued that political institutionalization was key to establishing the regulatory power of ratings, and the cultural institutionalization would have not been enough to explain the power of rating agencies and their role in the financial markets. Furthermore, rather than emphasizing the importance of context and conditions for such development, I underlined the role of actors making strategic decisions as agents in pushing a particular understanding for rating and sidelining possible alternatives of evaluating investment quality.

Similar to what the previous chapter showed, rating was not the main activity of rating agencies: they were focused on expanding their activities into new markets and new areas - especially of an investment advisory nature. They presented their ratings as opinions based on scientific methods and themselves as reliable experts and professionals independent of political influences that offered advice to investors based on statistical analysis and experience as market observers. Different from the period before instances of legal incorporation, rating of securities was offered more as a self-standing product whose acquisition required payment by issuers even before securities were put in the market. Furthermore, rating agencies presented themselves more confidently as defenders of public morality and individual investors' good as a result of their political institutionalization and the increased visibility emerging from more media publicity. The position of the SEC as supporter of industry and professional self-regulation (especially its support of powerful actors like NYSE, exchanges and the dealer/brokers community) and a disclosure organization helped the emergence of ratings and their rating agencies as regulatory mechanisms.

While the 1970s legal incorporation furthered the cultural and political institutionalization of ratings, the political institutionalization process at the same time could be seen as opening opportunities for the beginning of a process of deinstitutionalization. The public debates and controversies involving ratings and rating agencies made criticisms more accessible to the broader public and alternatives somehow more visible. However, even if was really the case, the process of deinstitutionalization is expected to take a long time to unfold because not only ratings were able to become a kind of boundary object, but also rating agencies built themselves into a kind of boundary organization that helped collaboration among divergent interests of issuers and investors through a more permanent organizational form.

In order to understand better the future of ratings and rating agencies, one needs to better understand why the 1970s incorporation that happen through a simple rule change gave so much power to rating agencies and their ratings? Why did the term NRSROs spread so quickly? The story about rating agencies we have told so far provides an important part of the explanation. Of course, another part of the story regards the way actors incorporated the term NRSRO in future regulations after the SEC rule introducing it, and this remains to be carefully researched and examined.

CHAPTER 6

The Cultural Institutionalization of Accreditation in Healthcare

The most well-known form of rating in healthcare is accreditation. It involves the evaluation by a specialized team of the degree to which an organization or its products and services comply with specified standards. The oldest and most comprehensive accrediting agencies in healthcare are two private not-for-profit organizations: The Joint Commission (TJC) and the Healthcare Facilities Accreditation Program (HFAP) (Jost 1983; Jost 1994b, Medicare et al. 2013). They were the first accrediting agencies to be designated by federal legislation -the Medicare legislation part of the Social Security Act Amendments of 1965- as nationally recognized accreditation organizations and providers of the 'deemed status' evaluation to healthcare organizations that wanted to participate in and receive federal payments from Medicare and Medicaid programs. Healthcare organizations accredited by these agencies were (and still are) 'deemed' to be in compliance with most of the government requirements for participating in Medicare and Medicaid programs, "including a certification of compliance with the health and safety requirements called Conditions of Participation (CoPs) or Conditions for Coverage (CfCs)" as specified in federal regulations (The Joint Commission 2016a). Healthcare organizations can get certification[94] for their compliance with CoPs or CfCs through a survey done by a state agency on behalf of the federal government - the Center for Medicare & Medicaid Services (CMS). The 'deemed status' surveys conducted by the private specialized agencies designated as national accrediting organizations are said to be voluntary for most

[94] Here, the term 'certification' is used to refer to the evaluation and rating of healthcare organizations given by government agencies.

healthcare organizations.[95] However, scholars recognize that the legal incorporation of accreditation through legislation has made their evaluations an inevitable necessity for healthcare organizations (Astrue 1994, Jost 1983, Jost 1994b, Kinney 1994; Roberts et al. 1987).

While there is consensus on the growing regulatory role of these not-for-profit accrediting agencies in healthcare, it is not clear why and how exactly did this form of accreditation through private specialized organizations attain such regulatory power. Some researchers highlight the power given to accrediting agencies by their legal incorporation in legislation, viewing the development of regulatory accreditation as an instance of governmental delegation of power for strategic political reasons (Astrue 1994; Cashman and Meyers 1967; Jost 1994b; Marmor 1973). Other scholars emphasize also the regulatory power of accreditation in healthcare as a result of professional projects aimed at building and maintaining autonomy and independence through the advancement of self-regulation (Jost 1983; Jost 1994a; Kinney 1994). These studies consider the extent to which the demand for accreditation through certain nationally recognized organizations was created through a process of negotiation between different actors—professional groups, lawyers, courts, government regulators, and most importantly the accrediting agencies themselves. Few, however, put these efforts within the broader context of the history of medicine and healthcare, changes in the overall regulatory framework and their effect on consumers of healthcare services—patients, and the development of the economics of information in the United States (Jost 1983; 1994b).

This chapter contributes to the understanding of existing work on the growing power of accreditation and its agencies in healthcare by contending that their legal incorporation and their

[95] For example, accreditation is required for advanced diagnostic imaging services, durable medical equipment, prosthetics, orthotics and supplies, and opioid treatment programs. But deemed status surveys are said to be voluntary for hospitals, ambulatory surgical centers, clinical laboratories, critical access hospitals, home health agencies, hospice agencies, and psychiatric hospitals (See The Joint Commission 2016b).

regulatory nature was owed a lot to an early successful cultural institutionalization processes. Professional groups and organizations in healthcare were able to make the product of accreditation and its production through private agencies an unquestioned accepted necessity in the healthcare system. Different organizations and individuals in healthcare gradually incorporated agency accreditation into their practices and contributed to their understanding as natural, inevitable, and irreplaceable solutions to the problem of evaluating the quality of healthcare organizations and their products and services. I argue that this process of cultural institutionalization involved certain organizations actively and creatively shaping contextual opportunities to do organizational work, that is, craft the form and identity of their organization and products receptive and responsive to the changing context of an emergent and divided healthcare field.

First, I offer a short history of the emergence of accreditation by private agencies in healthcare, with the aim of tackling the issue of confusing terminology and featuring the organizational and institutional context within which the organizational identity work of accrediting organizations takes place. Second, I delineate the processes and mechanisms through which accreditation and their agencies became culturally institutionalized. In this section, I point out that accrediting agencies became accepted as part of the field and its actors' practices partly as a result of their approach to building a positive organizational and product identity, that is, presenting themselves as a complementary and supplementary alternative rather than a competitive one. Lastly, I advance evidence on how accrediting agencies' organizational identity work was received and how it led to a successful process of cultural institutionalization. The conclusion of this chapter recapitulates the main argument and lays the ground for the following chapter on how the legal incorporation of accreditation and their agencies benefited from this successful cultural institutionalization process.

A brief history of accreditation and terminology issues

Accreditation involves the collection of information from different sources, its analysis according to certain specified standards, and its presentation in a standardized format as a summary evaluation. As a form of regulation-by-information, accreditation, is not specific to the field of healthcare: in the United States, it is recognized as a stamp of quality approval for many institutions in field of education (see Finkin 1994 and Pelesh 1994 on accreditation in higher education, and Martin 1994 on accreditation in postsecondary education). Generally, the term 'accreditation' is used to talk about the rating of an organization and/or its services and products by a private organization. The evaluation of an organization or its activities by a government organization is referred to as 'certification' or 'licensure' (see Kinney 1994). However, the use of these terms is not coherent and varies with context. Certification can also be given by private accrediting organizations—as an evaluation of a particular program within an organization. Some accrediting organizations also provide quality reports—an evaluations of certain services of an organization.[96] Accreditation is most often used as a comprehensive term referring to the rating of an organization as well as to the evaluation of its particular programs or specific products and services (for example, see the use of the terms in Joint Commission 2016). Licensure, however, refers only to the formal permission given to individuals or organizations doing professionalized work after an evaluation of their ability to perform a set of activities. In

[96] For example, the hospital can be accredited, can have its cancer treatment program certified, and have been issued a quality report regarding its services given to patients.

the US, state governments have the jurisdiction for issuing most professional licenses. Therefore, license standards and issues vary from state to state (Department of Education 2017).

The history of accreditation in healthcare is closely related to the history of standardization in the United States and broader developments in science, medicine, and society. Standardization was promoted by the engineering profession, as a way of reducing errors and advancing efficiency.[97] The efforts to find efficient systems that would save money for both producers and consumers became widespread as an objective for many societal enterprises and endeavors, especially after the publication of the first paper on 'scientific management' by Frederick Winslow Taylor in 1895 which explicated the benefits of applying rational principles to industrial processes.[98] Governments during the Progressive Era (1890s-1920s) helped advance standardization as an application of science and also supported the professionalization of scientific knowledge overall. Congress established a National Bureau of Standards in 1901, as an agency within the U.S. Department of Commerce authorized to dedicate itself fully to establishing and propagating standards.[99] In 1910, scientific management experts appeared in the "Eastern Rate Case" to testify that better management could help railroads save millions of dollars and therefore not have to increase rates for customers.[100] By the end of the nineteenth century and the beginning of the twentieth century there was optimism about science in general, especially its ability to identify and establish cause-effect relationships through observation.

[97] Engineers, as professionals key to increasing industrialization and urbanization in society, valued observation, measurement, and results.

[98] Taylor and also other engineers like Frank and Lilian Gilbreth conducted time and motion studies to find the most efficient way for workers to complete tasks and be more productive.

[99] Today the organization is known as the National Institute of Standards and Technology (NIST) and is still part of the US Department of Commerce. It is presented as "one of the nation's oldest physical science laboratories", established by Congress to increase US competitiveness (compared to the UK, Germany, and other economic rivals at the time) by improving the countries' measurement infrastructure (see National Institute of Standards and Technology 2016).

[100] Lois D. Brandeis, the Boston lawyer and reformer that had these experts appear in the case, was latter named to the United States Supreme Court by President Woodrow Wilson (Brauer 2001).

The uncovering of the infectious basis of deadly diseases such as anthrax, gonorrhea, bubonic plague, and dysentery in the last third of the nineteenth century, and developments in anesthesia and antisepsis, and the use of x-rays for medical diagnosis by the beginning of the twentieth century, transformed medicine as a profession as well as hospitals as healthcare providers (Starr 1982; Stevens 1989). The American Medical Association (AMA), established in 1847, advanced higher standards for medical education, medical ethics, and state licensing. As medical practice became more specialized, with surgery emerging as a specialty practice, hospitals came to be seen as modern scientific institutions rather than charitable institutions for the worthy poor (Davis 1960; Rosen 1974). Philanthropic foundations supported such efforts by upgrading certain medical schools and associated hospitals. In 1910, Abraham Flexner with the Carnegie Foundation released a report on medical education recommending that all medical schools worked in association with hospitals (Flexner 1910).[101] This recommendation was adopted and led to the proliferation of hospitals—established especially by surgeons who saw these institutions as their workshops (Davis 1960; Starr 1982). The discoveries and technologies like anesthesia and antisepsis that made surgeries safer and more efficient, led also to an increase in the number of birth in hospitals compared to those at home and transformed the image the American public had about hospitals. They were seen and supported as a place that cured afflictions, rather than one that just sheltered the afflicted (Stevens 1972; Rosen 1971; Risse 1999).

The first accreditation and the first accreditation system in healthcare was introduced by the American College of Surgeons (ACS). In 1918, the ACS established its hospital standardization program which consisted of a survey of hospitals and a determination on whether they met the

[101] Before the implementation of this proposal, medical school students did not have to see or care for real patients to graduate and become doctors.

ACS established 'minimum standards' in the form of a certificate of approval (Davis 1960; Schlicke 1973; Roberts et al. 1987). Thought the term used was standardization, the process this program involved was of the same logic as that offered by the Joint Commission on Accreditation of Hospitals (JCAH) since its establishment in 1951. The change in nomenclature—from standardization to accreditation—happened between the fall of 1950 and the spring of 1951, and there exists no record as to why it happened. It could be because the term 'accreditation'—which was widely used in the field of education—for many people implied peer-review by professionals, whereas 'standardization' had too much of a manufacturing connotation. There was no confusion or contestation regarding the change in terminology, as at the time, the terms 'accreditation', 'standardization', 'certification', 'inspection', and 'approval' were frequently used interchangeably (Brauer 2001, 30).

The accrediting agencies we know today in healthcare are closely linked to the history and efforts of professional associations. The Joint Commission (JC) was established in 1951 as a not-for-profit corporation called The Joint Commission on Accreditation of Hospitals (JCAH) to be governed by several professional organizations: the American College of Surgeons (ACS), the American College of Physicians (ACP), the American Hospital Association (AHA), the American Medical Association (AMA), and the Canadian Medical Association (CMA) (Jost 1983; Brauer 2001; Roberts et al. 1987).[102] The Healthcare Facilities Accreditation Program (HFAP) was also established as part of a not-for-profit organization representing osteopathic physicians[103] in 1943, and since then it has remained under the auspices of the American

[102] In 1987, the JCAH became the Joint Commission on Accreditation of Healthcare Organizations (JCAHO). The Joint Commission (JC) was adopted as the short version of JCAHO and incorporated in a new logo in 2007, under initiatives to rebrand the accrediting agency's identity (The Joint Commission 2016b).

[103] Osteopathic physicians or Doctors of Osteopathic Medicine (DOs) are doctors licensed to practice in all areas of medicine, and emphasize a whole-person approach to treatment and care of patients. They have special training on the musculoskeletal system of the body as they use the interconnectedness of nerves, muscles and bones to prevent symptoms not only cure them (Gervitz 2004; American Osteopathic Association 2007c; Malerba 2012).

Osteopathic Association (AOA) (American Osteopathic Association 2006; American Osteopathic Association 2007b). Both accrediting agencies made use of the existing professional infrastructure especially when advancing their product of accreditation and building their image as independent evaluators of the quality of hospitals initially and other healthcare facilities later. Professional organizations helped accrediting agencies gain access and gather extensive information about hospitals, initially even conducting surveys on their behalf and providing them the necessary information to make accreditation decisions (Brauer 2001, 34; Gervitz 2004).

The first accreditation decisions given by a private specialized accreditation agency in healthcare were those given to hospitals by the Joint Commission on the Accreditation of Hospitals (JCAH). The process of collecting information about hospitals and their quality through surveys was conducted also by other organizations—professional associations and states—long before JCAH's emergence. The ACS had been conducting surveys and approving hospitals under its hospital standardization program since the early 1920s. The ACS published the first standards manual in 1926, and by 1950, it had 3,290 hospitals, representing half the hospitals in the US, on its program's approved list (Brauer 2001, 26). The AOA has also been surveying hospitals since 1945 through its Healthcare Facilities Accreditation Program (Healthcare Facilities Accreditation Program 2017; American Osteopathic Association 2017b).[104] States started surveys of hospitals to assure their quality in the mid 1940s, as a way of managing the distribution of federal funds for hospital construction and other hospital-related projects offered through federal legislation at the time. Though professional associations and states did engage in accreditation, they were not agencies specialized on this activity. Furthermore, their initial accreditation decisions were made in absolute binary terms—as an

[104] Since October 2015, the HFAP is not owned by AOA and it is managed by the Accreditation Association for Ambulatory Healthcare, Inc. (AAAHC). (American Osteopathic Association 2017b).

approval or denial evaluation, and with the purpose of making other decisions, especially in the case of state licensure. The JCAH accreditation decisions were more fine-graded (not binary) in nature: hospitals and other healthcare organizations could have an ‘accredited’, ‘provisional accreditation’, ‘conditional accreditation’, ‘preliminary denial of accreditation’, or ‘denial of accreditation’ status (Jost 1983; Roberts et al. 1987; Brauer 2001). The HFAP also refined its accreditation decisions with time, giving ‘full accreditation’, ‘interim accreditation’, and ‘denial’ status to hospitals and other healthcare organizations (Healthcare Facilities Accreditation Program 2017; Gervitz 2004).

The Joint Commission has been the leader in introducing accreditation and related practices to new markets and parts of healthcare, offering today the most extensive coverage among all nationally recognized accreditation organizations with deeming authority from the federal government (see Table 3 on Approved Medicare Accreditation Programs by accreditation organization in Center for Medicare & Medicaid Services 2015, 13). Its program on the accreditation of hospitals is the oldest and the only one that had statutory status and did not require CMS review and approval from 1965 to July 15, 2010 (Center for Medicare & Medicaid Services 2015, 17). Though similarly to the JCAH, the AOA’s HFAP was mentioned by name in the Social Security Act Amendment of 1965, but it was made explicitly subject to the review and approval of the Secretary of the Department of Health, Education, and Welfare (DHEW) at the time or the Department of Health and Human Services (DHHS) today (Center for Medicare & Medicaid Services 2015, 15). The JCAH began to offer accreditation for services for the mentally retarded and other developmentally disabled persons in 1969, for psychiatric facilities in 1970, for organizations offering long-term care in 1971, for ambulatory health care facilities[105]

[105] These are facilities that offer non-hospital health services.

in 1975, for organizations offering home care services in 1987 (when it changed its name into the JCAHO), for managed care organizations in 1989, and for health care networks in 1994. Today, the JC offers voluntary deemed status not only to hospitals, but also to ambulatory surgical centers, clinical laboratories, critical access hospitals, home health agencies, hospice agencies, and psychiatric hospitals (The Joint Commission 2016a). The HFAP, the second most extensive accreditation organization, offers voluntary deemed status only to three kinds of healthcare facilities: hospitals, critical access hospitals, and ambulatory surgical centers (Center for Medicare & Medicaid Services 2015, 13; Healthcare Facilities Accreditation Program 2017). It was approved by CMS a year earlier than the JC (in 2001) for the accreditation of critical access hospitals, but more than six years later than the JC (in 2003), for the accreditation of ambulatory surgical centers.

There were two major phases of legal incorporation that changed the meaning of accreditation and accrediting agencies. The first phase in the 1940s transformed the product of hospital accreditation by mentioning in legislation the minimal standards for hospitals that were the basis for the ACS's hospital standardization program. The Hospital Survey and Construction Act—known as the Hill-Burton Act—adopted by Congress in 1946 provided federal funding for the construction and modernization of hospitals nationwide and also made the reception of funds conditional on accreditation by states -state licensure (Jost 1994; US Congress 1946; Hoge 1946; Perlstadt 1995). The second phase in the 1960s drew lines around the producers of accreditation - the specialized, not-for-profit agencies - with the creation of the deeming authority status. Part of the Social Security Act Amendments of 1965—known as the Medicare law—recognized accreditation by specialized agencies such as the JCAH and the AOA's HFAP as a substitute for state surveys and licensure of hospitals done to determine whether hospitals fulfilled conditions for participating in the Medicare program and benefiting from government reimbursement (US Congress 1965; Jost 1983; Cashman, Bierman, and Myers 1968; Kinney 1994).

The Hospital Standardization Program of the American College of Surgeons: standards for hospitals and the making of the accreditation product

The American College of Surgeons' Hospital Standardization Program (ACS/HSP) is the predecessor of the Joint Commission on Accreditation of Hospitals (JCAH). The ACS established the program in 1918. Under this program, the ACS first surveyed large hospitals (with 100 or more beds) to determine the extent to which they had in place a 'minimum standard' of care. It found out that only 89 of 692 hospitals surveyed met the minimum standard (Brauer 2001, 22). It began to publish the list of successful hospitals only in 1921, when the percent of hospital that met standards had increased. In 1921, 76 percent of hospitals were determined to meet minimum standards, a dramatic increase compared to the previous year when only 29 percent of hospitals were approved under the ACS/HSP. In 1922, when the approval rate for large hospitals reached the 83 percent level, the ACS began surveys for medium-size hospitals (with 50 to 99 beds) and reported that only 43 percent of surveyed hospitals of that size met the minimum standard (Brauer 2001, 23). The ACS published a *Manual of Hospital Standardization* in 1926, where it talked about the history, development, and progress of its program, and emphasized its standard-setting role for improving patient care overall.

The hospital standardization program was openly established to advance the practice of surgery as a speciality. The ACS accepted fellows only if they could present evidence of surgical judgment and technical ability in the form of records of patients they operated on. However, very few could present such evidence, as hospitals in the United States (and even Canada) rarely keep records. The availability of data and records on patients was also seen as a necessity for the surgeon to do his job: laboratory, x-ray and other essential diagnostic and therapeutic facilities in hospitals would help the surgeon "in making a proper pre-operative study of his patient" (American College of Surgeons 1926, 5). So, the modernization and standardization of hospitals was key to the consolidation of surgery as a speciality professional practice.

The ACS supported the idea of hospital standardization since its inception. In 1912, the New York Clinical Congress of Surgeons—the conference that offered practical postgraduate education to surgeons[106]—passed a resolution that called for the development of "some system of standardization of hospital equipment and hospital work" (Brauer 2001, 15). It also created a Hospital Standardization Committee headed by Ernest A. Codman, a Boston surgeon who formulated the End Result Idea, the notion that surgical patients should be closely monitored after their operation, openly documenting and reporting results to better determine the outcome and effectiveness of the given treatment.[107] The Codman Committee became a standing committee of the ACS but it could not advance for long Codman's End Result System which recorded and reported surgical outcomes in a standardized manner (Codman 1918).[108] Though initially the members of the committee supported Codman's idea,[109] its emphasis on

[106] The Clinical Congress of Surgeons began to be held every year since 1910 to the establishment of the ACS in 1913. They were organized with the idea that surgeons had to observe new procedures not only read about them. Franklin H. Martin, a Chicago surgeon, who had stablished a major journal *Surgery, Gynecology & Obstetrics* in 1905 to further specialist knowledge, and became well-known as a advocate of shared knowledge in the medical profession led these professional gatherings as well as the incorporation of the ACS as an elite group for those trained surgical specialists. Meanwhile, the AMA was focusing on reforming medical education and medical ethics (Brauer 2001, 14).

[107] The call for a standardized reporting of surgical outcomes was not new. Florence Nightingale, the English founder of modern nursing during the Crimean War, had urged hospitals and doctors to follow such practice before Codman, even though he was not aware of this. (Brauer 2001, 17)

[108] Codman developed his own detailed card filing system for recording surgical results and put it to use in his own 20-bed proprietary hospital from 1911 to 1918. His book *A Study in Hospital Efficiency: As Demonstrated by the Case Report of the First Five Years of a Private Hospital* he carefully documented the experience of his own hospital working with the End Result Idea (Codman 1918).

[109] Early committee reports reflected the logic underlying the End Result System. In 1913, compared the hospital to a factory, arguing that it had to assure its product quality for its customers in the same way factories did.

transparency about both positive and negative hospital outcomes, and its definition of hospital efficiency in terms of patient health outcomes, rather in terms of more structural factors like number of beds and staff employed, made it a difficult, costly idea that threatened the reputation of hospitals and doctors too.[110]

The ACS was able to pursue the idea of hospital standardization as it posed a lesser threat to medical professionals' reputations, autonomy and authority, and was in line with ideas held by foundations—a major sources of funding in the field of healthcare at the time. In comparison to Codman's End Result Idea, the idea of hospital standardization emphasized above all the assessment and addressing of structural and administrative deficiencies in hospitals, such as poor record keeping or lack of diagnostic equipment. This emphasis advanced the interests of surgery as a specialty within the medical profession, and those of hospital administrators organized under the American Hospital Association (AHA).[111] It also supported the reform efforts of the American Medical Association (AMA) to adopt the recommendations of the 1910 Flexner report of the Carnegie Foundation that made professionals' practice in hospitals an essential part of medical education (Flexner 1910.[112] Though it advanced their interests, neither AMA nor AHA

The report asserted that "A factory which sells its products takes pains to assure itself that the product is a good one, but a hospital which gives away its product seems to regard the quality of that product as not worthy of investigation… In a way, trustees of hospitals who do not investigate the results to their patients do not audit their accounts" (as quoted in Brauer 2001, 19).

