EUROPEAN CENTRAL BANK

EUROSYSTEM

ECB response to Financial Stability Board (FSB) request for action plans for reducing reliance on Credit Rating Agency (CRA) ratings

In the context of the request from the Financial Stability Board (FSB) for action plans for reducing reliance on Credit Rating Agency (CRA) ratings, the following describes the Eurosystem's current reliance on external ratings against the background of FSB Principle III.1 on central bank operations as well as Eurosystem initiatives to further reduce reliance.

Due to the very broad set of collateral which the Eurosystem accepts for credit operations, the elimination of external ratings entirely in the determination of an instrument's eligibility would indeed be very challenging. Notwithstanding this, the reliance of the Eurosystem on CRA ratings or any other credit assessment source is not automatic as the Eurosystem reserves the right to determine whether an issue, issuer, debtor or guarantor fulfils its requirements for high credit standards on the basis of any information it may consider relevant and may reject, limit the use of assets or apply supplementary haircuts on such grounds if required to ensure adequate risk protection of the Eurosystem in line with Article 18.1 of the Statute of the ESCB. Such measures can also be applied to specific counterparties, in particular if the credit quality of the counterparty appears to exhibit a high correlation with the credit quality of the collateral assets submitted by the counterparty. The Eurosystem can also apply positive discretion and waive the minimum credit rating threshold in certain situations where it has available information relevant for the credit risk assessment. For ECB investment operations, the eligibility of issuers does not only rely on CRA ratings but also involves an internal Eurosystem assessment and in fact for the most relevant cases the rules determining the treatment of assets have been modified to minimise and even avoid the automatic reliance on credit rating actions. Moreover, the Eurosystem reviews and refines its frameworks on an ongoing basis to ensure that the usage of external credit ratings within these frameworks remains appropriate. As such, the practices of the Eurosystem are consistent with the FSB principles on reducing reliance on CRA ratings.

A number of steps are currently ongoing which could serve to further reduce reliance on external credit ratings both in the Eurosystem criteria for determining if an asset is eligible for use in credit operations and also in the Eurosystem Credit Assessment Framework (ECAF), which defines the procedures, rules and techniques to ensure that the Eurosystem's high credit standards are met for all eligible assets: ECAF due diligence procedures on CRAs' ratings, rating processes and methodologies will be enhanced. An action plan, endorsed by the Governing Council of the ECB, has been initiated to accomplish this. This plan foresees a stepwise approach – in a first stage a stocktaking is to be undertaken and in subsequent stages, subject to decisions to be taken by the Governing Council of the ECB on an annual basis as the project

progresses, the ECAF procedures, rules and techniques will be enhanced. Moreover, the Eurosystem has amended eligibility criteria for Asset-Backed Securities (ABS) by introducing specific loan-by-loan information requirements for ABS accepted as collateral in Eurosystem credit operations. This will improve the transparency of these instruments and help facilitate any independent risk assessment of these instruments. Furthermore, a number of Eurosystem National Central Banks (NCBs) are building In-house Credit Assessment Systems for non-financial corporations with the aim to have these operational in the short to medium term. These new systems, together with already existing systems of this kind at several NCBs, also reduce the Eurosystem's reliance on external ratings.