Box 3
Eurosystem publishes more detailed criteria for accepting rating agencies

The Eurosystem has published more detailed criteria that rating agencies must meet to be part of its framework for mitigating financial risk in monetary policy operations. The Eurosystem credit assessment framework or ECAF defines the minimum credit quality requirements that ensure the Eurosystem accepts only assets with high credit standards as collateral. The Eurosystem has a legal obligation to lend money only against adequate collateral.[1] The ECAF also forms the basis of minimum credit quality requirements in the context of outright purchases.

Rating agencies are one source of information in the framework.[2] When rating agencies are accepted under the framework as "external credit assessment institutions" or ECAIs, their ratings are used mainly to assess the credit quality of marketable assets (traded debt instruments, in particular bonds). Rating agencies can also be accepted under the framework as providers of rating tools. In addition, the Eurosystem uses information from in-house credit assessment systems and counterparties' internal ratings-based systems. The last three types of credit assessment system are used mainly to assess non-marketable collateral such as credit claims. To ensure that the information provided by all four sources is consistent, accurate and comparable, the Eurosystem has established acceptance criteria for each credit assessment source as well as a harmonised rating scale, against which it regularly monitors the performance of all accepted systems. These procedures aim to protect the Eurosystem against financial risks as well as to ensure a level playing field among the credit rating providers.

In December 2015 the Governing Council decided to publish further details on the criteria for accepting a rating agency into the ECAF.[3] The published criteria refer to the acceptance of rating agencies as external credit assessment institutions. An agency must, at the time of its application, be providing minimum coverage of assets eligible for use in monetary policy operations in terms of rated assets[4], rated issuers and the volume of assets rated. The rating agency's coverage must be diversified across the eligible asset classes and across euro area countries.

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

2 See, for example, the Box entitled "Eurosystem credit assessment framework for monetary policy operations", *Monthly Bulletin*, ECB, April 2014; *The financial risk management of the Eurosystem's monetary policy operations*, ECB, July 2015; or the information provided on the ECB's website at http://www.ecb.europa.eu/mopo/assets/risk/ecaf/html/index.en.html

3 See *Decisions taken by the Governing Council of the ECB (in addition to decisions setting interest rates)*, 22 January 2016, on the ECB's website. The detailed requirements are available on the ECB's website at https://www.ecb.europa.eu/paym/coll/risk/ecaf/html/index.en.html

4 Assets must be rated in accordance with the ECAF priority rules defined in Article 84 of the Guideline of the ECB of 19 December 2014 on the implementation of the Eurosystem monetary policy framework (ECB/2014/60).

For example, it must rate at least three of the four eligible non-public sector asset classes (covered bonds, uncovered bonds, corporate bonds and asset-backed securities) in two-thirds of the countries. In each asset class it must provide ratings for at least 10% of the eligible assets, 10% of the issuers and 20% of the nominal volume. Moreover, in the three years prior to its application the rating agency must have complied with these criteria at a level of at least 80%.

The requirements are designed to ensure that rating agencies have broad credit risk expertise and a track record over time. For efficiency reasons and in order to ensure that only rating agencies with established and broad credit risk expertise are accepted, the requirements take into account market acceptance of rating agencies' ratings, the credit risk interlinkages[5] among the eligible asset classes, and the geographical concentration of eligible collateral in the euro area. At the same time, the thresholds are not so restrictive as to preclude the acceptance of new rating agencies: a rating agency assessing around 100 issuers, for example, may comply with the requirements, depending on the geographical and asset-class focus of its business.[6] Furthermore, the set of coverage criteria as a whole is designed to ensure that the Eurosystem has information to ascertain whether a rating agency has an adequate performance track record and to map its ratings to the harmonised rating scale. In addition, the 80% historical coverage requirement over the three years preceding an application allows new rating agencies to benefit from a gradual increase in their European coverage in order to apply to be accepted into the ECAF once they can demonstrate well-established broad credit risk expertise and proven market acceptance.

In the acceptance procedure, the Eurosystem investigates all additional information relevant for risk protection and the efficient implementation of the ECAF.[7] Compliance with the minimum coverage criteria serves only as a prerequisite for the initiation of an acceptance procedure. In view of the importance of the credit quality information for asset eligibility and valuation haircuts, the Eurosystem forms its decision on whether to accept a rating agency on the basis of a comprehensive due diligence assessment. Rating agencies must meet a number of information, regulatory and operational requirements. To be part of the framework they must, for example, be supervised by the European Securities and Markets Authority (ESMA). Furthermore, information on their credit ratings needed to monitor rating quality must be available to the Eurosystem. For efficiency purposes and in view of the resource-intensive due diligence process for each individual rating agency, the Eurosystem requires the minimum coverage criteria to be met before it considers accepting a new rating agency.

In addition, the Eurosystem is reinforcing its due diligence to avoid mechanistic reliance on external ratings. It is carrying out additional work to better understand the ratings, rating processes and methodologies of the rating

5 For example, rating structured finance products requires a sound credit risk assessment of the counterparties involved.

6 One credit rating agency with a market share of around 1% (according to calculations of the European Securities and Markets Authority) currently complies with the ECAF coverage criteria.

7 For the general acceptance criteria for external credit assessment institutions, which have been public since the introduction of the ECAF, see Article 120 of the Guideline ECB/2014/60.

agencies accepted in the ECAF. This is in line with various initiatives by international authorities aimed at reducing over-reliance on external ratings in legal, regulatory and other public frameworks.[8] In parallel, the Eurosystem has enhanced its internal credit assessment capabilities, for example by increasing the number of in-house credit assessment systems for non-financial corporations[9] and by establishing a due diligence process in the context of the asset-backed securities and covered bond purchase programmes.

8 See, for example, the roadmap for reducing reliance on credit rating agencies' ratings, as published by the G20's Financial Stability Board, at http://www.financialstabilityboard.org/wp-content/uploads/r_101027.pdf?page_moved=1

9 See, for example, *Thematic Review* on *FSB Principles for Reducing Reliance on CRA Ratings*, Financial Stability Board, May 2014, at http://www.fsb.org/2014/05/r_140512/