[110] Codman's commitment to the ideas of efficiency reflected the influence of contemporary engineering ideas. He attended meeting of the Taylor Society (named after Frederick Winslow Taylor, the proponent of scientific management at the time) and established friendship ties with the efficiency expert Frank Gilbreth. He was also guided by the scientific method of experimentation proposed by the British chemist William Thompson. In his hospital, Codman had an end result card with information on presenting symptoms, initial diagnosis, treatment given, in-hospital complications, discharge diagnosis, and the result of a year later for each patient. He classified errors and negative outcomes based on a system of his own creation and collected information on his patients. He shared this information -errors and deaths included- thought hospital reports he gave to prospective patients as well as other hospitals. He even offered a money-back guarantee to patients, expressing his convention that the End Result System ensured high quality service i.e. care for patients (Brauer 2001, 17; Codman 1918).

[111] The AHA was founded in 1899 as the Association of Hospital Superintendents (AHS) and changed its name in 1908 (Roberts et al. 1987; Lespare 1998).

[112] The AMA was founded in 1847. It included many prominent surgeons who later became ACS fellows, but still most of its members were generalist practitioners, that could already legally perform surgery with their licenses. Though it was ambivalent and divided regarding the ACS, and it prevented raised proposals for a separate licensure

were willing to take over or support financially the nascent project on hospital standardization of the ACS when its director John G. Bowman approached them with the offer in 1915.[113] Bowman could keep the program under the ACS only thanks to his connections with the Carnegie Foundation which helped him secure a $30,000 grant from them to further support efforts at putting in place an actual hospital standardization program (Brauer 2001, 20).

The Hospital Standardization Program (HSP) under the ACS started with the establishment of a minimum standard for hospitals. The ACS board of regents named a 21-member committee to devise a hospital evaluation questionnaire and establish the minimum standard. More than 2,700 hospitals in the United States and Canada received the evaluation questionnaire and many went through field trials the ACS director Bowman and his aides conducted in 1918. The results from the first survey and field trials were presented in a conference held before the 1919 Clinical Congress of Surgeons in New York City. They were said to be dramatic and shocking: only 89 of the 692 surveyed hospitals of 100 beds or more met all the minimum standards. The ACS regents incinerated the list of approved hospitals, fearing that these records would become public and embarrass many hospitals, especially prestigious ones that failed to make it into the list of approved hospitals (Roberts, Coale, and Redman 1987). The minimum standard was drafted and published afterwards through the quick collaboration of Martin and Bowman. These efforts were driven by the principle that the assessment of hospitals should be conducted by knowledgeable professionals and their agreed-upon standards, in order to have the greatest impact on advancing patient care (Brauer 2001, 22).

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for surgeons, it supported the Flexner report as it helped its own elitist project towards poorer medical schools (American Medical Association 2017; Flexner 1910; The Yale Law Journal 1954).

[113] Bowman held a Ph.D., was a former president of the University of Iowa, and had previously served as the secretary of the Carnegie Foundation, when the ACS hired him as their first director in 1914. He approached AMA and AHA with the offer, the year Codman resigned as chairman of the Hospital Standardization Committee (Brauer 2001, 20).

The HSP gathered information about hospitals through surveys and field examinations conducted by an ACS-employed staff of inspectors. The journal *Surgery, Gynecology & Obstetrics* reported in its May 1920 publication that the HSP had seven doctors evaluating hospitals in the field. In the 1920s, inspectors were all physicians and many of them ACS fellows. The ACS selected as inspectors fairly recent medical graduates, which it saw them as better trained and more knowledgeable of new medical developments. Most evaluators were full-time employees that traveled around the country to examine hospitals. They gathered periodically at the ACS headquarters in Chicago to report on their evaluations. The briefings and critiques of inspectors involved the processing of collected information and together with the answered (in-paper) survey were used to determine whether the hospital met the Minimum Standard. It is not clear who made the final decisions and compiled the list of approved hospitals the ACS published since 1921. However, it is known that the ACS/HSP gave hospitals certification of meeting the minimum standards—a certificate of approval—which they displayed proudly in their lobbies and even publicized in the local press (Brauer 2001, 24; Stevens 1972).[114]

The information gathered and processed about hospitals was presented to the public not only in the form of an ACS list of approved hospitals and a certificate noting approval to the hospital itself, but also indirectly through the *Manual of Hospital Standardization* since 1926. The manuals, which explained extensively each standard, were revised every several years and grew through additional explanatory sections. The 1946 edition had 118 pages compared to 18 pages of the first manual published 20 years ago. In 1949, hospitals would also get a score: a perfect score was 900 points, of which 640 points were considered "essential points" and 260 points

[114] This was similar to another voluntary program for producers and consumers developed in the 1920s - the 'Good Housekeeping Seal of Approval' (Stevens 1972)

were considered "complementary points" (Brauer 2001, 26). This point rating system was introduced at a time when the program's budget had grown to $68,500, and the demand for it increased after the enactment of the Hill-Burton Act.

The Joint Commission for Accreditation of Hospitals: a new organization to shape the accreditation product

In the early 1920s, the funding for the HSP came from grants from the Carnegie foundation, but in the 1940s the HSP was funded completely through the dues paid by ACS members.[115] Paul R. Hawley[116]—the new ACS director elected in 1950[117] started the search for a new HSP sponsor, because of the financial difficulties ACS had experienced (Stephenson 1994). The organization had operated with two associate directors since Franklin Martin's death 15 years ago, one of which—Malcom T. MacEachern[118]—was responsible for the administration of the HSP from 1923 to 1951. MacEachern advised Hawley to ask first the AHA whether it wanted to take over the HSP. Given that the ACS had historically better relations with the AHA, compared to those with the AMA, and with the permission of the ACS regents, Hawley approached the AHA's executive director George Bugbee with the proposal to transfer the HSP to AHA. AHA was enthusiastic about the idea and offered an annual budget of $100,000 for the program. By the summer of 1950, a draft agreement had been prepared to transfer the program to the AHA.

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[115] The Carnegie foundation gave a new grant to the ACS in the early 1920s - one that would support the HSP for three years with $25,000 every year. However, the ACS had to find the money to match the grant each year (Davis 1960; Roberts et al. 1987; Brauer 2001, 23).

[116] Before the appointment with ACS, Hawley had been the chief executive officer of the Blue Cross-Blue Shield Commission. He also had experience heading the Veterans Administration and working in the army. He served as the surgical head of the European theater of operations during World War II. (Brauer 2001, 27).

[117] Bowman resigned in early 1920s, and Franklin Martin died in the mid 1930s. Codman died in 1940.

[118] Before entering the ACS, MacEachern was a Canadian obstetrician with nine years' experience as superintendent at Vancouver General Hospital and one year experience as surveyor of nursing conditions across the country. He became a key figure in hospital administration. He had served on many AHA committees, and after his retirement from ACS in 1951, he wrote the main text in hospital administration and directed the hospital administration program at Northwestern University (Brauer 2001, 24).

However, the AMA learned about this agreement and expressed its dislike for such move, viewing it as threat to the doctors' power. Hospital administrators and trustees were viewed as "laymen" or "civilians", and AMA feared the loss of clinical control that could come from the AHA takeover of the HSP (Brauer 2001, 28). In August 1950 a high-ranking AMA delegation met with Hawley and four ACS regents to protest the program transfer to AHA and offer their full financial support or even takeover of the program. They presented this as an effort to unite with the ACS against hospital administrators which in their view could not be trusted (Davis 1960).

The ACS board of regents voted to pursue a cooperative plan that would include the AMA, the AHA, as well as the American College of Physicians (ACP[119]) in efforts to continue the HSP.[120] Initially, both the AMA and the AHA were not enthusiastic about the decision. The AHA trustees even adopted a resolution proposing to establish its own hospital standardization program. The AMA, however, slowly supported the idea by naming a committee to meet with representatives of the other organizations and start the establishment of a collaborative process to determine the future of the HSP. Negotiations started with the representatives of the four organizations meeting for the first time at the end of September 1950 in Washington, DC. According to the historian of the ACS Loyal Davis, the first meeting made clear the issues at hand in developing a collaborative entity to continue the HSP and indicated that there was a basis for further meetings (Davis 1960). The main issue was that over the control of the new entity, more specifically on the number of board seats that would be given to each contributing organization. While the AHA supported the representation of specialists through the two colleges

[119] The ACP was founded in 1915 as the specialist society for internal medicine. During the 1940s, it wanted to advance the training of its internists in the hospital environment (Brauer 2001, 28).

[120] The proposal to establish an independent joint commission that would take over the mid task of giving voluntary hospital accreditation was made by Evarts A. Graham, MD, FACS (Nahrwold and Kernahan 2012).

(ACS and ACP), it was concerned about the representation of the AMA with its largest constituency being the general practitioners would weaken or even damage the HSP (Brauer 2001, 30). Other issues included the relationship between the new entity and existing programs of the sponsoring organizations, the process of formulating standards, the carrying out of inspections, the making of accreditation decisions, and Canadian representation[121].

The draft agreement for the establishment of a joint commission to further the HSP was devised by a small negotiating team in March 1951. The four sponsoring organizations also invited the Canadian Medical Association to participate. The draft agreement established that the AHA and the AMA would have seven seats each and the ACS and the ACP would have three seats each on the board of commissioners. While all the organizational representatives of the negotiating team approved the agreement, the AMA faced resistance in its house of delegates meeting in June from the American Academy of General Practitioners (AAGP). The AMA's house of delegates called for seeking an increase in the number of AMA representatives and a decrease in those of the AHA. The AHA refused any change to the representation ratio in the joint commission and the AMA did not pursue this demand[122].

The new entity that would continue the work of the ACS-HSP was called the Joint Commission on Accreditation of Hospitals (JCAH), even though in November 1950 its name was thought to be the Joint Commission on Hospital Standardization.[123] It was incorporated in Illinois in November 1951 but held its first official meeting in December 15, 1951 in Chicago. In this first organizational meeting, the board adopted the[124] by-laws, elected officers, established

[121] Except for the AMA, all other sponsoring organizations—the AHA, the ACS, and the ACP—all had Canadian members.

[122] The AMA gave a general practitioner one of the seats in its board, addressing at the time the hostility of the AAGP over the AMA's role in the joint commission (Brauer 2001, 30)

[123] There is no evidence for why there was this change in nomenclature, but it could have been because accreditation sounded more professional and was used widely in the professional field of eduction.

[124] The by-laws were then immediately amended to include the Canadian Medical Association.

the rotation of the chairmanship position among the four corporate members, discussed the efforts to continue hospital inspection during the transition of the program from ACS to the new organization, and approved the operating budget of $70,000 and a reserve fund of $25,000[125] (Brauer 2001, 31). According to another historian of the ACS, the new agency aimed at fulfilling three main functions: 1) the surveyor, evaluator, educator role—inspecting and accrediting hospitals with the purpose of encouraging physicians and their institutions to use basic organization and administration principles for efficient patient care, promoting high quality of medical and hospital care, and promoting maintenance of diagnostic and therapeutic services in hospitals through the coordinated work of their staff and governing body; 2) the standard setter role—establishing standards about the operation of the hospital; and 3) the certifier role—giving certificates of accreditation to hospitals (Stephenson 1994).

In its first decade, the JCAH did not make substantial changes to what the hospital standardization program of the ACS offered. It started work in 1952 with a professional staff of two at the ACS headquarters in Chicago, headed by its first director Edward L. Crosby.[126] In 1953, the JCAH 'grandfathered' all hospitals that had been approved by the ACS-HSP and also published *Standards for Hospital Accreditation*, a publication similar to the ACS manuals of hospital standardization. Similar to the ACS-HSP, it gathered information about hospitals through surveys and on-site field examinations. It also kept the same point rating system that the ACS has initiated as the basis for accrediting new hospitals (Brauer 2001, 33).

[125] Each member organization would contribute to the budget proportional its representation on the board, nearly $3,500 per seat.

[126] Crosby was president-elect of the AHA when asked to become director of the JCAH. He first dismissed the idea but later changed his mind, realizing the influence he would have on the hospital field. He would not stay for long as JCAH director. In 1954, after having worked for a year part-time as research director on a task force on medical services in the federal government (as part of a commission on the organization of the executive branch chaired by former president Herbert Hoover), he resigned and returned to the AHA as its executive director (chief executive) (Brauer 2001, 35).

However, there were some important differences in the way in which JCAH collected and processed information: JCAH field surveyors were not paid—they were volunteers representing the corporate members of the JCAH—the ACS, the AMA, and the AHA. Furthermore, the JCAH made use of already-existing programs of its corporate members to survey hospitals. In 1953, for example, surveys were conducted by 20 field representatives of the ACS, the AMA, and the AHA plus the American Psychiatric Association (APA), which had already been surveying psychiatric hospitals and was discussing collaboration with the Joint Commission (see Table on "Number of Hospitals Surveyed by Each Group—1953" in Brauer 2001, 34).[127] Surveyors reported their findings to the JCAH, and then the board of commissioners made the final decisions on accreditation: whether to fully accredit, provisionally accredit, not accredit, or defer accreditation action.[128] Since the resignation of Cosby in 1954, the new director Kenneth B. Babcock[129] together with the board of commissioners were responsible for accreditation decisions and standards development. Accreditation decisions, though, were usually left exclusively to Babcock. He processed the information gathered by surveyors with the help of a small staff, made accreditation decisions and send them by mail to board members for ratification. His accreditation decisions were generally ratified on a highly pro forma basis, as the board had given him considerable authority on this matter (Brauer 2001, 40).[130] Reports on the surveys conducted were sent generally only to administrators of hospitals, even though JCAH quarterly publication *Bulletin* was sent to both hospital administrators and the chiefs of medical

[127] The first largest surveyor was the AHA with 564 surveyed hospitals, followed by the AMA with 400 surveyed hospitals, the ACS with 283 surveyed hospitals and the APA with 54 surveyed hospitals. The JCAH had surveyed only 5 hospitals on its own in 1953.

[128] Surveyors were presented as the "eyes and ears" of the Joint Commission and generally conducted a life on the road (see Brauer 2001, 34 for a typical example of the surveyor's travel).

[129] See Brauer 2001, 35 for background information on Babcock.

[130] The board of commissioners gathered three times a year in a private club in Chicago. Some or all of the executive directors of member organizations attended these board meetings. After the meeting, most of them stayed for cocktails and dinner.

staff (Brauer 2001, 37; American Medical Association 1956). It is not clear whether the JCAH offered certificates of accreditation, similar to those given by the ACS-HSP and whether they were used publicly as extensively as the ACS-HSP ones at this time.

Substantial changes in the process of gathering and analyzing information for hospitals and the accreditation product of the JCAH begin in the 1960s. In 1964, the JCAH starts to charge hospitals for its surveys and then began to have full-time employed surveyors with JCAH-provided training. After being recognized as a national accreditation organization with deeming authority for hospitals through the Social Security Amendments of 1965, it expands its accreditation services. It begins offering accreditation to long-term care institutions in 1966, organizations serving developmentally disabled persons in 1969, psychiatric facilities, substance abuse programs and community mental health programs in 1970, ambulatory healthcare facilities in 1975, hospice care organizations in 1983 (Roberts et al. 1987). The change of the organization's name in 1987, becoming the Joint Commission on the Accreditation of Healthcare Organizations reflected this expanded scope of its accreditation work. It continues its expansion with the accreditation of home care organization since 1989, for managed care since 1989, for health care networks since 1994, and for freestanding laboratories since 1995, among others (The Joint Commission 2017b). The cycle of accreditation changed several times during the 1970s, settling in the early 1980s into the pattern of being conducted every three years for most of accredited organizations. During the late 1980s and the 1990s there was a major transformation in the aim and focus of the accreditation process: from its emphasis on evaluating the capability of organizations to meet standards—that since 1970 specified optimal achievable levels of quality, rather than minimum essential levels of quality—to the examination of the actual performance of the organization as an indicator of its quality. Since the late 1980s and early

1990s, the Joint Commission accreditation decisions became more public, and the number of public members to serve on the Board of Commissioners increased (Jost 2983). Furthermore, the JCAH not only continued to have the deeming authority for hospitals, given by statute since 1965, but also acquired the deeming status for other healthcare organizations too (The Joint Commission 2016b).

The Joint Commission incorporated technological advancements in its practices, which shaped also the way it gathered, processed and presented information. In 2000, it decided to make random unannounced surveys without giving any previous notice to the organizations, and was planning to make the triennial surveys also unannounced. A year later it puts in place an automated, online application for survey. To publicize the value of accreditation, in 2003, the Joint Commission introduces a Gold Seal of Approval that is displayed in all certificates of accreditation awarded after January 2003. Since the early 2000s, the Commission also began certification programs: for disease-specific care in 2002, for stroke care provided by hospitals in 2003, and so on, the latest being the Integrated Care Certification and the Perinatal Care Certification in 2015. The standards and their logic changed several times since the 1980s and the 1990s, but the 2000s brought a transformation in the accreditation process as a whole. By 2001, the Joint Commission evaluated and accredited nearly 20,000 healthcare organizations and programs in the United States, including over 11,000 of hospitals and home health agencies. While it is recognized as the world's preeminent accrediting agency in the healthcare field, since 1986 with the establishment of a not-for-profit consulting subsidiary Quality Healthcare Resources it also offers educational and consulting services to professionals and organizations, to customers worldwide (The Joint Commission 2016b).

Cultural Institutionalization through Building Organizational Identity

The emergence of accreditation organizations and their accreditation owes a lot to this institutional background. However, rating agencies did not substitute these institutions but were able to grow in parallel with them. Rating agencies weaved together several of the ‘logics’ or ‘innovations’ regarding the gathering, processing, and presentation of information introduced by existing institutions in the financial field. They built an organizational identity that led their accreditation product and their kind of organization to be culturally institutionalized and then legally incorporated within regulations. As scholars note, accreditation in healthcare was became widely used despite absence of evidence for its performance in improving quality of care and patient outcomes at the time of legal incorporation (Kinney 1994; Jost 1994a; 1994b).

I argue that accreditation and their agencies became institutionalized partly because of the way in which they build their organizational identity given the institutional, political and economic context in which they emerged. I want to highlight not only the conditions that contributed to the cultural institutionalization of accreditation that existing literature emphasizes, but also the actors that perceived, seized and shaped the contextual opportunities through their actions. Looking at the organizational history of these accrediting organizations and the way in which they presented their product and themselves will help reveal the mechanisms through which cultural institutionalization became possible and laid the ground for political institutionalization to follow from the 1940s to the 1960s. I distinguish two paths of building organizational identity—what I call the path of doing product work and the path of doing producer work. Doing product work means engaging in activities that introduce the organization’s product to the pool of existing products in an organizational field and make it meaningful, acceptable, useful, demanded and purchasable. Doing producer work means engaging in activities that shape the organizations' reputation and performance as a producer of a particular product by making use of (or in relationship to) other producer organizations' reputations and performances.

This section will present an analysis of data about The Joint Commission, and not a lot about the HFAP as records on the AOA program are less abundant and accessible. The JCAH product work consisted in maintaining the legacy of its predecessor: the ACS/HSP. ACS's product work was key to the establishment of the JCAH and it became the basis for the new organization's producer work till the mid 1960s. While most of the product work was done by the ACS/HSP by the 1940s, the organizational identity of the JCAH as an accreditation organization was advanced through an extensive producer work till the 1960s. The AOA/HFAP began in the mid 940s, and it also drew from the AOA's organizational identity building efforts, but it remained under its sponsorship and could not develop a separate organizational identity even after it was taken over by the AAAHC in late 2015.

Product Work: Legacy and Complementarity

The product of accreditation emerged gradually through the work of organizations such as the ACS/HSP and the JCAH, as well as the context of individual entrepreneurs in the healthcare sector. The product the ACS's program offered was hospital standardization, or simply standards for hospitals. At the core of ACS/HSP was the establishment of the minimal standards. Minimal standards were presented as an indicator of acceptable quality of care. While standard-setting is a general function of professional organizations or associations, what the ACS was involved in with its HSP was accreditation—an evaluation of hospitals according to certain standards and a presentation of its judgment on whether they passed the threshold for being considered high-quality institutions.

The ACS promoted the idea of hospital standardization, to some extent, as an alternative to Codman's End Result Idea and System. Codman's proposed vision of measuring hospitals' quality and evaluating their performance by looking at the health outcomes of patients—that is, the extent to which they offered services advancing patients' health—was received with resistance and indifference (JC-Brauer 2001, 17). The End Results Idea and System was seen as threatening to professional authority (as it was questioning their competence through the evaluation and judgment of their practice with the patient as a reference).[131] Despite the partial or full adoption of Codman's system by some hospitals (JC-Brauer 2001, 19), and Codman's efforts to advance his idea while he headed the initial hospital standardization committee at the ACS, it was only hospital standardization—the establishment of standards regarding the environment within which care was given—that survived. This hospital standardization idea helped with one of the problems among surgeons in 1914: the rejection of ACS fellowship because of lack of data about procedures they performed as a result of poor record keeping in hospitals (JC-Brauer 2001, 19).

The ACS director Bowman and ACS board of regents named a 21-member committee—whose members were mainly surgeons from elite institutions to formulate an evaluation questionnaire for hospitals and a minimum standard. The minimum standard established in 1918 had only five requirements for hospitals. First, it required that hospitals had physicians and

[131] Part of the resistance he met was due to the way he marketed the system and his tactless presentation of the idea. He was overzealous in its efforts to market the End Results System. First, he used the results of its implementation to engage patients as customers that made choices among hospitals, disclosing the reports he distributed to prospective patients' data about deaths and errors in hospitals. Second, he drew bad publicity from the professional community when, in a meeting of Boston surgeons on hospital efficiency in 1915, he argued that physicians and hospitals perpetuated the existing system and did not adopt the End Result one, out of their self-interest not the public/patients interest. He argued the existing system did not care for medical science as physicians were not employees in hospitals and were happy to make money for themselves, while hospitals were also happy to keep using physicians as unpaid labor (Brauer 2001, 17-18; see in page 18, a picture of the satirical cartoon Codman had commissioned himself and showed at the meeting to represent the idea that physicians and hospital administrators benefited from patients without regard for how their offered care affected their paying patients).

surgeons practicing in their facilities organized as a definite group or staff. This proposition left to hospitals the definition of the exact structure within which to consider these medical professionals—either as the "regular staff", "the visiting staff" or the "associated staff". Second, it stated that hospitals had to reserve the staff designation only to those physicians and surgeons that had graduated from medical schools in good standing, had a license to practice in their respective states or provinces, were competent, of good character and abiding by professional ethics. This proposition specified the practice through which the hospital would commit to the requirement of having as staff only physicians and surgeons that were worthy in professional ethics: it had to prohibit any kind of fee-splitting among doctors, in which one paid another for referrals out of patient fees. Third, it required that hospitals approved and allowed the staff to develop, and put into place rules, regulations, and policies regarding the organization of all professional work within the hospital environment. It asked for the existence of two main staff practices: monthly or more frequent meetings, regular review and examination of its clinical experience within specific departments, focusing on the clinical records of patients (not whether they paid or not). Fourth, the minimum standard required a system for keeping accurate and complete written records of all patients in a hospital. This proposition specified what kind of information hospitals needed to record in order to provide staff with a complete case record.[132] Fifth, and last, was the requirement that hospitals had diagnostic and therapeutic facilities to assist in studying, diagnosing, and treating patients. It specified the necessity of having at least a clinical laboratory for chemical, bacteriological, serological, and pathological services and an X-

[132] This included identification data, complaint, personal and family history, history of present illness, physical examination, special examinations, such as consultations, clinical laboratory, X-ray and other examinations, provisional or working diagnosis, medical or surgical treatment, gross and microscopical pathological findings, progress notes, final diagnosis, condition on discharge, follow-up and, in case of death, autopsy findings.

ray for radiographic and fluoroscopic services (American College of Surgeons, 1919; Martin 1920; Schlicke 1973; Stephenson 1994).

