



EUROPEAN CENTRAL BANK
EUROSYSTEM

COURTESY TRANSLATION

Christine LAGARDE
President

Ms Manon Aubry
Member of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt am Main, 22 December 2020

L/CL/20/315

Re: Your letter (QZ-057)

Honourable Member of the European Parliament, dear Ms Aubry,

Thank you for your letter, which was passed on to me by Ms Irene Tinagli, Chair of the Committee on Economic and Monetary Affairs (ECON), accompanied by a cover letter dated 14 October 2020.

On 18 March 2020 the European Central Bank (ECB) decided to launch the pandemic emergency purchase programme (PEPP), a temporary programme to purchase private and public sector securities, in order to counter the serious risks to the smooth transmission of monetary policy and the outlook for the euro area economy posed by the outbreak and escalating diffusion of the coronavirus (COVID-19) pandemic. On 10 December 2020, the ECB increased the envelope for the PEPP by €500 billion to a total of €1,850 billion, with the horizon for net PEPP purchases extended to at least end-March 2022, and, in any case, until the Governing Council judges that the coronavirus crisis phase is over. All asset categories eligible under our asset purchase programme (APP) are also eligible under the PEPP. As PEPP purchases are conducted by both the ECB and the national central banks (NCBs), the following paragraphs refer to the Eurosystem as a whole (i.e. the ECB and the NCBs).

In response to your question on limits to purchases under our asset purchase programmes, the applicable frameworks establish a number of limitations, including quantitative limits for the issue share and issuer,

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credit quality thresholds, and additional risk control and monitoring processes.¹ The issuer limit refers to the maximum share of an issuer's outstanding securities that the Eurosystem is prepared to hold, while the issue share limit refers to the maximum share of a single security eligible under the public sector purchase programme (PSPP) that the Eurosystem is prepared to hold. Issuer and issue share limits are applied after holdings of PSPP-eligible public sector securities have been consolidated over all the portfolios of the Eurosystem central banks except the PEPP portfolio.² As regards the quantitative limits, an issuer limit of 33% and an issue share limit of 33%³ currently apply to purchases of securities of national public sector entities under the PSPP and the corporate sector purchase programme (CSPP), which are part of the APP. For entities listed as supranational institutions located in the euro area, an issue share limit and an issuer limit of 50% apply under the PSPP. For asset-backed securities, covered and corporate bonds, the Eurosystem applies an issue share limit of 70% and consolidates its holdings over all the portfolios of the Eurosystem central banks.⁴ When we announced the PEPP, we said that, to the extent that some self-imposed limits might hamper action that the ECB is required to take in order to fulfil its mandate, the Governing Council would consider revising them to the extent necessary to make its action proportionate to the risks that we face.⁵

In response to your question on how the Eurosystem technically provides liquidity to the financial system, the Eurosystem, as part of its monetary policy measures, purchases securities – in net terms – and by doing so creates central bank money. Central bank money is also created when commercial banks, through the Eurosystem's refinancing operations, borrow money from the Eurosystem against adequate collateral. The electronically created central bank money is held on the commercial banks' accounts with their NCBs, which are also referred to as bank reserves with the central bank. As the sole issuer of euro-denominated central bank money (i.e. banknotes and bank reserves), the Eurosystem will always be able to generate additional

¹ In accordance with Decisions (EU) 2020/188 of the European Central Bank of 3 February 2020 on a secondary markets public sector asset purchase programme (ECB/2020/9) (OJ L 39, 12.2.2020, p. 12), (EU) 2016/948 of the European Central Bank of 1 June 2016 on the implementation of the corporate sector purchase programme (ECB/2016/16) (OJ L 157, 15.6.2016, p. 28), (EU) 2020/187 of the European Central Bank of 3 February 2020 on the implementation of the third covered bond purchase programme (ECB/2020/8) (OJ L 39, 12.2.2020, p. 6), and (EU) 2015/5 of the European Central Bank of 19 November 2014 on the implementation of the asset-backed securities purchase programme (ECB/2014/45)(OJ L 1, 6.1.2015, p. 4).

² In addition, the consolidation of holdings under Article 5 of Decision (EU) 2020/188 (ECB/2020/9) does not apply to PEPP holdings.

³ Or 25% if the securities contain collective action clauses that differ from the euro area model elaborated by the EU Economic and Financial Committee.

⁴ See also Questions & Answers on the PSPP on the ECB's website, available at: <https://www.ecb.europa.eu/mopo/implement/app/html/pspp-qa.en.html>.

⁵ See "ECB announces €750 billion Pandemic Emergency Purchase Programme (PEPP)", *press release*, ECB, 18 March 2020, available at: https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200318_1~3949d6f266.en.html, and Decision (EU) 2020/440 of the European Central Bank of 24 March 2020 on a temporary pandemic emergency purchase programme (ECB/2020/17)(OJ L 91, 25.3.2020, p. 1).

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liquidity as needed to fulfil its mandate. Therefore, as I had the opportunity to clarify at the last hearing at the ECON Committee, by definition the ECB will neither run out of liquidity nor fail.

Furthermore, in response to your question on the soundness of the Eurosystem's finances, let me first recall that the ECB's mandate is to maintain price stability, not to maximise central bank profits. Our monetary policy is designed to fulfil this mandate. This notwithstanding, when pursuing our mandate we certainly also monitor very closely, and continuously manage, the risks associated with our monetary policy operations, including asset purchase programmes and collateralised refinancing operations, to minimise the risk of incurring financial losses. For instance, we only purchase assets complying with certain minimum eligibility criteria. Similarly, in our refinancing operations we only lend against adequate collateral, which is subject to valuation haircuts, variation margins and in some cases limits in order to mitigate the financial risks associated with the asset classes accepted as collateral. The Eurosystem also assesses, on an ongoing basis, the adequacy of its capital base to withstand potential financial losses under severe scenarios. The risk control measures are broadly harmonised across the Eurosystem and ensure non-discriminatory conditions for any type of eligible asset across the Eurosystem.⁶ Our available net equity, our risk management frameworks and other safeguards and means at our disposal ensure our financial independence⁷, and that potential financial losses will not impair our ability to seek and maintain price stability.

Yours sincerely,

[signed]

Christine Lagarde

⁶ If, hypothetically, financial losses nevertheless materialised, the Eurosystem central banks would first use the amounts set aside in previous years in provisions for financial risks and/or reserves to cover these losses. If this were insufficient, the ECB may cover the remaining loss with the monetary income of the NCBs of the relevant financial year, following a decision by the Governing Council. Any further loss amount may be recorded on the balance sheet of the ECB and the NCBs, to be covered by net income to be received in the near future.

⁷ See e.g. *Convergence Report*, ECB, June 2020, pp. 26-27, available at: <https://www.ecb.europa.eu/pub/pdf/conrep/ecb.cr202006~9fefc8d4c0.en.pdf>

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