



EUROPEAN CENTRAL BANK

EUROSYSTEM

ECB-PUBLIC

Mario DRAGHI

President

Mr Paul Tang

Member of the European Parliament

European Parliament

60, rue Wiertz

B-1047 Brussels

Frankfurt am Main, 21 February 2019

L/MD/19/049

Re: Your letter (QZ-004)

Honourable Member of the European Parliament, dear Mr Tang,

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 16 January 2019.

The ECB has paid close attention to the public debate on the risks emanating from climate change, both for economic and financial stability and for society at large. As stressed at the regular hearings before the Committee on Economic and Monetary Affairs on 26 February 2018 and 9 July 2018, and in my letters to you and your honourable colleagues dated 12 June 2018¹ and 26 October 2018², “the ECB supports and welcomes a number of initiatives on sustainable finance of the EU and international fora”, and “recognises that the correct pricing of financial risks stemming from climate change is key to promoting sustainable development and preserving a well-functioning financial system.” Aware of these challenges, the ECB participates in the Network for Greening the Financial System (NGFS), in collaboration with other central banks and supervisors across the world. It is also a member of the Technical Expert Group on Sustainable Finance (TEG) that has been set up by the European Commission in its Action Plan on Financing Sustainable Growth.³

¹ Letter from the ECB's President to Mr Paul Tang, Ms Neena Gill and Mr Jonás Fernández, MEPs, available on the ECB's website at: https://www.ecb.europa.eu/pub/pdf/other/ecb.mepletter180615_Tang-Gill-Fernandez.en.pdf

² Letter from the ECB's President to Mr Ernest Urtasun, MEP, available on the ECB's website at: https://www.ecb.europa.eu/pub/pdf/other/ecb.mepletter181116_Urtasun.en.pdf

³ More information on the Action Plan and TEG is available on the Commission's website: https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance_en

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In its First Progress Report of October 2018, the NGFS acknowledged that climate-related risks are a source of financial risk. Such risks call for a deeper understanding and for improved approaches and developments to address them.⁴ It is against this background that the report concludes that “climate- or environmental-related criteria are not yet sufficiently accounted for in internal credit assessments or in credit agencies’ models which many Central Banks rely on for their operations”. Below, I will elaborate on the measures that are being taken to ensure that both financial and non-financial risks are adequately taken into account in the credit assessments used by the Eurosystem.

First, the Eurosystem has, in the context of financial risk management, established the Eurosystem credit assessment framework (ECAF), which specifies the Eurosystem’s minimum credit quality requirements. The ECAF enables the Eurosystem to fulfil its statutory obligation to conduct credit operations only against adequate collateral⁵ and forms the basis of the minimum credit quality requirements for outright purchases. Within ECAF, credit ratings from external credit assessment institutions (ECAIs or, more commonly, credit rating agencies) are an important credit assessment source. Importantly, the ECAF has been designed in a way that automatically protects the Eurosystem against credit risk in its monetary policy operations provided that credit assessments appropriately account for changing risks.⁶ To assess the quality of external ratings, the Eurosystem conducts its own annual performance monitoring exercise for all ECAF-accepted credit assessment systems, including the four accepted ECAIs. Misperformance is duly analysed and may have consequences as prescribed under the ECAF rules.⁷ In addition, as I explained to you and your honourable colleagues in a letter dated 26 October 2018⁸, the Eurosystem avoids a mechanistic reliance on external ratings. To that aim, it carries out additional work to further deepen its understanding of ECAIs’ ratings, rating processes and methodologies. These aspects should be seen not only in view of the more general principles for reducing reliance on external ratings of the Financial Stability Board⁹, but also as representing the Eurosystem’s ability to monitor any financial risks, including those related to climate change, and to act promptly when necessary.

Second, the conclusion of the above-mentioned NGFS First Progress Report is proof in itself of the ongoing scrutiny of credit ratings. In this regard, the ECB welcomes a recent initiative regarding disclosure requirements by the European Securities and Markets Authority (ESMA), in its capacity as regulator of

⁴ See the “NGFS First Progress Report”, October 2018, available at: <https://www.banque-france.fr/sites/default/files/media/2018/10/11/818366-ngfs-first-progress-report-20181011.pdf>

⁵ See Article 18.1 of the Statute of the European System of Central Banks and of the European Central Bank.

⁶ This and similar points were also made by my colleague, Benoît Cœuré, in a speech on “Monetary policy and climate change” delivered at a conference on “Scaling up Green Finance: The Role of Central Banks”, organised by the NGFS, the Deutsche Bundesbank and the Council on Economic Policies, Berlin, 8 November 2018, available on the ECB’s website at: <https://www.ecb.europa.eu/press/key/date/2018/html/ecb.sp181108.en.html>

⁷ See Guideline ECB/2014/60 of 20 September 2011 on monetary policy instruments and procedures of the Eurosystem, in particular Article 126 on the ECAF performance monitoring process and Article 159 on Discretionary measures relating to the Eurosystem’s credit quality assessment.

⁸ Letter from the ECB’s President to Mr Brian Hayes, Mr Paul Tang, Mr Sven Giegold, Mr Wolf Klinz, Mr Ashley Fox, MEPs, available on the ECB’s website at: https://www.ecb.europa.eu/pub/pdf/other/ecb.mepletter181116_Hayes_Tang_Giegold_Klinz_Fox.en.pdf

⁹ See the Financial Stability Board’s “Principles for Reducing Reliance on CRA Ratings” of 27 October 2010, available at http://www.fsb.org/wp-content/uploads/r_101027.pdf

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ECAIs. The ECB shares the view of ESMA that it is worth drawing up guidelines for credit rating agencies to disclose if and how environmental, social and governance (ESG) factors enter their credit ratings.¹⁰ These guidelines will contribute to achieving a higher level of transparency regarding sustainability aspects in the course of 2019 as part of the Commission Action Plan on Financing Sustainable Growth referred to above. This will allow the Eurosystem and other rating users to gain a deeper understanding of credit ratings and to investigate potential shortcomings. The fact that ESG factors have come under increased focus in publications by credit rating agencies is a step in the right direction.

Third, looking beyond monetary policy portfolios, the ECB has already taken concrete steps towards incorporating ESG factors in its non-monetary policy portfolios. For its pension fund portfolio, as I explained in the hearing before the Committee on Economic and Monetary Affairs on 26 November 2018, the ECB has delegated proxy voting for equity investments to asset managers that have signed up to the United Nations Principles for Responsible Investment, requiring them to incorporate ESG factors in their voting policies. Furthermore, the ECB has started to investigate how similar principles could be implemented in the future in its own funds portfolio, consisting of its paid-up capital and the general reserve fund, and how to broaden options for ECB staff to invest their pension fund assets in sustainable financial products.

Finally, I would like to emphasise the ECB's continued commitment to the above-mentioned initiatives related to climate change. The ECB will continue its dialogue with credit rating agencies and other market participants to further promote the incorporation of ESG factors.

Yours sincerely,

[signed]

Mario Draghi

¹⁰ ESMA is currently running a consultation on its draft "Guidelines on Disclosure Requirements Applicable to Credit Ratings", which is open until 19 March 2019, available at: https://www.esma.europa.eu/sites/default/files/library/esma33-9-290_consultation_paper_on_disclosure_requirements_applicable_to_credit_ratings.pdf