Initially, the ACS was not clear about its product—whether it was only standards or also the evaluation of their implementation by hospitals, that is accreditation. Before publishing the five-point minimum standard and formally adopting it, the ACS promoted its product as a form of accreditation. The ACS director Bowman and his staff, in collaboration with the established state standardization committees, led and presented in around 20 hospital conferences in the western half of the United States and Canada, explaining the aim of ACS's standardization program and marketing the minimum standard. They presented the adoption of standards as a way for hospitals to invest in their reputations and financial future by building goodwill as well as attracting private patients and donations from the community (Brauer 2001, 22; Davis 1960).

The publication of the minimum standard was presented as a necessity to the healthcare community. In 1924—the then-ACS-director Franklin Martin advanced that the document had achieved international fame, and had become "to hospital betterment what the Sermon on the Mount is to a great religion" (Martin 1920; cited in JC-Brauer 2001, 24). The first *Manual of Hospital Standardization* published two years later, presented the participation of hospitals into the ACS/HSP as "the fulfillment of their obligations to their ill and injured patients" (American College of Surgeons 1926, 5). It also included a section on the "By-Products of Standardization" which -based on 13,360 surveys conducted in the previous nine years, noted resulting improvements in organization, facilities, personnel, and coordination in hospitals and also claimed better end results for patient care too, though it did not document them (JC-Brauer 2001, 26). Thus, the implementation of a minimum standard was thus presented as the moral and efficient thing to do, indicating an attempt to institutionalize the product of accreditation.

It became clear that what the ACS offered was not only standards, but also accreditation as a product, when the ACS started publishing a list of approved hospitals. It began awarding hospitals certificates of approval. Many of the approved hospitals would show the certificate in their facilities for patients to see, as evidence of their quality (Stevens 1972). This kind of certification was familiar to patients through a similar enterprise—The Good Housekeeping Seal of Approval—that operated with the same principle of producing information (serving as guarantee of quality) to assist consumers.[133] The idea of accreditation was also a familiar practice at the time because of its widespread use in education. Therefore, the change in nomenclature in Spring 1951 from standardization to accreditation—when forming the Joint Commission on Accreditation of Hospitals—was to some extent an indication of such broader developments at the time.

After the first manual of standardization of hospitals and the failure of many hospitals during the Great Depression, it was government involvement through legislation that shaped the product of hospital accreditation. The Hill-Burton Act in 1946 provided funding for hospital construction throughout the US (Perslstadt 1995; Home 1946). According to an official account of the Joint Commission, this legislation required hospitals receiving funding to have ACS certification (Brauer 2001, 26). The Act, however, only mentioned the requirement of hospitals to meet minimum standards of quality, without specifying the actual provider of such evaluation. The 1946 Act required that hospitals "provide minimum standards (to be fixed in the discretion of the

[133] The Good Housekeeping Seal of Approval was established by the women's magazine and its Good Housekeeping Research Institute (GHRI) in 1909. It was given to products as an indication that the GHRI evaluated them and guaranteed their quality backing them with a two-year limited warranty. By 2008, nearly 5,000 products got the seal (Nicholls 2008). In 1938, after the passage of the Food, Drug, and Cosmetic Act there were efforts to put in place a government grading system, which the corporation that owned GHRI and the magazine offering the seal saw as efforts of federal government oversight. Despite loosing a case brought against its activities - its seal included - by the Federal Trade Commission in 1939, the Good Housekeeping business continued unfettered (Goodhousekeeping 2017)

state) for the maintenance and operation of hospitals the receive Federal aid under this part" and its 1948 amendment specified "compliance with minimum standards of maintenance and operation" as a condition for maintaining and further having access to such funding (Hospital Survey and Construction Act 1946, 5; Hospital Survey and Construction Act Amendment 1948, 12). The 1940s legislation indicated that the ACS product of accreditation based on minimum standards for hospitals had been successfully institutionalized, inspiring the government to adopt its principle and put it at the center of developing state licensure for hospitals (Kinney 1994, 52).

The JCAH made use of the institutionalization of the ACS accreditation product and initially did not change much about it. It tried to maintain standards and certification as they were. The minimum standard, which changed with revisions to the ACS Manual of Hospital Standardization[134]—adding more standards regarding the physical facility conditions, equipment, and administrative organizational of hospitals, remained the foundation of JCAH accreditation process till 1970 (see Stover Report for a view of standards after five years of JCAH in AMA 1956, 24-32; Jost 1983; Brauer 2001, 32-33).[135] From the early 1950s to the mid 1960s, the surveyors—presented as the "eyes and ears" of the Joint Commission in the Bulletin of the ACS—gathered information from hospitals going on the field, used the same point rating system devised by the ACS/HSP, and reported the gathered information to the JCAH. Survey were conducted mainly by field representatives of the member organizations, who visited hospitals for other purposes too. For example, representatives of the ACS would use the same visit to survey a hospital's cancer clinic, those of the ACP or AMA would examine hospital's residency or

[134] The ACS revised the Manual of Hospital Standardization seven times in fifteen years (1926-1941) (Jost 1983)

[135] In 1970, standards were organized to represent "optimal achievable levels of quality", rather than "minimal essential levels of quality" (The Joint Commission 2016b).

internship program too, and AHA representatives would look for institutional registration (Brauer 2001, 42).

Even though accreditation claimed to evaluate and indicate quality, what quality meant has changed through time. Till the late 1960s, the principal focus of accreditation surveys remained the general fitness of a hospital—in terms of its environment or its administrative structure and resources. Among others, surveyors evaluated a hospital's physical plant, safety controls, and cleanliness (Brauer 2001, 40).[136] Based on these reports, the board of commissioners and the director of the program made accreditation decisions.[137] The size of the hospital was a large determinant of accreditation decisions: larger hospitals had a greater likelihood of being accredited (Brauer 2001, 34).[138] The logic underlying the JCAH's accreditation was that good structure and organization translated into good patient care. In 1961, for example, Babcock asserted that "The Commission considers fire hazards so serious that no matter how excellent the medical care, a hospital that is a fire trap will not be accredited" (Brauer 2001, 40). A committee designated by the AMA to examine the accreditation activities of the JCAH in 1962—the McCreary Committee—found that accreditation decisions emphasized much more standards regarding hospital administrative practices than those that assisted the improvement of essential diagnostic and therapeutic services given by medical professionals in hospitals. In the

[136] Evidence of a sound hospital environment included the existence of an organized medical staff, hospital and medical by-laws, satisfactory patient records, tissue review, mass casualty and disaster plans, as well as professionally staffed x-ray and dietary departments, clinical laboratories and pharmacies (see Stover report for a detailed description of requirements and standards for accreditation in American Medical Association 1956, 24-32)

[137] The director of the organization played a crucial role in the early decade of the JCAH existence. He played the role of the interpreter of standards for surveyors as well as hospitals. Babcock, for example, as director of the JCAH travelled widely and participated in various professional meetings and activities and generally communicated his interpretations through the *Bulletin* (Brauer 2001, 41). The assistant director of the JCAH during Babcock - Denver M. Vickers - a reserved doctor that joined in 1955—helped Babcock with reviewing and synopsizing survey reports from the field. For problematic cases, one of them would visit and sometimes even resurvey the hospital (Brauer 2001, 40).

[138] Hospitals with 300 or more beds got accreditation 99 percent of the time, while those with 25 to 49 beds were accredited 75 percent of the time (Brauer 2001, 34).

Committee's opinion survey, 92 percent of administrators and doctors reported the JCAH had helped their hospitals maintain high administrative and professional standards, and only about 21 percent of physicians and 35 percent of administrators indicated that the JCAH assisted in improving essential diagnostic and therapeutic services in their hospitals (American Medical Association 1962b; Brauer 2001, 42). Furthermore, till the 1980s, quality of care meant quality of services offered rather than the effect of those services on patients - patient results (Joint Commission 2016b; Roberts et al. 1987).

Producer Work: Reputation and Independence

The ACS was trying to present itself as an educational organization - not inspecting or supervising - but giving room to and regarding the needs of hospitals and their administration. In a section on the hospital standardization program of the ACS, the journal *Surgery, Gynecology & Obstetrics* in May 1920 noted that the surveyor on the field was given instructions "to collect facts…not [be] a detective…be helpful and constructive" (Martin 1920). Aware of the tension between inspection (investigating, approving, or disapproving) and educating (helping, advising, teaching), the ACS decided to start publishing the list of hospitals that had met the minimum standard in January 1921 as the percentage of approved hospitals had increased dramatically from 1920 to 1921 (Brauer 2001, 23). In this context, the ACS also began surveying medium-size hospitals.

The claim of the ACS-HSP and later the JCAH has been that they advanced the quality of care with their work - establishing standards, surveying and evaluating hospitals, and accrediting them. In the 1920s, the ACS presented itself as a private organization that was mainly involved in setting voluntary standards for hospitals with patients' interests in mind (Stevens 1972).

Through its Hospital Standardization Program (HSP), the ACS was boosting its reputation as being an organization that worked in the public interest, not just to support private professional narrower interests, and as such was widely relevant and influential at the time. This was visible in the publication of the *Manual of Hospital Standardization* by the ACS in 1926. The HSP was called "an epoch-making program in hospital and medical history" and the ACS was presented as initiating and driving "a movement" whose principles had acquired great influence - nationally and internationally and insured "efficient and scientific care of the patient" (American College of Surgeons 1926, 5; Brauer 2001, 24). The HSP gave ACS the chance to become the main forum in the 1920s for discussing and debating key questions of hospital management, leading the way for the AHA and AMA on these issues (Brauer 2001, 25). In 1952, Hawley -the ACS director at the time of the transfer of the HSP into JCAH - told the surveyors that "whatever may have been the original purpose of the program, the only important purpose it now serves is that of insuring the best care of patients possible at the present time, and of improving the quality of this care as rapidly as our knowledge and experience will permit" (cited in Brauer 2001, 33).

The JCAH presented itself initially as the continuation of the ACS-HSP - as a new venue for its advancement, using the familiarity with its program as the basis for building its own organizational identity later. Edwin Crosby, the first director of the JCAH, in the first issue of the *Bulletin* in November 1952 assured readers that it was committed to continue the ACS legacy: "we will continue the accreditation program with this same 'interest of the public' foremost in our minds…in our hearts…and in our actions." (Joint Commission on Accreditation of Healthcare Organizations 1952). The JCAH also kept the same space of the ACS/HSP as its headquarters in the first decade (Brauer 2001, 33), as another way of drawing from the reputation-building the ACS had already done. Among others, the ACS had developed good relationships with government legislators (American College of Surgeons 2017; Davis 1960; Stephenson 1994), presenting itself as mindful of the public interest above all. And the JCAH formal conveyance in December 1952 featured Senator Lister Hill—the co-sponsor of the Hill-Burton Act (Brauer 2001, 29) reflected these established relationships.

With the new sponsorship of the accreditation process, the JCAH emphasized its role in bridging the historic division between practicing physicians and hospital administrators. It indicated that it was somehow more impartial and more independent. However, even though it tried to address AMA concerns by giving it more representation than the AHA in 1958, it generally tended to favor one group—hospital administrators—over the other.[139] For example, its first director Edwin L. Crosby was presented as having both the medical and hospital administration experience, though he did not see himself as a practicing physician and had greater influence in the hospital field (Brauer 2001, 32). When the ACS was looking for a sponsor for the HSP it first addressed the AHA as the most 'logical' option. Furthermore, the JCAH tried to communicate with hospitals through a quarterly publication—the *Bulletin*—established in November 1952 initially as a four-page long newsletter. It sent the *Bulletin* to hospital administrators and chiefs of staff nationwide as well as state and local medical associations, hospital associations, and Blue Cross Plans (Brauer 2001, 33, see a picture of first issue in p.38).

The way in which the JCAH handled some of AMA's doubts and anxieties in the mid 1950 was indicative of its efforts to present oneself as an independent and impartial organization. In 1956, the AMA supported the report of a committee designated a year earlier to examine the

[139] After the Canadian Medical Association resigned from its corporate membership, its seats were given to AMA, which ended up having one seat more than the AHA who had seven seats in 1951 at the establishment of the JCAH (Brauer 2001, 36).

JCAH work—the Stover Committee—which overall supported accreditation but asked for changes to the standards that were the basis for giving accreditation to hospitals (American Medical Association 1956, 32). Babcock responded to each of the conclusions in the Stover report, trying to soothe the AMA concerns. He completely agreed with the committee's statements that the JCAH maintains the existing organizational representation at the time and does not become a punitive organization. Regarding other conclusions, including one on having more relaxed medical staff attendance requirements, Babcock noted either that the recommendation had been adopted or that it had been referred to a committee for action (Joint Commission on Accreditation of Hospitals 1956).

One strategy for bridging the division between physicians and hospital administrators was to emphasize the commitment to giving the best care for patients as their uniting aim under the JCAH, despite lack of evidence supporting the connection between accreditation and quality of care and patient outcomes (Sack et al. 2011; Sloan, Conever and Provenzale 2000. As Brauer (2001) notes, "the actual effects of the Joint Commission's standards and activities have never received careful documentation or systematic measurement" (Brauer 2001, 10). As the ACS director Hawley put it talking to surveyors before going to the field in 1952, "insuring the best care of patients possible…is the only purpose common to all the member organizations in the Joint Commission on Accreditation of Hospitals" (cited in Brauer 2001, 33). In 1963, the JCAH director Babcock offered the same logic. Three years earlier, the JCAH board had advised member organizations to encourage the adoption of a new practice by hospitals and physicians: the use on a trial basis of a method of internal appraisal for medical care[140] or to put in place medical audits. So, surveyors at the time were told to look at whether the medical staff reviewed

[140] A similar proposal was made by the ACP (JC-Brauer 2001, 41).

or evaluated clinical practice. When talking about this issue, Babcock presented the JCAH as an organization that respected medical authority but tried to define its position as nonpartisan—emphasizing the unifying goal of improvement to patient care. “There are honest differences in the treatment and care of the sick, and these must be honored. The Commission hopes that hospitals will continually, through every possible means, strive for improved care of patients. These exact mechanisms, of how attempts will be made to improve patient care, are not as important as the fact that there is intent and desire to do so” stated Babcock (Brauer 2001, 41). This is an example of the general hands-off position of the JCAH towards hospitals and physicians as somehow a strategy of not taking sides and signaling independence.

The JCAH strived to present itself not only as impartial and independent, but also as an organization based on voluntarism. It emphasized that hospitals voluntarily accepted its accreditation: reporting information, answering surveyors’ questions, and opening their facilities to their field visits. On this ground, in the mid 1950s, when the Canadian Medical Association resigned from its JCAH membership, the JCAH supported the newly created accreditation program—the Canadian Council on Hospital Accreditation—offering its standards, survey report forms and other supporting documents (Brauer 2001, 36).

However, the JCAH’s sense of voluntarism meant also leaving to hospitals many decisions and refraining from producing standards regarding certain issues—like the composition of hospital boards and the appointments of medical staff. When the AMA supported the Stover Committee’s demand that JCAH required the inclusion of physicians on hospital boards, Babcock mentioned that the Joint Commission had always encouraged close ties between the medical staff and hospital governing boards, and the decision resided within hospitals themselves. He stated that “the Commissioners think that the composition of the governing board of a hospital should be determined at the local level and that the Commission should not specifically state whether physicians should or should not be members" (Joint Commission on Accreditation of Healthcare 1956). In 1958, Babcock again presented itself as impartial by giving the suggestion to hospitals to put together "Joint Conference Committees" to enhance communication between the governing board and the medical staffs. Babcock used this suggestive language in the *Bulletin* arguing that the governing body had the legal right to appoint the medical staff and the moral obligation to appoint only those physicians who are judged by their fellows to be worthy, of good character, qualified and competent in their respective fields" (Joint Commission on Accreditation of Healthcare 1958). He viewed this decision as not an issue exclusively dependent on medical associations' credentialing—through membership, certification or fellowship in a professional body. The JCAH was unwilling to prescribe the kind of system or criteria hospital medical staff could apply to select members and delineate privileges. It maintained its image as not a policing body but an agency supporting self-regulation and broad principles and its standard-setting role above all (Brauer 2001, 39, 41).

The Commission was an exclusive organization. Adding new members required the unanimous consent of member organizations, which was not easy. The first and only addition was the American Dental Association which became a JCAH corporate member in 1979. The JCAH tried to be more inclusive by having representatives of other professional organizations and groups in its board as non-voting members or into various committees, task forces, and categorical councils (The Joint Commission 2016b). Even when it faced increasing demands for its accreditation in the early 1960s and membership financing for corporate organizations increased, it did not consider adding new members to decrease those membership costs but decided to change its financing model by making hospitals pay for accreditation surveys.[141] The ACP—the corporate member with a relatively smaller budget then others, that also felt the membership cost burden most—rejected an offer from the American Academy of Pediatrics that involved assuming the ACP's fees to the JCAH in exchange for one of its seats on the board of the Joint Commission (Brauer 2001, 42).

When the JCAH began charging hospitals for accreditation surveys in 1964, it became more difficult to preserve its image as an independent and impartial organization. Though over time the new model of financing its accreditation activities helped the organization achieve greater autonomy from its corporate members, it also made more visible its close connection with the AHA. Hospitals began to pay the bill for surveys and became the JCAH's main customer.[142] The JCAH notified hospitals a month before the survey was to be conducted and expected payment of the charge before the date of the survey. However, in attempts to address concerns about the actual or perceived objectivity of surveys under the new financing model (concerns the board was aware of), Babcock stated that "Whether or not payment has been received, the survey will be made. It is of no concern to the surveyor whether or not the payment has been made, and under no circumstances is he to accept the survey charge fee" (Brauer 2001, 44). Still, even though part of the fees collected in this way by the JCAH went to hire, train, and manage its own staff of surveyors (a recommendation of the AMA Stover committee in 1956 and of a latter AHA

[141] The JCAH conducted 1,687 surveys in 1962, 485 surveys more than nine years ago, when it first started its work (Brauer 2001, 42). It had accredited 3,947 hospitals by the end of 1962 and it had a total budget of $389,000 - $243,000 for field staff and $146,000 for administrative overhead—for 1963 (Brauer 2001, 43).

[142] According to the new funding system, hospitals would be charged for surveys—$60 per hospital, plus $1 per bed (exclusive of bassinets) up to 250 beds—and member organizations would still pay administrative overhead (Brauer 2001, 43-44).

task force), since early 1965 the fees began to contribute to Commission's administrative overhead (Brauer 2001, 45).[143]

Facing the tension between its private constituency and its professed public role, the JCAH saw itself mainly as responsible to hospitals, especially after they became their customers in 1964. It did not hold oneself responsible for the use of its accreditation by decision-makers other than hospitals - like government, insurance plans, etc. In a statement in 1960, the JCAH director Babcock explained in a defensive tone that "The Commission's function is to help hospitals…It is not punitive in character and has no authority to 'make' anyone do anything. The pressures come from other agencies which have recognized that the standards established by the Commission have proved to be effective in assuring safe patient care, and have used accreditation as a criterion for their own purposes" (cited in Brauer 2001, 43). Even before it established a formal not-for-profit consulting subsidiary—Quality Healthcare Resources, Inc—in 1986, JCAH leaders have emphasized that they viewed themselves as a private consultant, not a public regulatory program, paid by and responsible to the medical care industry (cited statements of president John Affeldt and director John Porterfield in a 1972 Senate Hearing session in Jost 1983).

The reception of accreditation and accrediting organizations: Evidence of successful institutionalization

The product

The ACS emphasized that the hospital standardization program was met with support. At its inauguration in 1918, it noted that the HSP was "received with interest beyond all expectations

[143] The salary of surveyors was increased from a maximum of 13,000 in 1964 to a maximum of $15,000 in 1965, putting it in line with ACS's payment of its surveyors of cancer programs (Brauer 2001, 45).

by the hospitals of the Unites States and Canada" (American College of Surgeons 1926, 5). After 1926, when the ACS printed and distributed thousands of manuals of hospital standardization, it claimed that they had become "the bible" for all hospital administrators seeking its approval and certification (Brauer 2001, 26; Stephenson 1994).

However, initially there was more suspicion around the HSP than enthusiasm. The presentation of the ACS's standardization program by Bowman and his staff was initially met with suspicion from hospitals. The AHA was frustrated with the ACS/HSP as it thought the non-medical aspects of running hospitals were neglected. The AHA thought establishing its own program (Lespare 1998). The AMA was busy with running its accreditation programs for internships and residencies and did not object to using the ACS program for the certification of hospitals (Brauer 2001, 28; The Yale Law Journal 1954; American Medical Association 2017). "Well-intentioned presentations were resented as being dictatorial" and Bowman was seen as a schoolmaster who was pedantic and who did not really attempt to see the viewpoint of others (Davis 1960; Brauer 2001, 22). It was also opposed by many physicians (Jost 1983, 849). The AMA declined invitation in 1914 to take the HSP and in 1918 made its own attempt of having a hospital standardization program through a rival hospital conference (Fishbein 1947; Jost 1983, 849). The ACS's decision to incinerate the result of the first survey of hospitals and the list of hospitals that met the initial minimum standard at the Clinical Congress of Surgeons in New York City at the end of October 1919 was seen by some as cowardly, reflecting the moral and intellectual weakness of the ACS (Schlicke 1973). However, the announcement of the numbers was enough to shock the medical world and create an opportunity for interpreting the situation as problematic and offer its standardization program, specifically the adoption of the minimum standard, as the solution (Brauer 2001, 22). The AHA and the Catholic Hospital Association (CHA) supported it later (Davis 1960; Stevens 1972).

In the 1950s, the AMA's doubts and anxieties about the accreditation and the established JCAH persisted. The group it represented—doctors—viewed the JCAH as a potential policing body that could fall under the control of hospital administrators and threaten their autonomy and authority on clinical matters (Stevens 1972; Roberts et al. 1987). The AMA house of delegates first voted to stop any "attempts by hospital accreditation authorities to propose, recommend and by threat of reprisal force the adoption of rules, regulations, and various and diverse requirements which would look to the most minute and detailed overlordship in every phase of our hospital practices" (American Medical Association 1954, 43). The following year, AMA even created a special five-member committee - called the Stover Committee, as it was chaired by Wendell C. Stover—to review the functions of the JCAH (American Medical Association 1955). In June 1956, the Stover report was endorsed by the AMA house of delegates. The report supported accreditation overall, and the JCAH specifically, however it noted concerns with some of the standards and practices considered in accrediting hospitals. The Stover Committee asked that hospital administration bodies have physician members, and that JCAH does not require specific attendance levels for medical staff meetings but let them be decided locally. It also advised that the Joint Commission sent reports on accreditation surveys to both administrators and chiefs of medical staffs, and that it directly employed, and supervised its surveyors. The AMA also expressed concerns about the quality of training the JCAH surveyors received, asking for new surveyors to "receive better indoctrination". Another point of conclusion of the Stover report was addressed to Blue Cross and other (insurance) associations, asking that they do not suspend full benefit to non-accredited hospitals "until these so requesting have been inspected"

(American Medical Association 1956, 32). This indicated how accreditation as a product was used widely and it had become culturally institutionalized. The anxieties of the AMA and their perception and doubts about the JCAH, are expressed in another point in the conclusion of the report stating that "the JCAH is not and should not be punitive" (AMA 1956, 32).

