



EUROPEAN CENTRAL BANK

EUROSYSTEM

ECB-PUBLIC

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60, rue Wiertz

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Frankfurt am Main, 26 October 2018

L/MD/18/350

Re: Your letter (QZ-065)

Honourable Members of the European Parliament,

Thank you for your letter, which was passed on to me by Mr Roberto Gualtieri, Chairman of the Committee on Economic and Monetary Affairs, accompanied by a cover letter dated 23 July 2018.

As I already had the opportunity to explain to your honourable colleagues Mr Burkhard Balz and Mr Brian Hayes in separate letters dated 17 June 2015 and 10 April 2018¹, respectively, the Eurosystem credit assessment framework (ECAF) defines the minimum credit quality requirements for collateral to ensure that the Eurosystem only accepts assets with adequately high credit standards. This framework, which has been established under the operational independence that is granted to the Eurosystem, enables the Eurosystem to fulfil its statutory obligation to conduct credit operations only against adequate collateral.² The ECAF also forms the basis of the minimum credit quality requirements for outright purchases.

As you correctly point out, the ECAF accepts information from four different types of credit assessment systems: external credit assessment institutions (ECAIs), national central banks' in-house credit assessment

¹ Available at https://www.ecb.europa.eu/pub/pdf/other/150618letter_balz.en.pdf and https://www.ecb.europa.eu/pub/pdf/other/ecb.mepletter180426_Hayes.en.pdf, respectively.

² See Article 18.1 of the Statute of the European System of Central Banks and of the European Central Bank.

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systems (ICASs), banks' internal ratings-based (IRB) systems, and rating tools (RTs). ECAs' ratings predominantly determine the eligibility of mobilised marketable assets, while ICASs and IRB systems are the main sources of assessment for the remaining mobilised assets, which mainly refer to non-marketable debt. RTs play a very marginal role.

There are several criteria for accepting credit rating agencies as ECAs³ under the ECAF, which are designed to ensure that the ECAF is implemented efficiently and to protect the Eurosystem against financial risks. These criteria include (a) that ECAs must be registered by the European Securities and Markets Authority, in accordance with Regulation (EC) No 1060/2009, and (b) that ECAs must fulfil operational criteria and provide relevant minimum rating coverage. Prior to the minimum coverage requirements being clarified in January 2016⁴, criteria for accepting credit rating agencies as ECAs under the ECAF already applied and included the requirement that ECAs must provide relevant coverage. The Eurosystem takes its decision on whether to accept an ECAI on the basis of a comprehensive due diligence assessment.

All ECAs have to comply with the acceptance criteria, including the minimum coverage criteria, on an ongoing basis. This is reviewed by the Eurosystem, for example, in the annual analyses of ECAs' performance on the basis of rating data that they submit. The Eurosystem analyses any breaches of the minimum coverage requirements and may request that the relevant ECAI rectifies them or decide to temporarily suspend or exclude the ECAI in question. An ECAI, or any other credit assessment system, may be excluded if it fails to comply with the acceptance criteria or other ECAF rules and procedures.

The minimum coverage requirements⁵ under the ECAF have been designed with the following objectives in mind. First, they show market acceptance of the ECAs' assessments. Second, the large number of covered countries⁵, asset classes and issuers ensures that ECAs have a broad credit risk expertise, which is necessary to be able to effectively assess the risk of complex finance products. For example, rating structured finance products requires a robust credit assessment of the counterparties involved in the transactions, which also calls for credit expertise in financial institutions. Third, such diversified coverage ensures that ratings are comparable and mutually consistent between countries, asset classes and issuers. Fourth, the requirements ensure that a sufficiently large sample of rating data is available to the Eurosystem. This helps the Eurosystem to ascertain whether the ECAI has an adequate performance track record and to

³ See Article 120 of Guideline ECB/2014/60.

⁴ The clarification was published on 22 January 2016, following a decision by the Governing Council on 30 December 2015. See <https://www.ecb.europa.eu/press/govcdec/otherdec/2016/html/gc160122.en.html>.

⁵ The minimum coverage criteria stipulate the range of rated assets and rated issuers, and the volume of rated assets that an ECAI needs to cover as a minimum. See Article 120 and Annex IX (a) of Guideline ECB/2014/60 and, for more information, the box entitled "Eurosystem publishes more detailed criteria for accepting rating agencies", *Economic Bulletin*, Issue 1, ECB, 2016, available at <https://www.ecb.europa.eu/pub/pdf/ecbu/eb201601.en.pdf>.

⁶ The rating agency coverage must be diversified across at least two-thirds of the euro area countries with eligible assets.

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map the ECAI's ratings to the Eurosystem's harmonised rating scale.⁶ These criteria differ from those applied to the other credit assessment sources accepted by the Eurosystem owing to different specialisations in marketable and non-marketable assets, respectively, and the particular characteristics of these instruments.

Let me conclude by outlining that the Eurosystem is also enhancing its due diligence to avoid mechanistic reliance on external ratings. In the context of the ECAF, it is carrying out additional work to further deepen its understanding of ECAIs' ratings, rating processes and methodologies. As part of the collateral eligibility assessment, the Eurosystem is able to complement the information provided by the different credit assessment systems with information on other features that are of relevance to the credit quality of debt instruments. Within the asset purchase programme, the Eurosystem also conducts credit risk and due diligence assessments, in particular for private sector securities. These aspects also relate to the Eurosystem's commitment to implementing the Financial Stability Board's principles for reducing reliance on external ratings.⁷

Yours sincerely,

[signed]

Mario Draghi

⁷ See "The financial risk management of the Eurosystem's monetary policy operations", ECB, July 2015, p. 20, available at https://www.ecb.europa.eu/pub/pdf/other/financial_risk_management_of_eurosystem_monetary_policy_operations_201507_en.pdf.

⁸ See the Financial Stability Board's "Principles for Reducing Reliance on CRA Ratings", October 2010, available at http://www.fsb.org/wp-content/uploads/r_101027.pdf.

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