Climate change considerations in the ECB’s collateral framework

Money Market Contact Group
Why does the climate change matter for monetary policy?

Reasons for the ECB to act:

1. Climate change and policies affect the **outlook for price stability** through their impact on macroeconomic indicators, financial stability, and the **transmission of monetary policy**.

2. Climate change and policies affect the value and the risk profile of the **assets held on the Eurosystem’s balance sheet**.

3. "Without prejudice to the objective of price stability", the Eurosystem “shall support the **general economic policies in the Union** with a view to contributing to the achievement of the objectives of the Union“ (Art. 127).

Source: ECB **Press Release** (2021), ECB Occasional paper on **Climate change and monetary policy in the euro area** (2021)
Climate action in monetary policy implementation

- Disclosure support
  - Input to regulators and standard setters
  - Own disclosures (NMPPs)
  - Disclosure requirements for private sector assets

- Risk assessment
  - Stress testing our balance sheet
  - Credit ratings

- Corporate asset purchases
  - Enhanced due diligence
  - Disclosures
  - Adaptations

- Collateral framework
  - Collateral valuation
  - Risk controls
  - Financial innovation

Source: ECB Press Release (2021), ECB Occasional paper on Climate change and monetary policy in the euro area (2021)
**Eurosystem collateral framework**

**Eligibility**

Ensures **effective conduct of monetary policy while mitigating credit, legal and operational risks**. Eurosystem Credit Assessment Framework (ECAF) constitutes a key element.

**Valuation**

*Recovery value* that can be obtained by liquidating an asset in the event of a counterparty default. *Relies on market prices* as a starting point for valuing all eligible marketable assets; internally derived for less liquid assets.

**Haircuts**

*Mitigates the market, liquidity and credit risks* that can hit the value of the collateral held by the Eurosystem in the event of a counterparty default.

**Limits**

*Restrictions on the use of certain assets* as collateral when the value would likely decrease dramatically in the event of a counterparty default (e.g. ‘wrong way’ risk).

Do **climate-related financial risks** warrant changes to methodologies and/or the treatment of certain assets?

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Questions being explored by the ECB

1. What **data do market and the ECB need** to incorporate climate risk considerations?

2. Are climate risks and externalities **adequately priced by the market**?

3. How do **credit rating agencies incorporate CC** in ratings and disclosures?

4. What is the effect of climate on the **risk in Europysystem balance sheet and the risk profile of the assets posted as collateral**?

5. Within the ECB’s mandate, which adjustments in its collateral framework would be most effective in **supporting the Union’s general economic policies** in the area of environmental sustainability?

**Relevant in particular for:**

- Own disclosures
- Disclosure requirements
- Market neutrality and efficiency concepts; Collateral valuation methodology
- Credit ratings for collateral and asset purchases
- Climate stress testing; Review of risk controls; Corporate asset purchases
- Assessment of green/sustainable financial innovation
Issues for discussion

1. Do you consider **climate change-related factors in secured lending** (e.g. counterparty selection, collateral eligibility and valuation, risk control measures? Do you plan to further study the impact of these factors on secured lending and possibly change current practices?

2. What **taxonomies, methodologies and metrics** do you currently use? What **gaps** do you need to close to be able to map climate risks and net zero pathways?

3. Do you consider that **credit ratings of credit rating agencies fully reflect all climate change-related factors** that could be relevant to assess collateral risks? To which extent do you rely on credit ratings by credit rating agencies to assess counterparty and collateral risks?
Background slides
## Eurosystem roadmap for MP implementation

<table>
<thead>
<tr>
<th>Focus area</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
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<tbody>
<tr>
<td>Disclosures in line with EU policies as an eligibility requirement in collateral framework and asset purchases</td>
<td><em>Proposal and adoption of EU disclosure regulation.</em></td>
<td>Design adequate policies and conduct legal and operational preparations.</td>
<td>Adaptation period for issuers.</td>
<td>First disclosures for 2023.</td>
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<td>Climate change risks in credit ratings for collateral and asset purchases</td>
<td>Assess rating agencies’ disclosures and understand how they incorporate climate change risk in ratings. Develop minimum standards for internal credit ratings.</td>
<td>Introduce requirements into the Eurosystem Credit Assessment Framework (ECAF) targeted to climate change risk, if warranted.</td>
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<td>Climate change risks in the collateral framework</td>
<td>Review collateral valuation and risk control framework to ensure that climate change risks are reflected. Assess financial innovation related to environmental sustainability.</td>
<td>Monitor the adequacy of the collateral valuation and risk control framework to ensure that climate change risks are properly reflected. Design and implement changes, if warranted.</td>
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<td>Climate change risks in the Corporate Sector Purchase Programme (CSPP)</td>
<td>Conduct enhanced due diligence to incorporate climate change risks.</td>
<td>Prepare climate-related disclosures of the CSPP.</td>
<td>Adapt CSPP framework.</td>
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<td>Assess potential biases in the market allocation amid market inefficiencies and the pros/cons of alternative allocations.</td>
<td>Make concrete proposals for alternative benchmarks, in particular for the CSPP.</td>
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<td>Market neutrality and efficiency concepts in monetary policy ops.</td>
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