By the early 1960s, accreditation by the JCAH had become widely used and culturally institutionalized. An opinion survey conducted by the McCreary Committee found out that the JCAH's accreditation was generally accepted by physicians, and widely accepted and even appreciated much more by hospital administrators (Brauer 2001, 41). The survey was mailed to administrators of 494 hospitals out of 1,687 hospitals that had been surveyed by the JCAH in 1962. Asked whether they thought the JCAH's accreditation program had improved patient care, half of the hospital administrators and 28 percent of medical chiefs of staff felt it had brought a great deal of improvement, 40 percent of administrators and 49 percent of physicians said it had brought some improvement, while 10 percent of administrators and 23 percent of physicians said the program was responsible for very little improvement or not at all (Brauer 2001, 42).

The producer

The establishment of the JCAH was seen as a necessity. A new organization was needed to provide the needed funding mechanism to keep alive a program that had grown so much under the ACS. This is an indication of how the work done by the ACS to publicize its HSP was successful in creating accreditation as a product and culturally institutionalizing its practices. As a featured speaker in a formal gathering of the ACS in December 1952, Senator Lister Hill of Alabama - the co-sponsor of the Hill-Burton Act in 1946 - praised the ACS as a powerful but publicly minded organization, that did not use its power over hospitals to serve its own interest, but to advance the interest of the public (Brauer 2001, 34). The JCAH was seen as just an extension of the ACS-HSP (Jost 1983; Roberts et al. 1987).

Evidence of the successful cultural institutionalization of the JCAH as the producer of accreditation before its legal incorporation in 1965 with the Social Security Amendments - was the increasing demand for membership in the organization. In 1957, Babcock - the director of the JCAH at the time -reported to the board that the American College of Obstetrics and Gynecology, the American Dental Association, the American Academy of General Practice as well as organizations of radiologists and pathologists had asked about becoming JCAH members (Brauer 2001, 37; The Joint Commission 2016b).

Despite the JCAH's efforts to bridge the doctor-administrator divide, the AMA's suspicion and unhappiness with the JCAH did not stop after the adoption of the Stover report. In 1962, there was a resolution in its House of delegates that proposed making the JCAH part of the AMA framework (American Medical Association 1962a; Roberts et al. 1987). Though the resolution was tabled, that same year, the AMA put together a new five-member committee chaired by Thomas W. McCreary to study again in even more detail the Joint Commission. The committee made visits to the Commission headquarters, assessed its operations and procedures, interviewed its director Babcock, traveled with surveyors to hospitals for their field work and asked for reflections, recommendations, and criticism from practicing physicians. The McCreary Committee, similar to the Stover Committee, did not challenge the organizational status quo - the JCAH. It found that the JCAH emphasized hospital administrative practices and suggested a revision of its standards so that it strengthened those related to patient care improvement, and therapeutic and diagnostic services (American Medical Association 1962b; 2017).[144]

[144] The JCAH supported 11 of the 13 suggestions of the McCreary report.

By mid 1960s, the JCAH's position as the source and producer of accreditation had not only become accepted, but also widely used. Third-party payers - especially Blue Cross, private health insurers, group health plans, and government - did not only recognize its accreditation as an indicators of good patient care, but also began to require it as a condition for reimbursement (Somers and Somers 1961; Brauer 2001, 43). When in 1962, the Joint Commission decided to change the model of financing hospital surveys and the accreditation process, hospitals did not object to the decision. They had become increasingly dependent on third-party payments, during a time when they struggled with meeting costs. The Kerr-Mills Act of 1960—part of the Social Security Amendments of 1960—put in place a program that reimbursed hospitals of participating states for the care of indigent patients (Stevens 1996; Social Security Administration 2017). In 1960, insurance benefits made up 64 percent of all nongovernmental payments for care given in hospitals, as nearly 68 percent of Americans had some hospital insurance, most of them through Blue Cross (Brauer 2001, 43; Stevens 1972). No hospital cancelled a survey because of the new charge and there was only one mild complaint reported to Babcock—JCAH director. In 1964, all hospitals paid the designated charge for the JCAH accreditation surveys. In the *Bulletin* in 1963, Babcock noted that many hospitals that applied for accreditation had to wait for six months to a year before a survey could be made, mainly because of shortage of personnel (Brauer 2001, 44).[145]

Another indication of the successful cultural institutionalization of the accreditation product and its source the JCAH was after 1965, after the JCAH was given "deemed status" authority under the Medicare legislation. Even though accreditation was available to hospitals through

[145] In 1962, after having accredited hospitals in six countries, the JCAH decided to not accredit any more foreign hospitals because of shortage of personnel. Depending on hospital size and travel requirements, each surveyor would have to conduct on average 110 to 130 surveys every year (Brauer 2001, 44).

state licensure, they preferred the Joint Commission accreditation route to gain Medicare eligibility (Jost 1983; 1994b; Roberts et al. 1987). By the time of its legal incorporation, the JCAH as a producer of accreditation was “a known quantity” strongly backed by professional organizations in healthcare, viewed as another way of maintaining and ensuring self-regulation (Brauer 2001, 55).

Conclusion

This chapter argued that accreditation of hospitals in healthcare became regulatory thanks to a successful cultural institutionalization process preceding its legal incorporation. These private accrediting agencies were able to make their product of accreditation and themselves as organizations, an accepted unquestioned part of the healthcare system. Their accreditation decisions became part of everyday practices of different organizations and individuals in healthcare and ended up being seen as natural and irreplaceable solutions to the problem of evaluating the quality of care offered by hospitals. I traced this process of cultural institutionalization and highlighted how accrediting organizations adapted to the changing context and actively and creatively make use of the opportunities context offered. They crafted the form and identity of their organization and products in a dynamic emergent and fragmented healthcare field such that it supported their institutionalization—silently but successfully.

First, I presented a brief history of the emergence of accreditation and its organizations in healthcare, with the purpose of clarifying terms and highlighting the organizational and institutional context within which the organizational identity work of these agencies took place. Second, I noted how accreditation organizations were able to become accepted in the field and into actors’ practices by building a positive organizational identity, that is, presenting themselves not as a competitive alternative to existing practices but as a complementary or supplementary one. I delineated two paths through such identity building proceeded for accreditation organizations: through cultivating the meaning of their product—accreditation—and through building a particular view of themselves as producers of accreditation. Lastly, I provided evidence on the reception of accreditation and their agencies' organizational identity work and the success of the cultural institutionalization process.

The process through which accreditation and accrediting agencies became institutionalized lays the ground for the following chapter which will examine the legal incorporation of accreditation and accreditation organizations through legislation. Understanding the nature of cultural institutionalization of accreditation and its producers is crucial to evaluate the role of different actors - government agencies, industry representatives, and other market actors - that contributed to their role in the regulatory framework through the 1940s and 1960s phases of legal incorporation. Among others, this chapter has created an awareness of how the meaning of accreditation and its agencies changes in interaction with their environment, but is not strictly determined by context and circumstances. It has also exposed some of the myths surrounding accrediting agencies, like that their most important activity and product was accreditation and that they were "voluntary, private solutions to public problems" therefore "distinctly American-type institutions" (Brauer 2001, 10).

CHAPTER 7

Legal Incorporation and the Political Institutionalization of Accreditation in Healthcare

Accreditation—as a process and system of collecting, processing, and presenting information in a particular summary condensed form—has a long history in healthcare. However, only accreditation produced by certain specialized organizations—what are known today as 'accreditation organizations'—has become a regulatory mechanism for markets and organizations in the field of healthcare. The accreditation of the Joint Commission and the Healthcare Facilities Accreditation Program (HFAP)—two of the most comprehensive accreditation organizations—impact most extensively the behavior of organizations and other market participants in the healthcare field. They are the first organizations to be nationally recognized through government legislation as legitimate sources of accreditation. Among them, the Joint Commission is "the only private sector entity that is entrusted by the government with quality oversight of an industry that affects individuals' most basic right to live" by statute (Brauer 2001, 10). The previous chapter showed how initially these organizations shaped their product of accreditation: moving gradually from the creation of standards into the adjudication of thresholds for successful implementation. It highlighted also the work through which these organizations built their identity as independent impartial evaluators of hospital quality and other healthcare organizations. I argued that accreditation organizations' legal recognition in the 1940s and in the mid 1960s reflected the successful cultural institutionalization of the product of accreditation and private specialized organizations as its producers.

While some scholars view these accrediting organizations in healthcare as a form of private regulation, many acknowledge the role their legal incorporation through government legislation played in enhancing their regulatory power (Jost 1983; Kinney 1994). This chapter will examine why exactly accreditation and accrediting organizations became part of government regulations and how legal incorporation shaped their meaning and identity. I argue that the successful cultural institutionalization of accreditation and its organizations was a necessary though not sufficient condition for their legal incorporation through legislation. Cultural institutionalization enabled the incorporation of accreditation as a product into legislation, by making it a process involving less contestation and conflict. However, it did not provide enough ground for the inclusion of accrediting organizations as producers into public legislation. A process of political institutionalization - that involved making accepted the political significance and implications of accreditation decisions from these specialized organizations—was necessary to incorporate accrediting organizations as the producers of accreditation in law. As in the previous chapter, I highlight how accreditation organizations adapted and made use of the contextual opportunities for doing organizational work—crafting the form and identity of their organization and products—in a way that supported existing institutional arrangements but also advanced their position as source of regulation in the dynamic emergent and fragmented field of healthcare.

First, I provide a brief history of the legal incorporation of accreditation and accreditation organizations through legislation. Second, I delineate the processes through which this legal incorporation became possible, focusing on how accrediting organizations worked on their organizational identity and navigated their context before and after each major instance of legislative incorporation. This section examines the role of major legal incorporation moments in advancing the cultural and political institutionalization of accreditation as a product and themselves as the producers. Lastly, I present evidence on the reception of the legal incorporation of accreditation and its organizations and the success of political institutionalization. This section traces how government and industry actors affected the meaning of accreditation and accrediting organizations, and the way in which alternatives to accreditation and accrediting organizations as regulatory mechanisms faded through time. I highlight the implicit negotiation among different actors involved in the outcome of giving regulatory power to these organizations' accreditation decisions. I note how the legal incorporation of accreditation and accrediting organizations through regulation contributed to furthering their cultural and political institutionalization and to silencing alternatives. In conclusion, I summarize important arguments and reflect on how the political institutionalization process at the same time offered opportunities for the beginning of a process of deinstitutionalization.

The legal incorporation of accreditation and accreditation organizations: a brief history of two phases

The regulatory incorporation of accreditation in healthcare happened in two phases: in the 1940s and in the 1960s. The first phase of legal incorporation involved the recognition of accreditation as a product, whereas the second phase resulted in the recognition of accrediting organizations as the producers of the accreditation product. Accreditation-based legislation was first introduced for hospitals, in the mid 1940s as part of the Hospital Survey and Construction Act of 1946 (PL 79-725), popularly known as the Hill-Burton Act, and in the mid 1960s as part of the Social Security Amendments of 1965, known as Medicare legislation, then spread into other healthcare industries spreading in the mid 1940s, became 'deemed status' legislation in mid 1960s, and later spread into other healthcare industries in the early l990s.[146] These incorporations

[146] In 1993, the federal government announced that home health agencies with accreditation from the Joint Commission on Accreditation of Healthcare Organizations (JCAHO) - given after conducting an unannounced survey—would be "deemed" to meet the Medicare Conditions of Participation (Brauer 2001, 140).

happened over a background of major political and economic events and broader regulatory changes.

The legal incorporation of the 1940s: recognizing accreditation as the product

According to Brauer (2001,138), the enactment of the Hill-Burton Act in 1946 to fund hospital construction around the Unites States, marked also the recognition of the American College of Surgeons' (ACS) hospital certification program by the federal government. The Hill-Burton Act, Brauer (2001, 26) claimed, specified that funding for hospitals was conditional on having ACS certification. However, government's validation of the ACS's contribution to hospital standardization and certification in healthcare was not direct in the Hill-Burton Act. It was indirect as neither the ACS nor its accreditation product was explicitly mentioned in the Act.

The language used in the Hill-Burton Act implicitly referred to the achievements and efforts of the ACS to create an accreditation product in the form of the minimum standard for hospitals. But at the same time it made states the primary suppliers of certification and began state licensure for hospitals. In 1946, there was only one reference to minimum standards: under section 623 titled "State Plans". Provision number 7 required that State plans for constructing hospitals under the Hill-Burton Act "provide minimum standards (to be fixed in the discretion of the State) for the maintenance and operation of hospitals which receive Federal aid under this part" (PL 79-725 in Walsh 1981, 5). This provision does not make meeting ACS minimum standards a condition for receiving funding. It seems to recommend hospitals receiving funding to pay attention and meet minimum standards. The conditionality of Hill-Burton aid based on compliance with minimum standards of maintenance and operation of hospitals became clear in

1948. An amendment to subsection (d) of section 623 of the Public Health Service Act[147] stated that "If any State, prior to July 1948, had not enacted legislation providing that compliance with minimum standards of maintenance and operation shall be required prior to that data…in the case of hospitals which shall have received Federal aid under this title, such State shall not be entitled to any further allotments under section 624 until such time as such State has enacted such legislation." (PL 80-723 in Walsh 1981, 12). The amendment stipulated that only after enacting the necessary legislation could the state be eligible to receive for funding under the Hill-Burton Act.

The implicit way in which the accreditation product was legally incorporated through the Hill-Burton legislation reflects its evolutionary legislative history. Though the bill was unsponsored,[148] it was enacted quickly[149] and passed almost without dissent (Perlstadt 1995; Starr 1982). According to Starr (1982, 348-351), this reflected the success, by that time, of healthcare interest groups' efforts to limit federal political discretion and intervention, somehow maintaining a form of self-regulation. For Fox (1986, 117-131), the Hill-Burton Act indicated a consensus at the time on a hospital-centered and decentralized healthcare policy, build through a fragile coalition between hospital interests (represented by the American Hospital Association (AHA)) and government (represented by the U.S. Public Health Service), supported also by philanthropic foundations and Congressional allies. Fox (1986) argued that that this coalition was able to assure conservatives that physicians autonomy would not be threatened and promise

[147] This is an amendment of the provisions of title VI of the Public Health Service Act relating to standards of maintenance and operation for hospitals receiving aid under that title. Titles I to IV, inclusive, of the Hospital Survey and Construction Act are also cited as the "Public Health Service Act" (PL 79-725 in Walsh 1981, 11).

[148] Formally, the bill was presented by Senators Lister Hill of Alabama and Harold Burton of Ohio. However, Perlstadt (1995, 85) presents evidence that the bill was not sponsored by the President, the Senate leadership or the Committee Chair.

[149] The bill was introduced in the Senate (S. 191) on January 10, 1945 and after several hearings was reported out on October 30th. The Senate passed it in December 1945, and the House in July 1946. It was signed into law on August 13, 1946.

liberals to address inequality and discrimination in provision of healthcare. By letting states and localities control hospital policy, including the accreditation of hospitals for meeting minimum standards, the Hill-Burton Act furthered healthcare industry interests as they could exert their power easily at that level.

Examining Congressional records and documents, Perlstadt (1995, 78) viewed the Hill-Burton Act as the result of nearly "a decade of planning and effort by the President, Congress and health interest groups", evolving through day-to-day compromises, advocacy and negotiations among champions of different interested parties. He argued that the Act benefited mainly healthcare interests: they seized a unique opportunity in late 1945, successfully organized and mobilized their supporters, and ended up securing special advantages for their members as well as advancing their image as contributors to the public good (Perlstadt 1995, 79). The hospital interests, for example, were able to keep legislation on hospital construction and funding separate from broader national health programs and health insurance (MLR 1979, 321). Even though conservatives and liberals both got something in their interest in the bill, it was named the Hospital Survey and Construction Bill clearly reflecting the dominance of hospital interests.

The Hill-Burton Act was one of two bills that attempted to address the problem of hospital availability and accessibility and related inadequacies in medical services after the Depression. Since the start of the Depression in 1929, many hospitals closed and the construction of new hospitals through private funds nearly stopped.[150] In 1934, President Franklin D. Roosevelt appointed a Committee on Economic Security that delineated a national health program as part of its general plan for economic and social security. Only maternal and child welfare and public health works were incorporated in the 1935 Social Security Act (as Titles V and VI). A report

[150] From 1928 to 1938 approximately eight hundred hospitals closed (MLR 1979, 318).

from the Technical Committee on Medical Care Report in February 1938 drew attention to the need for construction of new facilities as a way of enabling medical practitioners to give the level of care for which they were trained. President Roosevelt incorporated this in his "Health Security Message" to Congress and Sen. Robert F. Wagner (D-NY) introduced S.1620- a bill that proposed amending the Social Security Act to establish a National Health Program (see Perlstadt 1995, 80-1). The construction of hospitals and related facilities was part of this broader plan, financed by Federal grants to the states, and emphasized the needs of rural and economically distressed areas in line with the New Deal.

Construction of hospitals was the main focus of the Hill-Burton Act, and in its first draft it did not include provisions on uncompensated care and community service (MLR 1979, 322-23; Perlstadt 1995, 83). This issue was separated from the broader health programs in February 1, 1940, when President Roosevelt set apart proposals for building small hospitals in poor areas of the country (Congress 1940, 878). This move inspired the National Hospital Bill of 1940 (S.3230), which, among others, gave the Surgeon General (the equivalent of the Secretary of the US Department of Health and Health Services today) authority to issue necessary rules and regulations not only regarding construction and planning, but also on standards of personnel, maintenance and operations of such hospitals.[151] However, the Wagner Act provided federal funding only for public hospitals. Federal funds for the construction of private non-profit hospitals became available in 1941 through a public works plan -the Lanham Act (PL 77-137)— which gave Federal government no role in supervising or controlling the administration, provision or operation of non-federally owned or operated facilities (Perlstadt 1995, 83).

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[151] It was introduced by Sen. Wagner and Sen, Walter George (D-GA) (Perlstadt 1995, 82-83)

The start of the WWII gave the main healthcare interest groups time to organize. The AHA, the US Public Health Service (PHS), and the US Senate began studies on the future of hospital and health care in the United States (Perlstadt 1995, 83-85). A nationwide survey conducted by the Commission on Hospital Care in 1941, sponsored by the American Hospital Association (AHA) with the assistance of the United States Public Health Service, and testimonies on health needs gathered during hearings by the Senate Subcommittee on Wartime Health and Education, led Senate to consider developing a federal program to improve hospital and health facilities (Congress 1945, 7).[152] Another bill - a proposal for a national health insurance program presented by the Truman administration, which was broader in scope -also included a program on the construction of healthcare facilities (Congress 1946).[153] However, hospital interests were able to present the Hill-Burton bill - focused only on the construction and distribution of hospital and related public health facilities - as “the first step in finding a solution to our national health problems” (Congress 1945, 7; MLR 1979, 319-320).

Surveys and standards were used strategically to build conditionality and determine the flow of funding under the bill. They became politically useful not only in determining who was worth of federal funds, but also in addressing health professionals’ concerns about autonomy and self-regulation. The Hill Burton Act in 1946 outlined a federal-state operated program, where the Surgeon General approved and supervised the implementation of the plan designed by a designated state agency for administering the state-wide hospital construction and modernization program. The statute also created the Federal Hospital Council—an appointed body of hospital

[152] The Commission on Hospital Care was supported by grants from several private foundations, and the Public Health Service provided staff assistance. The end of WWII and the return to civilian life of thousands of Army physicians was also an impetus for this legislation (MLR 1979; Perlstadt 1995, 83).

[153] Truman’s administration proposed creating programs for the construction of new facilities, development of public health services and maternal and child care, expansion of medical research and professional education, expansion of the existing compulsory social security system into the inclusion of mandatory health insurance, and provision of comprehensive disability insurance (Congress 1946, 1-8).

experts and consumer representatives—that had final and binding power to approve or veto the Surgeon General's regulations. The bill limited the regulatory authority of the Surgeon General, even though Sen. Murray (D-MT) wanted the Surgeon General to be able to issue standards regarding the maintenance and operation of hospitals—in line with the 1940 hospital construction bill- in addition to the Hill-Burton provisions on standards for construction and equipment (MLR 1979, 323; Perlstadt 1995, 86). Sen. Robert Taft (R-OH), on the other side of the political spectrum, wanted to adopt standards to limit the growth of a hospital's district and maintaining a ratio of four or five beds per thousand people and also the amount of funds they could get from the federal government (Congress 1945, 67; Perlstadt 1995, 90).

The minimum standards for the maintenance and operation of hospitals benefiting from the Hill-Burton Act funding were left to be determined by each State. This began a kind of state licensure for hospitals and related facilities and implicitly legally incorporated the product of accreditation for hospitals, which the ACS had started since the early 1920s under the Hospital Standardization Program. Even though the ACS and its minimum standard were not mentioned explicitly, they had the support of hospital interests and were represented by them[154]. Furthermore, one of the formal sponsors and champions of the Hospital Survey and Construction Act (the Hill-Burton Act)—Senator (Joseph) Lister Hill of Alabama (D)- was the son of one of the South's most renowned surgeon (Perlstadt 1995, 79).[155] His father's influence affected his involvement in healthcare policy and his speech at a formal conveyance ceremony of the ACS

[154] The ACS had an interest in the Hill-Burton Act as hospital construction and modernization fitted well with their HSP logic and would increase the number of hospitals that would ask for voluntary accreditation under their accreditation program.

[155] His father, Dr. Luther Leonidas Hill, was the first American surgeon to perform surgery on an wounded heart and whose patient survived the operation in 1902. He named his son Joseph Lister Hill after the father of antiseptic surgery—Dr. Joseph Lister (http://www.encyclopediaofalabama.org/article/h-2949)

for the Joint Commission on Accreditation of Hospitals in December 1952 indicated that he was aware of the ACS's work on minimum standard for hospitals and voluntary accreditation.

Reception and aftermath. The proposal of the National Hospital Bill in 1940 to designate an advisory council -patterned after the National Advisory Cancer Council was another indication that Congress was aware of the ACS's accreditation product during the legislation of the Hill-Burton Act (Perlstadt 1995, 83; Senate Report 1558, 1940).[156] In 1931, the ACS started surveys of cancer programs in hospitals and accredited the first three hospital cancer programs based on the standards developed by its Committee on the Treatment of Malignant Disease (established in 1922 at the same time and under the same leadership of Ernest A. Codman as the Committee on Hospital Standardization) (ACS 2012; Stephenson 1979; ACS 2017).[157] The aim of accreditation for cancer programs and that for hospitals later expressed a similar underlying logic: making sure institutions had the structures and processes necessary for providing quality care.

The Hospital Survey and Construction Act of 1946 was presented as a crucial step in achieving a national health program. In an article in the *Bulletin of Social Security*, the chief of the Division of Hospital Facilities at the US Public Health Service at the time, claimed the Act was "more or less unique in social legislation" as it had "the unanimous support of so many interest groups, both professional and consumer." (Hoge 1946, 15). He mentioned that regulations would be issued on the standards for the construction and equipment of hospitals, emphasizing that they would not interfere with the administration of hospitals. In conclusion, he

[156] The advisory council was first called the Federal Advisory Council, but it ended up being the Federal Hospital Council in the Hill-Burton Act (Perlstadt 1995, 88).

[157] In 1933, the Committee on the Treatment of Malignant Disease also published the first list of approved institutional cancer programs (Breslow 1977). The Committee developed into the Commission on Cancer, though different it remained within the ACS program (Stephenson 1979).

praised professional organizations like the AHA and American Public Health Association for their leadership in planning the program authorized by the Act, and concluded by emphasizing the role of hospitals in helping “bring the benefits of the health-saving sciences to the people, …raise the Nation’s health standards” and establishing “the keystone in the arch of the national health program” (17). President Truman, however, in his statement upon signing the Act, expressed his objection to two provisions: the regulatory power of the Federal Hospital Council’s and the ability to appeal to the federal courts for any issues regarding the federal administration of the program. He considered both as establishing a “potentially dangerous precedent” in challenging the power of appointed officials and federal administrators (Truman 1946).

The AHA recognized its role in making Hill-Burton possible, but emphasized the major role government played in its development and realization. James Hague, director of publications and corporate secretary of the AHA noted that the interest of the Surgeon General and the US Public Health Service (PHS) in realizing the Hill-Burton legislation. “Dr. Parran had a notion of a big program that finally turned out into Hill-Burton. He needed data to sell it to the Congress…Dr. Parran had a political, legislative problem on his hands and he wanted those data and he wanted the fact-finding done. So the PHS was the hidden financier of the whole thing. All the statistical work was done by PHS people…The PHS was privy to the data before those data were public” (Hague 1984 cited in Weeks and Berman 1985, 47). On whether the Commission on Hospital Care initiated by AHA and its findings and reports led to the Hill-Burton Act, Bugbee, the chairman of the AHA and lobbyist for bill- stated: “they are related, but hardly as direct a lead-in as later the Public Health Service said. They were the ones who indicated that it was the source. I don’t feel it was.” (Bugbee 1984 cited in Weeks and Berman 1985, 31). Regarding the AMA, he noted their reluctant support: “they had been so against everything that they essentially said they needed something to be for. So they agreed to support it, and they did testify in support of it, but reluctantly as far as their inner circle was concerned" (Bugbee 1984 cited in Weeks and Berman 1985, 38).

The legal incorporation of the 1960s: recognizing accreditation organizations as the producers

Historical context. The 1960s brought revived discussion about healthcare policy. The most well-known legislative developments are the Kerr-Mills Act as part of the Social Security Amendments of 1960 (H.R. 12580), which gave states limited aid for healthcare,, and the Social Security Amendments of 1965 (H.R. 6675) which contained Medicare (Parts A and B) providing medical benefits for all elderly Americans, regardless of income, financed through Social Security, Title 19 or Medicaid which offered health benefits to the needy (children, families, aged, blind, and disabled) through a joint Federal-State program, and further Social Security cash benefit increases (Anastos 2011; Brauer 2001). The passage of Medicare legislation in 1965, however, marked the second phase of legal incorporation - that of the producer of accreditation. The Joint Commission on Accreditation of Hospitals was recognized as the legitimate source of evaluation and certification—being given authority to provide "deemed status" to hospitals nationwide meaning that its accreditation would indicate hospital compliance with most of the Medicare conditions of participation and make them eligible for receiving government reimbursement.

Developments in the field of health insurance played an important role in making possible this phase of legal incorporation for accreditation and their producer. Most of 68 percent of Americans who had some kind of hospital insurance relied on Blue Cross for it. Blue Cross (and other private providers of health insurance) recognized the JCAH accreditation as indicator of good quality patient care and even began requiring it as a condition for reimbursement (Brauer 2001, 43). The government used the plans of private providers like Blue Cross (and Blue Shield) to devise its own Medicare provisions for health insurance. Relying on private providers of insurance as intermediaries for administering Medicare, the government ended up recognizing the JCAH accreditation. The JCAH director at the time Babcock in 1960 also attributed the development of its accreditation's regulatory power to these "other agencies which have recognized that the standards established by the Commission have proved to be effective in assuring safe patient care, and have used accreditation as a criterion for their own purposes" (Brauer 2001, 43).

During this time the JCAH did not have its own policy or lobbying presence in Congress. Its main challenges were arising from increasing specialization within the healthcare field and the change of hospitals legal responsibilities for patient care. In 1963, it faced a suit from two podiatrists in Washington, D.C., that had been asked by their hospital not to operate independently, so that the 300-bed proprietary facility could restore the JCAH accreditation.[158] The JCAH and the hospital were charged for restraint of trade (Brauer 2001, 52). The JCAH board authorized their lawyer to settle the case, however, maintaining all patient care under the oversight of licensed physicians. In 1965, the *Darling* case - where the Supreme Court of Illinios decided in favor of a football player who argued the hospital did not provide adequate care and was responsible for the amputation of his leg—established a precedent for maintaining hospitals legally as well as financially responsible for patient care offered within their facilities (Brauer 2001, 53).[159]

[158] The podiatrists had been operating independently and without proper supervision from medical staff at the Doctors Hospital for nearly 20 years (Brauer 2001, 52).

[159] In 1969, the JCAH had to deal with many AMA house of delegates resolutions not the controversial issue of the relationship between governing boards and medical staffs (Brauer 2001, 53).

These cases were costly for the JCAH, not only monetarily but also for its efforts to build an organizational identity based on principles of independence and impartiality, among others. Inspired by the podiatrists case, other non-MD health professions such as dentists, oral surgeons, osteopaths, psychologists, physical therapists and nurse midwives expressed their opposition to the standards the JCAH used to determine hospital accreditation. They viewed the JCAH as an instrument of the medical profession and their efforts to privilege their members by restricting access to hospitals for other emerging health professions. The *Darling* case and other state court rulings, especially in California, diluted the old divisions between civilian and clinical domains within hospitals that the JCAH also attempted to maintain. It also increased public visibility and scrutiny of its product of accreditation, and increased its struggle in managing the relationships among its major founding members and the different interests they represented (Brauer 2001, 53).[160]

In 1964, there was a change in leadership at the JCAH. Babcock resigned,[161] and in June 15, 1965 John D. Porterfield III took over.[162] Before resigning, Babcock expressed observed that "over the past eleven years, the Commissioners have eased and lower Standards in many respects". Alluding to frequent AMA criticism, he insisted that accreditation had to be "a means to insure that the medical staff are controlling the activities in the hospital which are concerned with medial and patient care", not a means to control the medical staff (Brauer 2001, 46). Similar

[160] In 1969, the JCAH had to deal with many AMA house of delegates resolutions not the controversial issue of the relationship between governing boards and medical staffs (Brauer 2001, 53).

[161] He went on to work as a consultant for hospitals. He had alienated the board of JCAH by assuming too much of personal authority, acting in some cases without approval form the Advisory Committee (Brauer 2001, 45).

[162] Porterfield was a graduate of the University of Notre Dame. He had a medical degree from Rush Medical College, though he had never been a clinician. Before joining the JCAH, he had a distinguished career in public health administration—first as director of the Ohio State Department of Health (1947-1954), then as Director of the Department of Mental Health and Correction, and elected as deputy surgeon general of the U.S. Public Health Service. He also had held an academic appointment at the University of California, Berkley. He lectured and published widely (Brauer 2001, 46).

to Babcock, Porterfield traveled extensively to speaking arrangements and was very active in other professional organizations too. He also struggled to build the identity of the JCA as a unified and independent entity, as some of the commissioners viewed themselves as representatives of the member organizations - the AHA or the AMA being the two largest corporate parents of the JCAH (Brauer 2001, 47).

Moment of legal incorporation. The Social Security Amendments of 1965 was a three-layered legislation Wilbur Mills carefully put together by combining different proposals of Republicans and Democrats. Part A of Medicare increased social security taxes to subsidize the cost of hospitalization and nursing home care for certain periods of time for people at least 65 years old. Part B of Medicare offered recipients of care a supplemental insurance program funded through their individual payments as well as government contributions. It reimbursed certain diagnostic tests, home-nurse visits and doctors' fees. The Medicaid program provided federal matching grants to states that had programs to pay for health care for the poor and indigent (Corning 1969; Anastos 2011; Cohen and Ball 1965).

The enactment of the Medicare legislation as part of the Social Security Amendments of 1965 - Public Law 89-97—became possible after the landslide election victory of President Lyndon B. Johnson in 1964, his strong legislative leadership, and a huge Democratic majority in Congress (Corning 1969; Cohen and Ball 1965; Anastos 2011; Weeks and Berman 1985, 88). The AMA was part of the conservative majority opposing this government program of health insurance since the 1940s, lobbying Congress on the issue. It became one of the most vocal organizations building a case against Medicare, a government program it presented as "a definite step toward either communism or totalitarianism" and "socialized medicine" (Anastos 2011;

87th_Congress 28_29July_1_2Aug_Hearings 1961, 1123). The AMA supported a program that was financed through tax money—known as the Kerr-Mills bill—and was against a plan that was financed by individual contributions to a social security fund - known as the King-Anderson bill[163]. Many doctors supported the AMA framing and its position, however, by the 1960s hearings, the support for the AMA position decreased. After periodical exposition though Congressional hearings and print and television reporting on the inability of the American health care system to address the precarious situation of the elderly, its own doctors and other healthcare organizations, including the AHA, began endorsing in principle the extension of social security to include health insurance for the aged (Corning 1969; Anastos 2011; 87thCongress_2_3Aug_Hearings 1961, 1601; Weeks and Berman 1985, 86).

The fine print of the Medicare statute included a provision that legally incorporated accreditation by certain private accrediting organizations as another way of meeting conditions of participation for the Medicare program. It stated that "any hospital accredited by the Joint Commission on Accreditation of Hospitals will be deemed to meet all the requirements in the definition of "hospital" in section 1861(e) except the utilization review requirement. If the Joint Commission requires a utilization review plan (or imposes another requirement serving the same purpose) for accreditation, the Secretary is authorized to find the accredited hospitals meet all the requirements in such definition. The Secretary may also accept the findings of the American Osteopathic Association, or any other national accrediting body, as to the eligibility of institutions and agencies to participate if he finds reasonable assurance that the

[163] The AMA fell the medical profession was threatened by this health insurance bill by Senator Clinton Anderson (D-NM) and Representative Cecil King (D-Calif.) introduced in 9160 to Congress. It organized a huge camp against the bill—through extensive with ratio and television commercials, pamphlets, the establishment of a special speakers' bureau and a "letter to your congressman" effort. In 1961 it even established the American Medical Political Action Committee (AMPAC), with the hope of supporting the Kerr-Mills Act. However, the Kerr-Mills implementation could not address the problems of the aged and poor, as AMA hoped (Weeks and Berman 1985, 81; Anastos 2011).

pertinent requirements of section 1861 are met" (89thCongress_HR_Mar 1965, 171). Medicare certification also meant eligibility for Medicaid participation. Though the Secretary of the Health, Education, and Welfare (HEW) and the states had the ultimate authority to decide whether a hospital met necessary health and safety requirements, they could not establish requirements that exceeded those of the JCAH.

The recognition of the JCAH as the source of accreditation for hospitals in the Medicare statute had two main political reasons: to dilute the vigorous consistent opposition of the AMA to the Medicare program, and given the stakes for the Johnson administration, to start the operation of Medicare as soon as possible (Jost 1983; Weeks and Berman 1985, 86-88). In the initial appearance of the idea of relying on private accrediting organizations in determining the eligibility of providers of health services for participating in Medicare—in a report titled "Action for the Aged and Aging" in January 1961- there were no specific organizations mentioned. The Secretary of the HEW would publish at times of his choosing a list of hospitals and other healthcare providers that met Standards established by the Secretary himself. Only licensed agencies would be included in the list and reliance on private accrediting organizations was given only as a possibility side by side that of state licensure. "In setting eligibility standards for any class of institutions or agencies, the Secretary may take account of standards set by any recognized national listing or accrediting body" (87thCongress_SR_jan 1961, 22).

The first set of hearings on *Health Services for the Aged,* it was clear the government at the time saw reliance on private accrediting organizations as primary and that on state licensure as secondary, even though there was a language of possibility rather than certainty used to support the Secretary's final authority on the matter. "The Secretary could accept accreditation of a hospital or other facility by a recognized national organization as prima facie evidence that the institution has met some or all of the conditions for participation in the program. The help of State agencies would be used for the most part to determine whether unaccredited hospitals and nursing homes are eligible to participate" (87thCongress_24_26_27July 1961, 37).

Reliance on private accrediting organizations for determining eligible providers was presented as a cost-reducing measure for government. The HEW Secretary noted that accreditation organizations would help in "reducing the need for inspection activities by State agencies" and "avoid duplication of Federal, State, and nongovernmental activity in the collection and analysis of…information from providers" (87thCongress_24_26_27July 1961, 149).[164] This argument resurfaced in many later instances. For example, when Dr. Brandfass - a local physician that in line with the AMA position defended the existing Kerr-Mills bill—[165] expressed his opposition to the new King-Anderson bill (which gave the HEW Secretary to list participating hospitals and physicians to Medicare) stating that he wanted "to keep centralized bureaucratic type of medicine out of medicine", Mr. James G. O'Hara (D-Michigan)—explained that accreditation was ensuring the efficient and careful administration of the Medicare program under the King-Anderson bill. O'Hara noted that "the aim of the King-Anderson bill is to accredit so that the funds are used when adequate care is given to patients" (87thCongress_20Feb_2_5May 1962, 247).

The political and economic arguments surrounding accreditation and its provision by private organizations were complemented by a cultural and normative argument that emphasized the reputation of the existing accrediting organizations—mainly the JCAH—and its recognition within the healthcare sector and its broad professional community nationwide. In the report

[164] Government used the same logic to justify and defend reliance on nonprofit -mainly Blue Cross- or other organizations regularly in the healthcare business for cost information, to support its audit and cost analysis (87thCongress_24_26_27July 1961, 149).

[165] The Kerr-Mills bill left the administration of medical care for the aged at the local level.

Health Insurance for Aged Persons the HEW Secretary Ribicoff submitted to the Committee on Ways and Means House of Representatives in July 24, 1961, the Secretary mentions only one specific accrediting organization as the source and producer of standards and accreditation helpful for government in certifying providers of Medicare eligibility: the JCAH. The report states that State agency's "inspection and certification workload would be reduced greatly by the accrediting activities of the Joint Commission on Accreditation of Hospitals" (79, cited in 87thCongress_24_26_27July 1961, 151).

The way in which the Secretary of HEW at the time—Mr. Ribicoff—defended the Medicare reliance on accrediting organizations in an exchange with Mr. Ullman (R-Oregon) and Mr. Betts (D-Ohio) indicates the extent to which by the 1960s the JCAH was culturally institutionalized as the producer of hospital accreditation. When Mr. Ullman asked about the delegation of authority to accreditation organizations, Secretary Ribicoff stated that he would not interfere with their decisions and welcomed the cooperation with them: "This is a big job. I would give the greatest respect, as I do now, to the joint commission on hospital accreditation. I think they are doing a fine job in America to raise the standards of our hospitals, and I would not look behind their accreditation… because they are aware of the conditions in the States better than are we in Washington" (87thCongress_24_26_27July 1961, 224). To address Mr. Betts concern that the absence of a policing for the system did not acknowledge the "differences of opinion…as to whether or not a hospital should be accredited", Secretary Ribicoff noted that he relied on trusting hospitals and doctors for not abusing the system. Regarding the reliance on private accrediting organizations, he stated: "Somebody has to judge…I do not believe that the Joint Commission on Hospital Accreditation acts capriciously. I believe that these people take their jobs seriously and that the representatives in every State and every locality made up of the AHA, ACP, ACS, and AMA are interested in lifting up the standards of hospital care, and it is my opinion that they would act fairly and properly to make sure that a hospital was an accredited hospital (236).

The argument was that recognizing accreditation meant giving importance to the quality of care in hospitals and other healthcare providing facilities. In his statement to the House Committee on Ways and Means on July 26, 1961, the president of the AHA—Dr. Frank S. Groner accompanied by associate director Kenneth Williamson, mentioned the JCAH was a voluntary organization and urged to keep the provision on JCAH accreditation in the Health Insurance Benefits Act of 1961 (H.R. 4222). These AHA representatives thought "… it would be most unfortunate if Congress passes any legislation which will reduce the quality of care. For instance, H.R. 4222 provides for the acceptance of accredited hospitals without additional proof of standards" (87thCongress_24_26_27July 1961, 250). Dr. Groner also noted that the JCAH and its standards specifically would help address the problem of hospital over utilization by requiring a utilization committee as condition for accreditation (261). Statements of Arthur L. Adams and Zalmen J. Lichtenstein -Secretary and Program Director of the Council of the Golden Ring Clubs of Senior Citizens respectively—used the provision on hospital accreditation within the King-Anderson bill to argue that the bill had quality of care in mind and to oppose the argument that a Federal program would result in lower standards for hospital care (87thCongress_28_29Jul_1_2Aug 1961, 609).

The reliance of Medicare on standards set by private accrediting organizations and specifically the JCAH of which the AMA was a founder organization, diluted its opposition to the Medicare program because it weakened its delineation of the program as government intervention. Hearings from early on made visible that the AMA concerns had no base and were not supported by the majority of doctors. In his statement Dr. Allan M. Butler, past chairman and member of a national organization of private practice physicians established to discuss proposals for improvement, availability, efficiency and quality of medical care presented evidence from different polls of doctors showing that they did not support the AMA opposition to the financing of care for the aged under the social security system (87thCongress_28_29Jul_1_2Aug1961, 1121-3).

Accreditation was presented as a way of respecting professional authority and autonomy by maintaining the principle and practice of self-regulation. The JCAH was recognized as the main source of accreditation in the Medicare statute, but the accreditation program of the American Osteopathic Association (AOA) also received a possibility of recognition. In his statement, the chairman of the Council on Federal Health Programs of the AOA at the time—Carl E. Morrison-noted that State and Federal agencies had also recognized AOA accreditation (87thCongress_4Aug 1961, 2224). However, the Medicare proposal that was being discussed in 1964 hearings on *Medical Care for the Aged*-the Hospital Insurance Act of 1963 (H.R. 3920)—mentioned automatic eligibility to the program was given only to hospitals accredited by the JCAH. In his testimony Dr. Morrison of the AOA asked that the eligibility be extended to osteopathic hospitals accredited by the Committee on Hospitals of the AOA. He made a very clear demand to be given the same status as the JCAH: "Specifically, we respectfully request that immediately following the words "joint commission on accreditation of hospitals," lines 2-3, page 30, insert the words: "or by the Committee on Hospitals of the American Osteopathic Association"" (88thCongress_1964, 2373).

The AOA's recognition in the final Medicare statute did not recognize its accreditation program equally to that of the JCAH. It was partly a way to counter arguments such as those

Hon. Edwin R. Durno—a representative in Congress of the State of Oregon and a doctor himself—that even with accreditation the government's proposal H.R. 4222 would be unfair to minority groups within the health professions as it did "not recognize osteopaths, chiropractors, and other members of the healing arts" (87thCongress_2_3Aug 1961, 1603). It was left to the Secretary of the HEW to decide on whether the possibility of relying on the AOA or other accrediting organizations could help meeting conditions of participation in Medicare (see exact wording above in 89thCongress_HR_Mar 1965, 171). Because of the strong vocal support of the AHA for the JCAH as the main provider of accreditation, it was given a higher status than the AOA accreditation program in the final Medicare legislation. Statements form representatives of the AHA always specifically supported the JCAH accreditation arguing that it is "desirable and helpful" (statement by Dr. Wilson in 88thCongress_18_10Nov 1963, 36). The JCAH standards and accreditation in hospital care in 1964 were generally seen as "well established, generally accepted, and notably successful" (88thCongress_20_22Jan 1964).

Another important and neglected reason for the legal incorporation of the JCAH—not just any accrediting organization—was the AHA lobbying efforts to involve intermediaries i.e. insurance companies in the implementation of the Medicare program. Though there is no record from the JCAH's minutes and publications at the time on how exactly its name was included in the Medicare legislation (Brauer 2001, 54), congressional records show that the role of JCAH standards and accreditation increased side by side that of private health insurance providers—mainly Blue Cross—in Medicare, owning a lot to the AHA. The AHA worked to establish a good relationship with the Johnson administration and it was among Medicare supporters[166] (Weeks and Berman 1985).

[166] The supporters of Medicare were labor unions, churches, the American Public Health Association, as well as several prominent physicians that formed the Physicians'

The AHA began collaborating with private insurance companies like Blue Cross since the beginning, producing studies the diagnosed the unique problem of the healthcare provision to the elderly (Weeks and Berman 1985, 82). Several insurance companies during the Kennedy administration tried to address themselves the problem of elderly care, developing their own low-cost insurance for persons 65 and over. Walter J. McNerney—president of the Blue Cross Association (BCA) in 1961, noted that their initiatives were not received well and interpreted as "an effort to solve the problem naively, throughputs the private sector, undercutting, if you will, the legislative process (McNerney 1984 in Weeks and Berman 1985, 83). Daniel W. Pettengill with the Aetna Life Insurance Company from 1937 to 1978 and a leader within the commercial insurance industry on health policy issues, argued that after the landslide victory of President Lyndon Johnson in 1964 "the fact that the insurance industry was doing something constructive for the elderly was just lost on the Congress" (Pettengill 1984 in Weeks and Berman 1985, 84).

The Johnson administration introduced the King-Anderson Medicare bill to Congress as H.R. 1 and 5.1. The AMA quickly resisted by presenting an alternative bill to Medicare called "eldercare", which aimed to use federal and state grants to subsidize private health insurance for the elderly. Another alternative to Medicare was a bill introduced by John Byrnes (R-Wisconsin) in the House of Representatives, latter doubled as "better care". It asked for federal subsidies to subsidize the private health insurance for Social Security beneficiaries (Weeks and Berman 1985, 90; Corning 1969; Anastos 2011; Cohen and Ball 1965). Mills -was able to make use of both those plans in making the Medicare legislation, through a "three layer approach" (Mills 1984 in Weeks and Berman 1985, 91).[167] Regarding the use of private insurance -intermediaries- to

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Committee for Health Care Through Social Security (Weeks and Berman 1985, 81).

[167] "The top layer was the Byrnes payment plan for the physicians. The middle layer was for hospital care, financed by payroll taxes and employer taxes. The bottom layer represented an enhanced Kerr-Mills program for the low-income and indigent, or Medicaid, as it became known." (Weeks and Berman 1985, 91).

administer Medicare, Mills recognized it was meant to soften the relationship between doctor and government and Cohen saw it “as a way of building the relationship between the public and private sectors” (99).

The idea to administer Medicare through intermediaries and specifically through the Blue Cross Association (BCA) came out of the AHA. The AHA was against the active administration of the Medicare program through Social Security. Kenneth Williamson—former director of the Washington Serve Bureau of the AHA—stated that “the role Blue Cross had in Medicare I negotiated. The intermediary was *my* idea… I have heard all sorts of talk about how Blue Cross worked in developing this role. Hell’s bells, they had nothing to do with it! …The arguments favored Blue Cross, fit the times, and I was able to sell it” (Williamson 1984 in Weeks and Berman 1985, 100). As James Hague—former director of publications and corporate secretary of the AHA—put it about intermediaries: “We fought for them and won” (Hague 1984 in Weeks and Berman 1985, 99). Hearings on Medicare legislation also indicate the strong support of the AHA for Blue Cross, which would mostly accompany the AHA statements on accreditation and the JCAH (for example, see 87thCongress_24_26_27July 1961, 149; 261-263). When officials and lawyers from the HEW were designing on reimbursement rules and formulas with Blue Cross and other private representatives, they relied extensively on exiting reimbursement practices in the private sector, which had been using JCAH accreditation for a long period of time (Brauer 2001, 55).

Reception and aftermath. The “deemed status” authority affected greatly the JCAH-as well as its product and producer work (i.e. organizational identity building). The JCAH saw itself as a victim - surprised and troubled by the role it was given (and supposedly it had not asked for directly). In a 1972 speech, a board member of the JCAH—Carl Schlicke—stated that “JCAH was catapulted on the national scene and cast into an entirely new role as a quasi-public licensing body”. For Porterfield, this also meant that the JCAH was seen to have an obligation to the public even though it was not funded by taxes. The legal incorporation of JCAH and its accreditation in the Medicare legislation was perceived to be “a burden” “sudden and almost without warning”. However, as Brauer (2001, 55) correctly puts it “no one asked to be relieved of that burden” of greater public accountability and criticism that legal incorporation created. Mostly because everybody recognized that the “deemed status” increase the JCAH prestige, influence, and power (Brauer 2001, 55; Jost 1983).

Some view the 1960s legislation as transforming the JCAH into a quasi-governmental organization in that it had to get greater government oversight and increasing public examination, and face pressures towards more disclosure and accountability. The increase in public members on its board (to six in 2001) is a reflection of this trend however its corporate structure had very few changes - though it has tried to have representatives from different professionals it has added only one—the American Dental Association in 1979—as a corporate member, despite the expansion of its services and activities covering many different kinds of healthcare organizations (JC history 2017?).

The legal recognition in Medicare in 1965 and the increasing litigious environment in the mid 1960s also led the JCAH to revise and clarify its standards and do much more product work. It helped the JCAH revise its hospital standards and also expand quickly into offering accreditation for other kinds of healthcare organizations beyond hospitals (Brauer 2001, 62-64; Jost 1983). In 1966, the JCAH attempted to get HEW to give it deemed status for its new long-term care program, but it was rejected. The JCAH became essentially a codifier of standards already established by leaders in the healthcare field and an “effective, objective and helpful” consultant of hospitals and other institutions (Brauer 2001, 56).

Some of the major challenges to the JCAH and its accreditation emerged from the government and also consumer groups. In 1967, a notorious advisory group to Medicare -the Health Insurance Benefits Advisory Council (HIBAC)—criticized harshly the JCAH and its initiative to revise its standards (Jost 1983). The group called for federally established standards, arguing that JCAH standards and their implementation were inadequate on health and safety conditions in hospitals. Porterfield—the JCAH commissioner at the time tried to address these emerging concerns and face the challenges by introducing ‘survey teams’ made not only of physicians but also nurses or administrators, and shortening the survey cycle from three to two years (Brauer 2001, 57). The Social Security Amendments of 1972 were another response Congress gave to JCAH accreditation reliance. It increased the authority of the Secretary and the HEW—giving them authority to establish own government standards, and validate JCAH accreditation decisions through ‘validation surveys’ based on random or reported complaints. The government agencies would be also able to decertify organizations if they failed to comply with federal regulations. The legislation would act as a quality and utilization peer review program for Medicare and Medicaid financed hospital care (Jost 1983).

In the private sector, there was also rising awareness and concern about the JCAH “deemed status”. A Professional Standards Review Organizations (PSRO’s) emerged that challenge the dominance of the JCAH regarding hospital regulation. These organizations operated independent of the JCAH and even duplicated some of the its quality audit procedures. Till the mid 1970s, there was growing consumer awareness and more pressure to change the role of the JCAH in the Medicare program (Schlicke 1973, 382-3). The JCAH met with consumer groups that had around

25 demands for opening up the accreditation process and changing standards so that they included more consumer involvement, and gave greater possibilities to the poor (Jost 1983; Brauer 2001, 58-9). The press criticized the JCAH, calling it the “hired hand” of hospitals or portraying the organization as an “elite”, “private” “secretive” organization that was only accountable to its corporate parents, and not to the public (Brauer 2001, 61).

Another instance of how the legal incorporation of the producer in the Medicare legislation affected the JCAH was the one when consumers’ groups sued the HEW for delegating authority for Medicare accreditation to the JCAH, arguing that it was unconstitutional (Jost 1983, 855). Legislative proposals in the 1970s - especially a bill introduced by Senator Edward Kennedy- for an independent federal commission for accreditation were challenging for the JCAH (Brauer 2001, 61). In 1972, the secretary of HEW—Abraham Ribicoff—was given authority to establish standards that exceeded those of the JCAH, somehow making one think the accreditation product and its producer were facing challenges of being de-institutionalized (62).

Evidence of successful political and cultural institutionalization of the product and the producer of accreditation

The establishment of the Joint Commission on Accreditation of Hospitals - as an ‘independent’ specialized organization on accreditation representing a broad professional consensus and bringing together different professional groups and interests within the healthcare sector - reflected the success of the political institutionalization of the accreditation product. In 1951, the accreditation program was transferred to the JHAC just because the ACS could not afford it. The AHA was the initial proposed beneficiary for the accreditation program - where the

ACS leadership first went to with the transfer proposal. Its transfer had also an important political message.

The expansion of JCAH accreditation beyond the hospital field looked “logical and proper” in the early 1960s. As Russell A. Nelson of the AHA had observed in 1962 after he became board chairman, the JCAH “had succeeded in winning acceptance”, accrediting nearly “70 percent of eligible acute general hospitals in the country”. Accreditation had become widespread in the healthcare field to a large extent thanks to the JCAH example and leadership, growing independently of the Commission in many specialized areas. For example, the College of American Pathologists and the American Association of Medical Clinics had established their own voluntary accreditation programs for clinical laboratories, while there were some regional efforts around accreditation of skilled nursing homes and residential care facilities (Brauer 2001, 48).

The expansion of the products the JCAH began to offer and extension of the accreditation product into other kinds of healthcare organizations beyond hospitals also indicate that the political institutionalization of the product resulting from the legal incorporation in legislation in the 1940s was successful. The JCAH presented itself as a standard-setter, an educator and a consultant, especially having gained financial independence since the beginning of their new financing model through fees for surveys.

The JCAH expansion was seen as an act of offering, sharing of “its prestige, experience and expertise in order to encourage a more rational and effective approach for the accreditation of health facilities and services” (citing John Brewer, a veteran ACS commissioner, statement in a 1971 article, Brauer 2001.48). While some welcomed this expansion as a well-intentioned act, others saw it as an expression of arrogance of doctors and hospitals. The expansion, however, started shortly after Porterfield became director of the JCAH, in August 1965, when the board expressed intention to start an accreditation program for extended care facilities.[168] Initially, standards for the extended care facilities were adopted from the programs that already edited in the field.[169] The JCAH extended care program also known as the long-term care program began in January 1966. A year later another program on accreditation of rehabilitation centers, sheltered workshops and organized programs for the homebound began to operate out of the JCAH offices.

Throughout this product expansion, the JCAH was more involved in doing producer work - showing itself to be an organization aimed at consulting and educating hospitals during their survey, and leading as an impartial balanced representative of the healthcare field (Brauer 2001, 49). In an effort to maintain its position in the field of accreditation, it expanded its board to include representatives from the American Association of Homes for the Aging, and one from the American Nursing Home Association.[170] It also grew using a contractual relationship model like the one it established with the Commission on Accreditation of Rehabilitation Facilities (CARF) to offer accreditation services in 1967 for rehabilitation centers, sheltered workshops and organized programs (Brauer 2001, 51). The JCAH established "categorical councils" in order to work with healthcare organizations other than the acute care hospitals, which were to contribute 10 percent of their gross survey fee income to its new division of research and education (Brauer 2001, 52).[171]

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[168] The work of JHAC to set standards for the extended care facilities was funded with grants from the Hartford Foundation that came through the AHA (Brauer 2001, 49).

[169] Only in mid 1964 was the JCAH able to start its expansion beyond hospitals. Its member organizations had started their own programs of accreditation for extended care organizations: in 1963, the AMA and the American Nursing Home Association had started a new accrediting body for nursing homes apart from the JCAH. The AHA also had is own extended care program (Brauer 2001, 49). The JCAH extended care program was financed with fees charged to surveyed institutions, similarly to the model used for hospitals.

[170] In January 1966, the JCAH moved to larger offices, leased by another accrediting organization that terminated with the JCAH's entrance in the field - the National Council for the Accreditation of Nursing Homes.

[171] The Accreditation Council for Services for the Mentally Retarded and other Developmentally Disabled Persons in 1969, the Accreditation Council for Psychiatric Facilities in 1970 and the Accreditation Council for Long

The ability of the JCAH to deal with the risk of de-institutionalization of the producer (and product) in the 1970s and emerge successfully from them, is another indicator of the extent to which legal incorporation of the product of accreditation and the producer of JCAH contributes to cultural and political institutionalization. Though hospitals could get approved for Medicare eligibility using state licensure, a majority used the JCAH route of accreditation. For example, in 1970, 85 percent of hospitals were Medicare certified and 71 percent had JCAH accreditation. The JCAH had become "a known quantity" as doctors and hospitals still maintained a strong voice in it through their professional organizations (Brauer 2001, 55). By 1982, 38 states had relied on JCAH standards or accreditation for the licensing programs regulation regarding healthcare institutions (either by statute, regulation or administrative fiat) and in at least 2 states, there were insurance laws that allowed private health insurance companies to pay only to JCAH accredited facility provided care (Jost 1983, 844). The private healthcare sector also relied extensively on JCAH accreditation: some hospitals had to get accredited to participate in some Blue Cross plans, to gain membership to certain professional organizations, and to get be approved for residency programs (Hair 1972).

Despite consumer complaints about the opaqueness of the JCAH accreditation process and government legislation that tried to reverse the recognition of the JCAH as the producer of accreditation, the JCAH survived and thrived. It revised its standards, expanded them to engulf and codify existing standards in the field, attached to those standards a preamble recognizing patient's rights, and even added public interview within the accreditation process (Jost 1983; Brauer 2001).[172] The JCAH was able to reach a settlement in October 1975 over a case it opened

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Term Care in 1971 and others were some examples. Federal government grants and contracts played a key role in creating the need for such new accreditation services and also helped launch them (Brauer 2001, 51).

[172] In April 1971, when the *Accreditation Manual for Hospitals* that included revised standards and the preamble on patient's rights was published in a loose-leaf binder, demand was so high for them that the JCAH had

against the HEW in 1972 for releasing its accreditation reports and some JCAH deficiency letters to consumer organizations (as part of a Freedom of Information Act request). The JCAH argued that it was a breach of confidentiality for the institutions they served and won the case: the HEW would not release letters or recommendations or comments from the JCAH accreditation reports to the public (Jost 1983; Brauer 2001).

By late 1970s and early 1980s, the battle for the political institutionalization of the producer of accreditation had ended, and the JCAH was the winner. The relationship between the government and JCAH improved: a report from the Government Accountability Office (GAO) supported the continued reliance on JCAH for Medicare certification. Government focused on reconciling discrepancies between accreditation and state licensure programs rather than monitoring and policing the JCAH. Even though there was an increasing number of lawsuits with the JCAH as defendant, questioning its role as a private and public regulator, the JCAH won.[173] This was due partly to its revised standards which became more simple and flexible for accredited organizations, and its changes in the accreditation process - relying more on self-conducted surveys by hospitals (Jost 1983, 859). The Reagan administration also permitted the JCAH to certify nursing homes in the late 1970s, starting a new wave of acquiring deeming authority for the JCAH.[174]

The accreditation program has been at the center of the controversy over the Joint Commission—most well-known for it—because of the complexity of standard-setting—or despite of it. The quality standards of the JC have become widely accepted in the field. Changes

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to reprint them. It also received a three-year grant from the Kellog Foundation to educate the medical and hospital staff on their application. These educational workshops by the JCAH gained popularity to the extent that the JCAH started charging for them (Brauer 2001, 59-60).

[173] For example, there were antitrust cases regarding the exclusion of some non-physician heathcare practitioners form access to hospitals, and a case from patients of a psychiatric hospital that had lost eligibility to Medicare when the hospital lost its accreditation from the JCAH (Jost 1983, 859).

[174] Today, it has the most extensive comprehensive deeming authority in the field of accreditation.

in quality definitions—from measuring stated capability of health care organizations to measuring actual performance—began in the early 1980s. The JC followed trends in other industries when it began to encourage "continuous quality improvement" and adopt a more systems-oriented approach to assuring quality and safety (Brauer 2001, 11). Brauer argues that the JC work on accreditation is generally misunderstood—because it involves so much complexity and has a vitally important role (10). He notes that the process of setting standards involves a lot of negotiations which have become more and more difficult with increasing specialization, sub-specialization, and proliferation of new professional organizations.

Conclusion

This chapter highlighted the process through which the cultural institutionalization of accreditation organizations gave way to their political institutionalization and advanced their regulatory power. It did so by emphasizing the way in which demand for accreditation was created through different venues and different actors: the accrediting organizations themselves, the health insurance industry, professional organizations, and the government agencies. I focused on the decisions to incorporate accreditation in legislation for the healthcare sector and to recognize specialized private accrediting organizations as legitimate evaluators of the quality of hospitals and their provided care. The legal incorporation of ratings and their agencies happened in two stages: the first one during the 1940s and the second one in the 1960s. I argued that political institutionalization was key to establishing the regulatory power of accreditation, and the cultural institutionalization would have not been enough to explain the power of accrediting organizations and their role in the healthcare markets. Furthermore, rather than emphasizing the importance of context and conditions for such development, I underlined the role of actors making strategic decisions as agents in pushing a particular understanding for accreditation and sidelining possible alternatives of evaluating the quality of hospital and their provided care.

Similar to what the previous chapter showed, accreditation was not the only activity of accrediting organizations: they were focused on expanding their activities into new markets and new areas - especially of a consultative and educational nature. They presented their accreditation as voluntary evaluations based on the health professionals interest in improving quality of care for patients, and themselves as reliable experts and professionals independent of political influences that offered advice to hospitals. Different from the period before instances of legal incorporation, hospital accreditation was offered more as a self-standing product whose acquisition required payment by hospitals. Furthermore, accrediting organizations presented themselves more confidently as defenders of public morality and healthcare organizations and their patients' good as a result of their political institutionalization and the increased visibility emerging from more media publicity. The position of the AHA as active lobbyist for industry and professional self-regulation that was able to negotiate with the government agencies, other professional associations, and also private insurance companies, helped the emergence of accreditation and its producer organizations as regulatory mechanisms.

While the 1960s legal incorporation furthered the cultural and political institutionalization of accreditation, the political institutionalization process at the same time could be seen as opening opportunities for the beginning of a process of deinstitutionalization. The public debates and controversies involving accreditation and accrediting bodies made criticisms more accessible to the broader public and alternatives more visible. However, even if it was really the case, the process of deinstitutionalization is expected to take a long time to unfold because not only accreditation decisions were able to become a kind of boundary object, but also accrediting organizations built themselves into a kind of boundary organization that helped collaboration among divergent interests of the providers and consumers of healthcare through a more permanent organizational form.

In order to understand better the future of accreditation and accrediting agencies, one needs to better understand why the 1960s incorporation that happen swiftly and somehow silently through a simple mentioning of a name in a statute gave so much power to accrediting organizations and their accreditation decisions? Why did the nationally recognized accreditation organizations with deeming authority spread so quickly? The story about accrediting organizations we have told so far provides an important part of the explanation. Of course, another part of the story regards the way actors incorporated and made use of the 'deemed status' in future regulations after initial one given to JCAH, and this remains to be carefully researched and examined.

CHAPTER 8

Why and How Rating in Finance and Accreditation in Healthcare Were Legally Incorporated

The Emergence of the Private-to-Public Form of Regulation-by-Information

This chapter concludes that among the explanations offered by the literature on the state regulation of industries—capture theory, interest group theory, and the institutionalist theory—the latest is the most helpful in making sense of the transformation of the mostly privately operated form of regulation-by-information into the increasingly publicly operated one, that is, the emergence of the private-to-public form of regulation-by-information. To reach this conclusion I first evaluate the plausibility and relevance of each explanatory framework in each case (first in healthcare and then in finance). Then, I underline what the most useful explanatory framework would need to acknowledge in order to account more comprehensively for the transformation of regulation-by-information in each case.

The existing institutionalist theory explanations are helpful in understanding the legal incorporation of rating and accreditation and their organizations, that is, the addition of a new public operator identity, but they could be improved to better explain the emergence of the private-to-public form of regulation-by-information. They need to explain the persistence of private operators and the greater extent of regulatory power this hybrid form entails.

I rely on theories of institutionalization to comprehend more thoroughly the private-to-public form of regulation-by-information in both cases. First, I draw up on theoretical pieces on institutionalization and institutional change to put together a framework of institutionalization within which I will make sense of each case. Second, I compare the paths of institutionalization for rating and rating agencies in finance and accreditation and accrediting organizations in healthcare based on the model of institutionalization presented in the previous section.

I concentrate more on similarities of the two paths to institutionalization, as they are intriguing given the differences in the structure and organization of each field. I argue that these similarities in the path of institutionalization of rating and accreditation, and their organizations as regulatory mechanisms lie on the similar ways in which trust and power interact and affect decision-making and the structure of action in each field. Part of my argument is that regulatory power emerges out of efforts to negotiate and manage the divergences within a complex field of organizations and relationships, especially those that involve status or a system of reputations.

In conclusion, I also highlight some important differences in the processes through which institutionalization of the private-to-public form of regulation-by-information in finance became successful and reflect on whether those are due to the sectoral differences—finance versus healthcare—or due to the differences between the system of information management involved in each sector—rating versus accreditation. Furthermore, I discuss the implications of this study for literatures on regulation and institutionalization.

Comparing The Why(s) of the Private-to-Public form of Regulation-by-Information

a. Capture Theory

In the case of regulation-by-information in finance, capture theory does not provide a plausible explanation to the legal incorporation of rating. While the producers of securities and industry insiders like banks and broker/dealers played an important role during moments of legal incorporation, market forces contributed to increasing competition and lower prices within the industry, and there were failures by industry insiders to control the market and prevent their members' practices, they were not the ones to demand such legal incorporation. Initially, they explicitly opposed the 1930s legal incorporation of the rating product. They did not use regulation as a strategic tool, even though they ended up voicing less opposition to legal incorporation in the 1970s.

In the case of accreditation in healthcare, capture theory provides a plausible but incomplete explanation to the legal incorporation of accreditation. Producers of healthcare services, hospitals and other provider organizations as well as surgeons, were important actors during moments of legal incorporation. However, they were not united in demanding regulation to use it strategically for their own benefit, in the attempt to control the industry. Initially, surgeons demanded the legal incorporation of hospital accreditation but not all medical professionals and hospitals supported this move. It was the technological and scientific developments and the consequent opportunities for the profession of surgeons that created more competition and drove the efforts of surgeons in the first phase of legal incorporation in finance. However, these did not happen as a result of the failure of mergers or cartels in enforcing control of the industry, as capture theory would suggest. Furthermore, capture theory does not have room for making sense of insurance firms and health plans' role in the second phase of legal incorporation, that of the accreditation organizations themselves in 1965.

b. Interest Group Theory

In the case of regulation-by-information in finance, interest group theory does not provide a feasible explanation to the legal incorporation of rating. While consumers of securities and industry outsiders were important actors, especially during the second phase of legal incorporation in 1970s, their struggle did not challenge the legal incorporation of rating, but only that of the rating agencies. Political factors such as elections, government changes, and prevalent social issues such as provision of healthcare for the elderly, were an enabling context for legal incorporations. However, legal incorporation of rating and rating agencies was not a compromise mechanism for consumers and industry outsiders in the way interest group theory suggests. Consumers and industry outsiders became increasingly powerful—in terms of numbers and resources, but there was no sign that legal incorporation rewarded consumers and industry outsiders directly.

In the case of regulation-by-information in healthcare, interest group theory provides a reasonable but incomplete explanation to the legal incorporation of accreditation. Consumers of healthcare provider organizations - medical professionals, employers, and individual patients—and industry outsiders—politicians, courts, health plans, regulators, foundations, and the media—were very important actors in the legal incorporation of accreditation, especially in the second phase that recognized specific accreditation organizations. They were powerful and interested in shaping the substance of regulation but they did not all aim to challenge hospital dominance and limit their power, especially surgeons during the first instances of the legal incorporation of accreditation. Moreover, these interest groups were not struggling that much among themselves, as the interest group theory claims. The healthcare provider organizations grew through time, and hospitals maintained their role and importance within the healthcare system. The legal incorporation was partially a compromise mechanism between industry outsiders and insiders, especially in the case of recognizing certain accreditation organizations.

c. ***Institutional theory***

In the case of regulation-by-information in finance, institutionalist theory provides a reasonable and more complete explanation to the legal incorporation of rating. The state, with its regulatory and other agencies, was an important initiator for the legal incorporation of rating and rating organizations. Institutional theory helps make sense of how the professional landscape of the field, how its degree of professionalization, affected the decisions to legally incorporate rating and rating agencies and support them as legitimate solutions to the problem of evaluating securities and their issuers and traders. The driving logic behind the legal incorporation of rating and rating agencies was legitimacy – the attempt to support prevailing principles of rational and just order: the trust in private enterprise and reliance on experts and their experiential local wisdom that has characterized the American state. The legal incorporations became possible in the context of a legitimacy crisis for companies and government as issuers of securities and a questioning of the practices of banks and broker/dealers towards investors, especially the increasing individual investors. Furthermore, this kind of state regulation happened in the context of debates for designing large-scale regulatory reform in finance, an indicator of the considerate capacity of the American state to implement models of order impartially, as institutionalist theory suggests. This kind of regulation was definitely a mechanism for aligning meanings offered by different groups on the nature of the financial system overall.

Similarly, in the case of regulation-by-information in healthcare, institutionalist theory offers a more tenable and comprehensive explanation to the legal incorporation of accreditation and accreditation organizations. The state and its different agencies supported legal incorporation in the context of a legitimacy crisis: the healthcare system' and government's role in helping citizens get the best care, were put into question. Legal incorporation of accreditation and accreditation organizations was an arena of meaning-making, to shape the view of the state, experts, consumers, and their relationships in healthcare.

Most helpful approach to explain the private-to-public form of regulation-by-information

In sum, I conclude that institutional theory on the state regulation of industries provides a more plausible and thorough framework for understanding the emergence of the private-to-public form of regulation-by-information than capture theory and interest group theory. It helps understand the transformation of the operators of rating and accreditation systems into increasingly public entities.

However, I argue that another strand of institutional theory, that on institutionalization, is necessary for fully making sense of the private-to-public form of regulation-by-information. Literature on institutionalization offers explanations for the mostly private nature of regulation-by-information: why these information management systems have remained mostly privately operated for such a long time.

Comparing the How(s) of the Private-to-Public form of Regulation-by-Information: Institutionalization, persistence of private operators, and increasing regulatory power

Institutionalization is an important concept institutional theories offer to understand not just how certain objects and practices move through social spaces, but also how they stick around and reproduce themselves. In an article published in the journal *Sociological Theory*, Jeannette Colyvas and Stefan Jonsson (2011) suggest a framework for studying institutionalization -both as process and outcome, that identifies the objects and the extent to which they stick, the subjects and the extent to which they influence, and the settings through which objects travel. Following the sociological tradition, they consider institutionalization as a process of attaining a social order that reproduces itself and as an outcome of having in place such a self-reproducing order (Grief 2006; Jepperson 1991).

To understand the degree of institutionalization one has to examine the extent to which a practice or structure is incorporated into a social order, can be reproduced without repeated, frequent mobilization, and is impervious to contestation (Scott 2001). A practice or structure becomes institutionalized when it can reproduce itself (Jepperson 1991): by integrating values associated with it into areas of social life that support their use either formally through sanction or enforcement (Stinchcombe 1968) or informally through symbolic, normative and cultural sources (Ruef and Scott 1998), and by being resilient to contestation.

Institutionalization: Beyond legitimacy and meaning, towards embeddedness and practices

The ability to gain legitimacy—an emphasized part of claims about institutionalization—is also not sufficient to indicate and explain institutionalization. Though some source of legitimation such as law or policy may facilitate the adoption of a practice or structure and support its diffusion, it is not enough to institutionalize it. For an entity, acquiring legitimacy - "a generalized assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions" (Suchman 1995, 574 as cited in Colyvas and Jonsson 2011) - matters for its institutionalization, only when it affects the relationship between meanings and practices by linking a recurring pattern of activity to higher-order cultural frames, norms, and rules. Therefore, legitimation has to determine the range of what is permissible to contribute to institutionalization (Friedland and Alford 1991; Scott 2001, 58).

Similarly, becoming part of a system of meaning (Dobbin 1994; Zilber 2006), taken-for-granted, understood as evident, accepted as real or true and "infused with value beyond technical requirements at hand" (Selznick 1957, 17) may not lead a practice or structure to be institutionalized. It is “the embedding of practices or categories in routines and logics of action that are then largely unquestioned” and contribute to their reproduction that matters most for institutionalization (Colyvas and Jonsson 2011, 40).

Comparing the Objects, the Subjects, the Social Settings of Institutionalization: Highlighting alternatives to legal incorporation (remaining private or becoming fully public) and their fate

The Objects

In finance, the objects were the product of rating (for securities and their issuers) and the producers or sources of rating—rating agencies. Both objects stuck, though only the product spread. In healthcare, the objects were the product of accreditation (for healthcare provider organizations and their services) and the producers or sources of accreditation—accreditation organizations. Similarly, both objects stuck, but only the product spread.

The Subjects

The subjects who adopted, influenced or abandoned these objects become visible when we compare the activity of rating and accreditation in each field. In finance, securities or financial instruments more broadly are rated. In healthcare, it is hospitals or healthcare provider organizations that get accredited. Though the accredited entities differ from the rated ones in that they are organizations (composed of people and with greater materiality than the financial instruments), they resemble each other in that they are also products.

Several groups of actors contribute to the production of hospitals (and other healthcare provider organizations) as a product. The first set of producers are those that fund its construction, own the hospital, and direct it like the CEO and the executive board. This set of actors can come from the private or public, for-profit or non-profit sector, and they have greater decision-making power and ability to shape the identity of the product. The second set of producers are administrators and managers. They contribute to the making of the product by facilitating its operation—how it works and holds together as an entity. The third set of producers are physicians and other medical professionals such as nurses. Their work, as individual providers of medical care, shapes the kind of services healthcare provider organizations offer, therefore, the nature of these organizations as products.

The consumers of the hospital or healthcare provider organization as a product are patients who get its services of medical care and who themselves or through other funding sources pay for using the facility. Physicians are also a consumer of the hospital as they use its building, its technology and administrative staff to practice medicine and do their job. These consumers at the same time could be considered a fourth set of producers as their experience of the use and consumption of the product could shape the product itself (especially with the increase of satisfaction surveys for patients and employees). The community where they are located and the characteristics of the population using this product also could have an impact on kind of product it becomes.

In finance, the first set of producers are the issuers[175] of securities (issuers of bonds or sellers of stock). These are the entities that are trying to raise money through the financial market: either through bonds - asking for money to borrow with the promise of repayment—or through stock—offering to sell their shares to those interested in benefiting from ownership of the entity. These decisions are made by the executives or owners of the entities. Bonds can be issued by governments, municipalities, and other governmental entities for public projects, and

[175] The term "issuer" is used only for those offering bonds but I am also going to use it to indicate companies/corporations that sell their shares and sell stocks in the primary market. See Flowers (2016/7) for an explanation of the terms.

corporations (for-profit and non-profit too). Stocks, however, can be offered only by for-profit corporations.[176] The second set of producers are investment bankers and other intermediaries that facilitate the initial offering and buy stocks for the purpose of selling them to make profits from the transaction like brokerage firms and independent broker-dealers[177]. Investment banks also underwrite securities, after evaluating the issuing entity and its financial condition and prospects. By putting their name on these securities they certify their quality and that they can be offered to the public in the financial market. They can shape therefore the nature of the product sold in the market.

The consumers of securities as a product are investors or buyers, who can be individuals from the general public, corporations and financial institutions like investment banks and brokerage firms or financial professionals like broker-dealers. Similar to patients in healthcare, investors through their behavior in the market and their experience with the product may shape the product itself by making it more valued or demanded. The ability of consumers to contribute to the production of securities and bonds depends on the feedback mechanisms and channels of communication that exist between these groups, and this is historically contingent.[178]

In finance, the adopters of ratings were investment houses and bankers, dealers, insurance companies, investors, industrial firms, banking regulatory agencies (like the researchers at the Federal Reserve of New York) and other state regulators. In some cases, the adoption was direct, through the use of the rating form of evaluation, that is the symbols, to make investment decisions and the mentioning of the word in written documents like research, reports, rules or

[176] Though see Lamb (2013) on ways of using the same logic to raise money for non-profits—re-branding the term “Initial Public Offering” as “Immediate Public Opportunity”.

[177] These are broker-dealers that operate as independent contractors, and not as part of an institution either an investment bank or a brokerage firm.

[178] I will elaborate on this latter when I talk about rating agencies and their role -providing an evaluation and evaluative judgement about these products - in the consumer-producer relationships.

regulations. In other cases, like in the early 1930s rating-dependent banking regulations, adoption happened indirectly - through the reliance on manuals and other products and services of rating agencies which ratings were part of. Those that influenced the spread of ratings were statistical organizations and other firms the offered data and statistics as services (the information or knowledge industry), financial media publications industry, the banking and securities trading profession, the courts, municipalities and other bond issuers. Those that abandoned rating -at least formally- were the banking regulators in 1938.

For private specialized organizations as the source or producers of ratings, adopters were the New York Stock Exchange (NYSE), the National Association of Securities Dealers (NASD (today the Financial Industry Regulatory Authority (FINRA)), and the Securities Exchange Commission (SEC). The main influence on the path of this form of organizing ratings were the investment bankers, research organizations, issuers of evaluated securities, most importantly municipalities, and government regulators like the SEC. Except for investment bankers, most of this influence was exercised as challenge to the organizational form of private specialized rating agencies as legitimate source of accurate fair ratings. Municipalities contested ratings given by these private firms as subjective, inaccurate, and political evaluations, and even argued for an alternative source—the government. In a way, municipal bond issuers tried to abandon rating agencies as a source of evaluations for their bonds, but ultimately were not able to do so in the mid to late 1960s. The NYSE and the NASD seem to be formal abandoners, as they removed the reference to specific recognized rating agencies in their rules and documents after 1975. Most probably, this abandonment was not a real one because government regulators through the SEC rules supplanted them with the designation of the Nationally Recognized Statistical Rating Organizations (NRSRO) as the legitimate source of ratings.

In healthcare, the adopters of accreditation were the surgeons and their professional association -the American College of Surgeons (ACS), hospital administrators and their respective association -the American Hospital Association (AHA), the federal regulators and state governments, insurance companies, and other professional associations for physicians and other healthcare professionals (like nursing). The adoption of accreditation as a product was again mostly indirect - through the support for greater standardization. Insurance companies and hospital administrators had the most influence on the path of accreditation of hospitals and healthcare organizations. And there were no abandonments of accreditation as a product.

Regarding the accreditation organizations as producers of accreditation, the adopters were insurance companies, federal and state governments and agencies. Among the influencers were the American Medical Association and some groups of the medical profession, again through challenges to this source of accreditation. These influencers also tried to abandon this particular source of accreditation—a specialized separate organization—but most of them failed to do so.

The Social Settings or Fields

Finance and healthcare are two distinct and separate fields of activity. Nevertheless, they also resemble each other in many ways. The stakes are high in these fields as one deals with human health and the other with the health of the economy. Both fields resemble "coupled systems where errors spread" (Schneiberg and Bartley 2010, 296) in that they involve high risks, are characterized by rapid organizational change, "complexity, plurality of players, a proliferation of regulatory agencies and strategies" (Healy and Braithwaite 2006, S56). The questions of trust—who or what, and when we trust—and decision-making or judgment—how and when we decide to act or not act in a particular way—are similarly central to these fields. Addressing these questions in both cases involves examining the production of different kinds of knowledge and their relationships with each other (for example, how scientific knowledge and experiential knowledge interact or whether these interactions are valued in each field). The processes of rationalization advanced through this fields—medicalization and financialization—have the ability to shape society widely and today even define the late stages of modernity. Therefore, a comparison of the configuration of structures and relationships in each setting could help understand the extent of their impact and their future.

The organization of production or field processes. In finance, there are two kinds of products: financial goods and financial services.[179] Both involve the production and management of money[180], and are aimed at caring for the investor. Banks are one of the oldest and largest institutions that produce both financial goods and also financial services. To issue bonds or offer stocks in the primary market—the initial public offering (IPO), for example, a corporation or any other organization would need the assistance of investment banks.[181] The producers or issuers of securities give different kinds of information -organizational and financial data, statistics, etc.- to these intermediaries, who process them applying their expertise and professional knowledge and produce advice and suggestions for investors who will purchase the securities.

In healthcare, the main final product is care for patients' health. This care is offered by the provider organizations as well as by individual providers - physicians or other medical professionals. Healthcare provider organizations, however, offer intermediary products that

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[179] This article uses the distinction between consumer goods and capital goods by economists to explain that between financial goods and financial services. The consumer goods are those goods purchased to be consumed as they are (e.g. buying an orange to eat) while the capital goods are those goods purchased to be used in making something else that you will not consume (e.g. buying an orange to make orange juice that you will sell in your restaurant).

[180] Though there are many debates and a large literature on the meaning of money and its making (see Polillo 2013 for a review of literature and a conflict theory of money, Carruthers and Ariovich 2010; Carruthers and Kim 2011).

[181] See Mishkin and Eakins 2014 for a simple explanation of the process and the role of investment bankers in issuing bonds and for an explanation for the initial public offering (IPO) through which organizations offer stock for the first time.

‘care’ for physicians[182] and other medical practitioners, not patients directly: laboratory tests, medical records, x-rays, for example, are consumed by physicians, who interpret and use them through the application of their medical and professional knowledge, to make decisions about patents’ health, the diagnosis and their needed care.

Both securities and the product of care offered by healthcare organizations are distinguished from most other products by “credence qualities”: the consumers have to trust professionals as they cannot evaluate the product easily by searching themselves before purchase and also cannot understand and evaluate the experience after the consumption of the product. In both cases, the process of production involves important intermediaries that engage in knowledge or expert work. There are two forms of expert work that are involved in this chain of production: the technical expertise given through the primary producers -issuers of securities (through their accountants and auditors) and hospitals or other healthcare organizations providing care (through medical technicians like radiologists or those working in labs and diagnostic facilities broadly)—and the non-technical subjective expertise given by intermediary producers—investment bankers (or other financial institutions) and physicians (or other individual providers of care). The first knowledge production process is considered to be exact and the second one is considered to be more inexact.[183]

The degree of structuration or the ordering of relations. In finance, the relationship between the primary producer of securities (financial product)—the issuer—and the intermediate producer of securities (financial service)—the (investment) banker—has generally been a tight one. Bankers have had privileges regarding access to information by issuers, exemplified by their

[182] I use the term physician broadly to include surgeons and other specialties too.

[183] The wording here is influenced by a quote from a trade credit man that compared his business to that of medicine “an inexact exact science” (Olegario 2006, 204).

increasing presence in corporation's boards. Banks and bankers were linked to the issuers not only by their role as certifiers of their securities but also as buyers of those securities. Issuer's securities would be sold in the market by investment banks. They were investors in securities of many other issuers. The investment banker's purchase of an issuer's securities was also a signal of their certification, besides their underwriting (for bonds) and support in the IPO (for stocks).

In healthcare, the relationship between the primary producer of care -the hospital or another healthcare provider organization- and the intermediate producer of care—the physician—has historically been a loose one, gradually rising in importance as the practice of medicine and education of physicians became more closely tied to the hospital and other provider organizations. While the existence and growth of hospitals depended on the presence of physicians and other healthcare professionals, the growth and development of the medical professionals was not always dependent on these organizations. They tended to practice independently as individuals, and offered most of their services in patients' homes or in their own home or offices. Physicians and other medical care providers would collect the information they needed about the patient themselves. The increasing role of technology in gathering information about the patient and making diagnosis led to a separation of more technical professions within healthcare and concentrated physicians on the interpretation of information and making of decisions about treatment.

The relationship between investment bankers and investor revolves mainly around the provision of advice and consulting regarding investing decisions. The investor may have a formal relationship with a banker and provide them information regarding his goals and preferences in investing. In return, the investor will receive information in the form of expert opinion that they would take into account in making an investment decision. The physician-patient relationship has a similar pattern of information flow: the patient provides information about his health (current and past) and receives a diagnosis and treatment suggestions from the medical professional (the expert)—that he may follow or not.

The primary producers—the issuer of securities and the administrators of the hospital or another healthcare provider organization—are trying to attract customers—investors and patients respectively. Providing information about themselves is one way to do so: arguing that their products are high-quality and worth purchasing and consuming. However, patients in healthcare can resort to healthcare insurance (plans) to help them bear the costs of purchasing healthcare provision and minimize the risks associated with not getting appropriate care. Investors do not have a similar mechanism to help them invest more and spread the risks of purchasing a certain security from a particular issuer. Structured financial products (that combine more than one issuer) serve that purpose to some degree and banks' underwriting for bonds too.

The authority structure. One indicator of the authority structure that characterizes the relationships between parties involved in the production of securities and hospitals or other healthcare provider organizations (care) is each party's ability to organize. In theory, the ultimate decision of purchasing or not a product lies with the consumer. The investor will get the insurance given by the banker as advice and as suggestion to buy the security (their knowledge product) and decide whether and how to use it—trust it and buy the security or not. Similarly, the patient of a hospital or another healthcare provider organization will hear the diagnosis and treatment suggestions given by the doctor(s) and decide whether they want to accept them and follow them or not. However, customers in both fields have difficulty organizing, not only because they are too heterogeneous as a group but also they are not able to evaluate their experience after the use of the product.

Issuers of securities in finance are also a diverse group that may organize into trade associations depending on their common production activity but based neither on their identities as corporations or governmental agencies nor on their position as sellers of securities. Hospitals and other healthcare provider organizations, however, are generally much more organized: their administrators represented by associations like the American Hospital Association (AHA) and other technical (non-medical) healthcare professionals like the American Society for Clinical Laboratory Science (ASCLS).[184] Nevertheless, the authority of hospitals and other healthcare provider organizations has increased with time, with the increase in profession's reliance on technology and science.

The intermediary producers—bankers and physicians (financial and medical professionals broadly)—constitute the fulcrum of the authority structure in each field. Bankers are organized into associations such as the American Bankers Association (ABA) and generally operate within their organization - the bank. Though they were regulated by these associations, state involvement in regulating bankers grew early on with the emergence of the Federal Reserve System and the Comptroller of the Currency (in the late 1910s), with the 1933 Banking Act that separated commercial and investment banking with the Glass-Steagall provision, and the Bank Holding Company Act of 1956 that brought more oversight for bank holding companies.[185] Bankers constitute a profession in a sense but they do not have the same degree of unity and independence that medical professionals have. Investment banks have analysts, broker-dealers, and financial advisors, among others. They can operate independently, but are mostly working within certain financial institutions, specifically investment banks.

[184] ASCLS began in the 1930s: in 1933 called the American Society of Clinical Laboratory Technicians (ASCLT), in 1936 called the American Society of Medical Technologists and in 1973 as the American Society for Medical Technology (ASMT) (Karni 2017).

[185] See Mishkin and Eakins 2014 for details.

Physicians are organized into professional associations like the American Medical Association (AMA) but also into other forms of private provider organizations like the physician groups and and the independent practice associations (IPAs) (both kinds of physician organizations). Though there are many specialties, the most important division within the medical profession is that between physicians that can do surgery and those that cannot. Both groups are extensively organized and mostly self-regulated. Government involvement in professional regulation has been increasing recently, but generally it consists of state medical boards that grant privileges to practice medicine under their laws with the aim of protecting public's interest. The regulate physicians' work through licensing, evaluation of educational and training institutions, and disciplining of individual medical practitioners (ACP 2012).

Different from physicians, bankers not only evaluate the quality of a security as a product but at the same time they evaluate their security. The evaluation of securities, especially the one about its security, is closely tied with the evaluation of their issuer. Physicians, however, engage in the evaluation of a hospital or another healthcare provider organization as a product only to a certain degree - when they choose to practice medicine in that particular institution or support peers that practice in that particular institution. They evaluate the quality of hospitals or other healthcare provider organizations as a product and to a certain degree the risk involved in practicing medicine in that institution. With the increasing role of technology in medicine, the institutional inability to provide for the necessary technological infrastructure can be risky as it can impact the physicians' practice and even his reputation among patients and peers. Different from bankers though, they do not certify or underwrite hospitals formally and do not engage in "buying" or "selling" hospital care formally in the same sense that bankers do regarding securities or their issuers. Some indirect certification (a kind of underwriting) can happen through physicians' professional associations, but that generally remains broad and in principle rather than specific to the product or producer, and in action, as the certification of bankers for securities.

In healthcare, the market for hospital and HPO-provided care seems to be separate from the one for physician-provided care. In finance, there is more overlap between securities provided by the bank or another financial organization, and those provided by an individual banker or dealer. Similarly, however, ratings helped the individual broker/dealers (that did not have their own analysts but engaged only as sellers and buyers of securities) in finance, and accreditation served the physicians, surgeons specifically, in healthcare. Rating agencies and accreditation organizations affected the authority of individual bankers and broker/dealers, and physicians, without threatening the authority position of banks or other financial organizations and hospitals.

The mutability for institutional reproduction. Mutability in the field and social setting shapes the degree to which reproduction persists and leads to the institutionalization of an object (Clemens and Cook 1999). One way of examining the mutability in a field is to notice the authority embodies in rules and how it changes through time. There are rules that command or prescribe ("musts"), rules that prohibit or discipline through punishment ("must nots"), and rules that allow a range of possibilities ("mays") (Crawford and Ostrom 1995). The transformation of rules, not only in substance, but also in the degree of mutability they allow, shapes the extent to which some objects will spread or stick and the degree of their transformation in form in the process. Colyvas and Jonsson (2011) argue that the form of mutability (i.e. must, must not, or may types of rules) determines whether the diffusion of a practice is consequential i.e. whether the practice takes hold or not. There will be a shift in the form of mutability as the practice takes hold and becomes self-reproducing, in institutionalization.

Both fields experienced a transformation of rules that affected their reproduction: they became more authoritative, broadly changing from “mays” to “musts” and increasing in scope. In finance, rules about rating as a product changed from a “must” rule in 1931 (with the Office of the Comptroller of the Currency (OCC) ruling that all banks carry at cost on their balance sheets only bonds rated in a Baa/BBB or higher rating category and keep others at market value), to a “must not” one in 1935 (with the ruling of the Comptroller that prohibited banks’ purchase of “distinctly and predominantly speculative investment securities” as determined by recognized rating manuals, to a “may” rule in 1938 (when the direct reference to ratings was removed from banking regulations and the banking regulators agreed to apply new common standards for examining banks which gave ultimate authority to bank examiners). The rules about rating agencies as producers of evaluations or ratings were always “musts”, but changed in scope. They were at different levels: in 1971 the NYSE rule specified ratings had to come from “any nationally known statistical service which is recognized by the Exchange” and in 1973 the SEC rule required certain National Recognized Statistical Rating Organizations (NRSROs) as the legitimate providers of standards for determining the market volatility of securities.

In healthcare, rules about accreditation as a product changed from a “may” rule in 1946 (with the recommendation that hospitals receiving funds under the Hill-Burton Act pay attention and meet minimum standards devised by the ACS), to a “must” rule in 1948 (when an amendment made Hill-Burton aid to hospitals conditional on accreditation -demonstrated compliance with minimum standards of maintenance and operation), and another “must” rule of broader scope in 1965 (when the Medicare statute had a provision requiring accreditation as a way of meeting conditions of participation to the Medicare program). The rules about specific accrediting agencies as producers of accreditation were generally “must” rules: in 1965 the Medicare provision specified the source of accreditation— “by the Joint Commission on Accreditation of Hospitals” and it mentioned the possibility that the American Osteopathic Association and other national accrediting bodies could be also given the position of legitimate sources of accreditation for hospitals.

Comparing Stages or Paths of Institutionalization: Recognizing transformation in meaning and form through time

My study, however, identifies and distinguishes two phases of institutionalization: the cultural institutionalization phase and the political institutionalization phase. During the phase of cultural institutionalization, rating and accreditation as products were institutionalized through their incorporation into the existing repertoire of practices of market participants (the investment bankers and broker-dealers in the securities market and the surgeons and health insurance plans in the market for hospital care). The role of individual and organizational entrepreneurship was key at this phase, especially the way in which it navigated and used institutional effects to shape organizational identity and get incorporated in the existing institutional framework.

Till the 1930s, the product of rating in finance spread by association with other products - financial statistics, business and financial reports, manuals or reference books, and advisory and consulting services. Agency ratings were generally part of manuals and other advisory reports. They were not independent publications you could subscribe to and use independently outside of the other products and services of rating agencies. Till the 1940s, the product of accreditation was similarly developed as a result of standardization and spread because of its relationship to this process of developing and adopting and following standards (through the American College of Surgeons' work). That is why the initial legal incorporation of the ACS accreditation happened in the form of a requirement to follow a minimum standard.

During the phase of political institutionalization, rating agencies and accrediting organizations as producers of evaluations gained more spotlight and faced contestation leading to the envisaging of alternative sources of evaluation. These organizations used this publicity and contestation to defend their claims of independence and their right to make judgment and give opinions about organizations and their product. They drew attention to greater problems, especially the economic and political implications of technological development for the state and society, to dilute their own responsibility on contested issues. They used their politicization to deepen their incorporation in the existing social setting: establishing connections with the different parties involved in contestation.

In finance, rating agencies became publicized and politicized as a result of their rating actions on bonds issued by municipalities and states. Their decisions -mainly downgrades- were contested and they were asked to be more accountable and transparent, threatened even by a governmental investigation of rating agencies overall and the suggestion for building an alternative private research organization financed by all interested parties as the source of ratings for municipality bonds. Rating agencies used the increasing awareness of their role and power that publicity created, to defend themselves and strengthen their claims of independence, impartiality and professionalism. They projected their issues as similar to the issues other agencies had at the time—governments included: inability to incorporate technological advances into their practices. Thus, they justified their decisions based on the insufficiency of their material, technical, and financial capacity, diverting attention from the claims of subjectivity, partiality, and political nature of their rating decisions. Even the Penn Central crisis could not challenge their authority, as rating agencies made changes to their organizational structure and reinforced the message that they were impartial expert and professional organizations trying to do their job—which involved more than rating—better. In the mid 1970s, after the legal incorporation of rating agencies, rating agencies resisted successfully challenges to position as recognized legitimate sources of rating (and implicitly standards for evaluating) securities. Legislation that supported SEC involvement in setting standards for rating municipal bonds failed and court cases against rating agencies after the 1970s always were concluded with agencies' winning.

In healthcare, the Joint Commission on the Accreditation of Hospitals (JCAH) was formed as an 'independent' specialized organization on accreditation after negotiations between different professional groups and interests within the healthcare sector. The transfer of the accreditation program from the American College of Surgeons into the JCAH was politically important as it projected the message of a united front on the issue between administrators and physicians within hospitals, as well as between surgeons and other physicians within the medical profession. Such organizational identity would enable either less government involvement and more room for self-regulation or government involvement that relied on already established self-regulatory or private forms of regulation. In the 1960s, the JCAH legal incorporation was used as a bargaining chip for getting support from different actors -especially the AMA—to pass Medicare. The JCAH seemed surprised by its recognition, but it did not object to it. It used the legal incorporation criticisms and challenges to advance its prestige, status and claim its leadership across the healthcare field regarding accreditation—expanding its activities into the accreditation of other kind of healthcare organizations beyond hospitals. It was successful in overcoming the contestation from the government and also consumer groups with their proposals and attempts to have alternative standard-setting and accrediting organizations. By late 1970s and early 1980s, the JCAH was successfully institutionalized.

Cultural (product) institutionalization advanced political (producer) institutionalization. Political (producer) institutionalization furthered the diffusion of the product (as it changed its meaning) and cultural institutionalization, but also opened the way of the diffusion of the organizational form of the producer of rating and accreditation and resulted in lower-level contestations. The rating and accrediting organizations were generally the winners of these contestations, therefore maintaining and further establishing their record as institutionalized (I.e. self-reproducing) entities.

An examination of the three stages of institutionalization devised by Berger and Luckman (1967)—externalization, objectification, and internalization—supports the conclusion that institutionalization of rating and accreditation as products, and rating and accrediting specialized private organizations as sources of evaluations was successful.

In finance, rating as a product began to be understood as a supplementary and helpful tool for participants in the securities market. They were seen as only a small part of other statistical services and products like the manuals which rating agencies were most known and praised for (externalization). By the 1930s, these shared meanings about rating as a product, created through interactions among market actors and symbolic structures like advertising employed by rating agencies themselves, proliferated and gained the quality of a fact, seen as constituting a commonly shared reality (objectification). By the 1960s and 1970s, ratings were used as tools in the research work of government agencies, and as part of conditional rules of large market participants like the NYSE and latter included in educational material used to train future finance professionals—bankers, insurance agents, securities dealers, etc. (socialization). Ratings rationalized the belief that more information is better in making decisions and minimizing costs of transactions, especially under uncertainty.

Rating agencies were initially viewed mainly as statistical service firms and a version of the credit reporting firm but for financial products. They were latter seen a kind of financial advisory firm. They rationalized the belief that they were a mechanism supporting the self-regulation of the financial industry. Self-regulation was seen preferable to government regulation, and rating agencies were not subject to government regulation at the time (externalization). By the 1960s ratings had become fact-like in that they were considered a respected part of the financial sector. Their existence and their line of work overall was not questioned. Even when they were contested as legitimate sources of ratings, they were valued for their contribution to the already exiting tools in the financial sector for evaluating securities (objectification). With the change in their practices of rating securities, rating them before their issuance rather than after, and especially when requiring payment from issuers rather than subscribers to finance the evaluation of the securities, rating agencies reentered the cognition of firms and became part of individuals work setting (internalization). Rating agencies portrayed themselves as providing information of different kinds—statistical, objective information in the form of manuals but also analytical, subjective summaries or judgments and opinions. With the adoption of the issuer-pays business model for ratings, they considered rating as part of the advisory and consultative services rather than part of the statistical one (which was what they did before). This change in form and presentation of rating made possible the emphasis on these organizations as producers of rating above all.

In healthcare, accreditation was equated with standardization, which meant being progressive and scientific to a large extent, and was considered a familiar term in society. As a product, especially by the 1940s, it meant a tool of advancing professional projects especially those of physicians working in hospitals. The shared understanding among the medical professionals was that accreditation (as standardization) were useful, not only because it enabled the flexibility of professionals among different institutions but also because it minimized the possibility of government involvement in setting standards for them (externalization). Accreditation became a common shared reality for hospitals, especially after the ACS's list of approved hospitals under its program and the creation of a specialized organization with members from the hospital as well as medical professional community—the JCAH (objectification). It became part of hospitals working setting as health plans like the BlueCross (supported by the AHA) began requiring accreditation for hospitals' participation in the plan and as the JCAH expanded its educational and consulting services for hospitals (internalization). Accreditation as a product rationalized the idea that scientific processes help increase the quality of health care provided to patients, therefore it became well integrated in the existing social setting with time and self-reproducing.

The accrediting organization as the source of evaluations about hospitals and their quality was initially understood as a compromise among different interests of the healthcare sector, in particular the hospitals', surgeons' and other physicians' associations. Interactions among these groups led to the JCAH becoming the image and symbol of a somehow united rather than divided sector. In a sense, it rationalized the idea that self-regulation was possible and reliable, therefore, a sound option in the healthcare sector with much more expertise and legitimacy than the alternative of more government involvement in standard-setting and even enforcement of standards (externalization). The way in which the JCAH was created, made this accrediting organization quickly be seen as commonly shared reality for many hospitals and latter other healthcare provider organizations. Most other accrediting organizations were in subfields within the healthcare sector, and no other matched the JCAH in terms of comprehensiveness of the accreditation program. By the mid 1960s, the majority of American hospitals had been accredited by the JCAH (objectification). The accrediting organizations had also become part of the socialization of hospital administrators and medical professionals through their efforts to provide supportive training and consulting to those aspiring to begin the accreditation process or to renew their accreditation (internalization).

Focusing on a Telling Difference: Emphasizing the Role of Context-agency Configurations and Organizations in Transforming Regulation-by-Information

Who pays for rating in finance and accreditation in healthcare?

In the finance case, first, it was subscribers to rating agencies' services for other products—analysis, manuals, and reports—that payed for the rating. It was only an interested audience that paid for it. So, some issuers were rated even when they did not want to be rated, because the product of rating was mainly aimed at supporting consumers (investors) and other interested audiences. This business model changed in the early 1970s, when issuers of securities were asked to pay for their rating by credit rating agencies. With this model of financing their rating activities, rating increasingly targeted producers or issuers of securities—a specific field of organizations—even though it maintained the discourse of serving the public and the consumers (investors) and other audiences interested in evaluating producers (issuers) of securities products and making informed decisions regarding their management.

In the healthcare case, first, it was the professional associations—that of the American College of Surgeons (ACS) specifically—and the accreditation organization—through the corporate association members of the Joint Commission on Accreditation of Hospitals such as the American Hospital Association (AHA), the American Medical Association (AMA), etc.—that paid for accreditations. The accreditation was presented as voluntary for hospitals, representing only an evaluation of the association in an attempt to serve the interests of the consumers of hospital and other organizational provider services—the medical professionals and individual patients. This financing model changed in the 1960s when hospitals and the other relevant evaluated healthcare provider organizations were asked to pay for most of the cost of accreditation. The accreditation was increasingly seen valuable for hospitals and provider organizations in signaling by their quality as producers to all potential customers (patients), employers, insurance firms. The target of accreditation activities was not just the medical professionals but the provider organizations—the organizational context and workplaces of those professionals[186]. Later on, it was also aimed increasingly at consumers—especially individual patients, employers, insurance firms.

The change of the financing model for accreditation in the healthcare case was different from that for rating in the finance case. The former remained focused on professionals and producers, the latter become less targeted on consumers and more focused on producers.

Why financing model changes did not challenge rating and accreditation organizations

The changes in business model—though increased the conflict of interest for the rating agencies and accreditation organizations—could not challenge their existence and their products. One reason was that rating and accreditation were not the only and main work they were doing. In

[186] Later, accreditation changes in form—into quality reports and even ratings for hospitals and other healthcare provider organizations—to increasingly target consumers of provider services—especially individual patients and employers.

both cases, rating agencies and accreditation organizations were involved in consultancy work and therefore had great alternative sources of revenue from other activities. Another important reason for their resilience was their relationship with professional communities and experts in each field, which supported them as 'of their kind'—not challenging their independence and contributing to self-regulation. Furthermore, the lack of more credible alternatives by the state and its reliance on rating and accreditation as embodiments of expertise incorporated in legislation contributed to such resilience and overseeing of the increasing conflict of interest involved in these evaluations and adjudications—as they evaluate an organization that pays it.

Discussion

Putting the project in perspective: Contributions to existing academic conversations

This project compared the processes through which rating and accreditation, and their specialized organizations, emerged and gained their regulatory power in finance and healthcare in the United States. As a comparative historical study of rating and accreditation, it provides valuable insights into the nature of what are called today forms of regulation-by-information. My findings suggest that rating and accreditation, and their agencies, gained their regulatory power not only through (implicit and explicit) 'delegation' of regulatory authority from the state, that is, through legal incorporation, but also through efforts of professions and organizations to shape and support them broadly as in the interest of self-regulation. The legal incorporations of rating and accreditation, and their agencies, in finance and healthcare resemble each other as both reflect the evolving relationship between private regulation and public regulation. In both fields, regulation-by-information seems to be just another form of private regulation formalized and empowered by government regulation.

The comparison of the paths and processes through which rating and accreditation, and their specialized organizations, gained their regulatory power and ended up being legally incorporated helps better understand institutionalization and institutional complexity. Colyvas and Johnsson's (2011) analytical framework was helpful to some extent in distinguishing diffusion from institutionalization but their schema was difficult to employ through time. My work suggests that we think of the process of institutionalization in terms of configurations of objects, subjects, and social settings or fields that change through time. While the stages of institutionalization and its phases or processes can be overlapping, considering their temporality matters for better understanding the extent of each influence on the whole process.

Edelman et al. (1999) on the spread of formal grievance procedures as indicators of complying with Equal Employment Opportunity law is a good example of work on institutionalization that takes temporality seriously. The stages of making grievance procedures into rational myths were: first, organizations' response to the law (coercive isomorphism), their modeling of ways to show compliance with the law (mimetic isomorphism), and professions and organizations' efforts to support grievance procedures as a particular form of compliance with the law in courts (normative isomorphism). My research presents another temporal operation of these isomorphic pressures: first, professions' and organizations' efforts to present rating and accreditation, and their organizations, as part of the industry, recognizing them as a useful supplement to the field practices (normative isomorphism); second, the rating and accreditation organizations' presentation of their products as similar to or in line with the existing ones in the field (mimetic isomorphism); and lastly, the way in which rating and accreditation organizations presented themselves and changed their practices in face of contestation from governments and consumers (coercive isomorphism). One contribution of this study then lies in clarifying how moments of legal incorporation are not necessarily the beginnings of a process of institutionalization and not necessarily the origins of regulatory power.

Sociological literature has emphasized rating and ranking as evaluation technologies, and has emphasized the consequences and the context of employing these technologies. However, they have neglected examining how they became such powerful mechanisms that regulate organizations and human lives to such a large extent. In doing so, they have contributed to their myths of usefulness and naturalness. By examining the processes through which these evaluation technologies emerged, became institutionalized, and gained their power, my work illuminates the mechanisms through which these evaluative technologies persist and also suggests venues through which these technologies might change and even lose their tremendous power.

After legal incorporation: whether and how can de-institutionalization happen

The persistence and stability of rating and accreditation, and their organizations, are generally attributed to legal incorporation and also to the conditions of crisis and increasing uncertainty. In this line of thinking, removing references to rating and accreditation, and their organizations, from rules and regulations and field stability and certainty would lead to extensive de-institutionalization of rating and accreditation and their organizations (in a way, the transformation of the coercive isomorphic pressures). However, my research indicates that de-institutionalization of rating and accreditation, and their organizations, depends two other important factors: 1) the way in which professionals and organizations in each field view and consider rating and accreditation, and their organizations (the transformation of the normative isomorphic pressures), and 2) the way in which rating and accreditation as products are associated with exiting products or services in each field (the transformation of the mimetic isomorphic pressures).

The role of professions and private organizations in these fields are very important for the future of rating and accreditation, and their producers. As long as the professionals and organizations in each field support these evaluation technologies and consider them as a way of defending their self-regulatory power and capability, they will be well grounded and integrated in each field, and efforts of contestation would not lead towards de-institutionalization. The extent to which governments and states rely on self-regulation and believe in not questioning private sector and professional 'wisdom' will also affect the success of de-institutionalizing events, especially in times of crisis. Nevertheless, the ability of the professional and organizational community to defend their self-regulatory power would define the fate of de-institutionalization efforts.

In this context, the fate of rating and accreditation, and their organizations, depends to a large extent on the fate of other products or services offered in each field, especially the role of educational, consulting and advisory services in each sector. The process through which rating and accreditation as products was institutionalized was one of institutionalization-by-association: it spread and became incorporated in the field by positioning itself as a useful addition and derivative of other products—the credit reporting business, manuals, and advisory services in finance, and standardization and educational as well as consulting services in healthcare. It was the product work as part of the organizational identity building efforts of rating and accreditation organizations—showing their product as complementary optional though useful tool in the existing repertoire of market actors—one of the many other existing tools—not challenging or competing with any of them—that contributed to its durability and silent integration. Therefore, one would not expect the use of rating to diminish and ratings to be de-institutionalized unless the other products and services offered in the financial sector are de-legitimized and become less valued and even used in the field.

Therefore, the institutionalization and use of rating and accreditation, and their organizations does not depend on legal incorporation. Legal incorporation helped it spread and get integrated more broadly, but it did not begin or even constitute the basis of the durability and stability of the process that is of the institutionalization outcome. That is why steps to reverse the legal incorporation of rating would be insufficient in de-institutionalizing the practice of rating and its use. An early example of this process was the dropping of the reference to rating in the banking sector regulations in the mid and late 1930s: they were not de-institutionalized as their use persisted together with the implied understanding that they were useful and acceptable tools for evaluating securities and specifically bond quality among market actors, though there was not any evidence of their superior performance.

Conclusion

This study took seriously and conceptualized the variety of regulation-by-information, as well as examined and explained its transformation through time in two distinct major fields—finance and healthcare—in the United States. It highlighted the emergence of a new quasi-hybrid form of regulation-by-information—what I call the private-to-public form—characterized by the change in the identity of the operator of the information management systems involved—from being mostly private to becoming increasingly public.

I conclude that institutionalist theory can offer more comprehensive and plausible explanations to the transformation of regulation-by-information and the emergence of the private-to-public form than capture theory and interest group theory. As I expected, the private-to-public form is highly institutionalized in both fields. The process and extent of institutionalization accounts for the substantive regulation power and institutional resilience of the form in both fields. The transformation of the operator of the rating and accreditation system of information management was key in changing the meaning of these systems: not as just helping consumers—investors and physicians, patients, employers, health insurance firms—but also as assisting producers—issuers of securities and healthcare provider organizations—to sell their products—securities and hospital services—and get more consumers. Therefore, this transformation indirectly regulated the field of producers, not as it was intended to do.

This study calls for more research on the transformation of regulation in meaning and form. The existing literature tends to examine specific forms of regulation and take for granted their regulatory power and nature, instead of explaining its emergence. What is the relationship between self-regulation, government regulation, and regulation-by-information in time? Institutional theory can be helpful in devising a better framework for studying regulation and its variety sociologically, and gradually moving towards a sociology of regulation.

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APPENDIX: Figures and Tables

Figure #1. Components of Regulation-by-Information (based on description provided by Schneiberg and Bartley 2008)

Actors/Features	Who they are	What they do
Operators of the System	Organizations - Private - Public - *Private-to-Public**	Collect/Gather information Process information Present information Do not specify sanctions
The Targeted/Regulated by the System	Organizations Individuals	Disclose/Provide information about themselves to operators of the system Use information processed by operators of the system - To understand themselves and change their behavior - To communicate with stakeholders and the broader public, especially the consumers of their products and services
Consumers of the products and services (Clients/audiences) of the Targeted/Regulated by the System	Organizations Individuals	Use information processed by operators of the system - To make decisions about their behavior towards the targeted/regulated by the system i.e. the producers of the products and services they consume

**My contribution to the Schneiberg and Bartley (2008) proposed description/conceptualization*

Figure #2. Regulation-by-Information Compared to Other Typical Forms of Regulation

Form\ Components of Regulation	*Creation of Standards*	*Creation of Enforcement Mechanisms*
Self-regulation	Producers (through associations or other forms of organization)	Producers (through associations or other forms of organization)
Command-and-Control Government Regulation	Government/State (through legislation, regulations, or rule-making through government agencies)	Government/State (through legislation, regulations, or rule-making through government agencies)
Regulation-by-Information	Producers OR Government/State	Consumers/Clients/Audiences

Figure #3. Forms and Features of Regulation-by-information by Processes involved in the System

System\Operators' Information Work	*Information gathering*	*Information processing*	*Information presentation*
Disclosure	- extensive - self-report through questionnaires or other reporting media (e.g. survey) - more specification of information considered relevant	- limited - specifying report content - implicit standards - limited formal evaluation and adjudication	- limited - providing venues for direct access to collected information - to certain interested audiences
Rating	- extensive - publicly available information, formal self-reports (surveys/questionnaires) informal disclosures and investigations - less specification of information considered relevant	- extensive - formal and informal analysis and evaluation of collected information - adjudication based on implicit and explicit standards	- considerate - providing summary reports (with varying degrees of length/condensation) and standardized symbolic form - to interested audiences (and evaluated organizations)
Certification	- extensive - formal self-reports (surveys/questionnaires) and on-ground formal investigations - most specification of information considered relevant	- extensive - formal analysis and evaluation of collected information - adjudication based on mostly explicit standards and an explicit threshold	- considerate - providing a summary detailed report, a certificate with symbol for being above threshold - to evaluated organizations (and indirectly to interested audiences)
Ranking	- considerate - publicly available information, formal self-reports (surveys/questionnaires) - more specification of information considered relevant	- considerate - formal analysis and evaluation of collected information - adjudication based on mostly explicit standards	- extensive - providing standardized summaries/ratings and an overall ordinal position/classification - to most interested audiences

Figure #4. Examples of Regulation-by-information Studies by Treatment of Operators of the (Information Management) System

Form\Operator through Time	*Remaining Mostly Private*	*Remaining Mostly Public*	*Transforming from Private-to-Public*
Disclosure/Reporting	X Olegario 2006	X Fung et al. 2010	
Rating	X Cohen 2012		X Carruthers 2013
Certification	X Seidman 2007		X Bartley 2007
Ranking	X Espeland and Sauder 2016		

Figure #5. The Distinctive Features of Each System of Information Work/Management

System\Operators' Information Work	*Information gathering*	*Information processing*	*Information presentation**
Disclosure	**- self-report through questionnaires or other reporting media (e.g. survey)**	**-** evaluation and adjudication based on **mostly implicit standards**	***[limited]*** **-** providing venues for **direct access to collected information** - to certain interested audiences
Rating	- **publicly available information, formal and informal disclosures and investigations**	- evaluation and adjudication based on **implicit and explicit standards**	***[considerate]*** - **a standardized symbolic form** **- to interested audiences** (and evaluated organizations)
Certification	**- formal disclosures and investigations**	- evaluation and adjudication based on **mostly explicit standards** and **an explicit threshold**	***[considerate]*** - **a certificate with symbol for being above threshold** **- to evaluated organizations (**and indirectly to interested audiences)
Ranking	- **publicly available information,** formal disclosures	- evaluation and adjudication based on **mostly explicit standards**	***[extensive]*** - providing standardized summaries/ratings and **an overall ordinal position/classification** - to most interested audiences

Figure #6. Forms of Regulation-by-Information by Extent of Information Work Involved (evaluation, adjudication and judgment exercised by operators of the system)

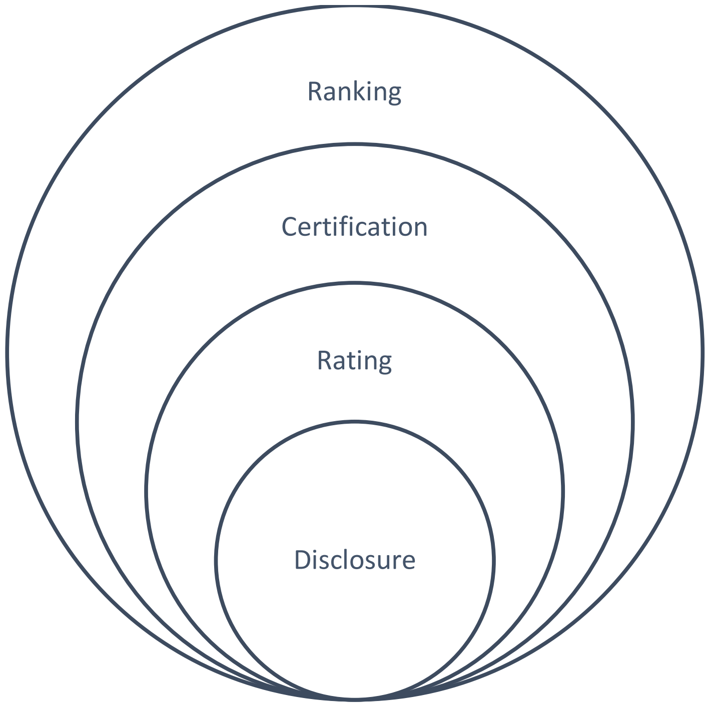

Figure #7. Forms of Regulation-by-Information on a Spectrum of Public Visibility or Audience Reach (from least to most public/visible to consumers of products/services offered by regulated) [note how it depends on the role of the media and links with the public]

Least Public Visibility
Smallest Audience Reach
Least Anxiety Producing

Most Public Visibility
Greatest Audience Reach
Most Anxiety Producing

Figure #8. Approaches to Explaining the Emergence and Transformation of Regulation-by-Information (based on Schneiberg and Bartley's (2001) work on industry regulation in the US)

Features\Approaches	***Capture Theory***	***Interest Group Theory***	***Institutionalist Theory***
Key Actors	Producers (Firms) Industry Insiders	Consumers Industry Outsiders	The State Professions/experts Other institutional structures and dynamics Organizational fields
Driving Logic	Market forces Intra-industry dynamics (of competition and collective action) Firms' interests	Struggles among interest groups	Legitimacy (alignment with prevailing principles of rational or just order and its resulting positive evaluation, credibility, or certification) Normative, coercive, mimetic isomorphism
Enabling Context	Market conditions Failure of mergers or cartels, in enforcing control of industry	Political factors	Legitimacy crises (created by firms' market control activities, overall questioning of market order) State capacity to implement models of order impartially
Understanding of Regulation	Strategic tool	Rewarding/compromise mechanism	Meaning-making (alignment) mechanism/arena Opportunity for alternative models
Role of Politics	Firm-dominated To allow capture by following, affirming and supporting producers	Contender-dependent To enable challengers to firm dominance To threaten corporate dominance and limit its power	Contest-enabling Game/Rule-defining or status-changing To process meanings offered by professionals, experts, or public authorities like courts, states
View of Consumers (and other Industry Outsiders)	Powerless (especially in terms of having low resources or stakes) Unable to organize Interested in *no* regulation	Powerful (especially in terms of having high numbers and resources or stakes) Able to organize Interested in shaping substance/content of regulation or just *oversight* regulation	Institutionally/context-dependent (enabled or constrained) Role in producing controversy and crisis (changing regulatory environment)

Figure #9. Regulation-by-Information in Finance

Actors/Features	*Who they are*
Operators of the System	Credit rating agencies Private for-profit firms Legally incorporated in government rules and regulations since 1975
The Targeted/Regulated by the System	The issuers of securities
Consumers of the products and services (Clients/audiences) of the Targeted/Regulated by the System)	Investors - Institutional (e.g. investment banks) - Individual (e.g. broker/dealers in securities)

Figure #10. Regulation-by-Information in Healthcare

Actors/Features	*Who they are*
Operators of the System	Healthcare organizations accreditation organizations Private non-profit firms Legally incorporated in government rules and regulations since 1965
The Targeted/Regulated by the System	The provider organizations of healthcare services (e.g. hospitals)
Consumers of the products and services (Clients/audiences) of the Targeted/Regulated by the System	Medical professionals (e.g. physicians, surgeons) - Employers (corporations or government) - Individual patients