BANCO DE ESPAÑA
Eurosistema

ECONOMIC BULLETIN
2023/Q2

The role of loans and the ICAS BE in the Eurosystem's collateral framework in 2023

https://doi.org/10.53479/30149

Article 06
06/06/2023

Rationale

The share of non-marketable assets (mainly bank loans) pledged as collateral in the Eurosystem's monetary policy credit operations has increased in recent years. The Banco de España's corporate credit assessment system (ICAS BE) has contributed significantly to this development and may lead to these assets playing a greater role in the future.

Takeaways

- In the wake of the COVID-19 crisis there has been a considerable increase in the share of non-marketable assets in the collateral pledged by Spanish counterparties in Eurosystem financing operations. A significant proportion of these non-marketable assets are loans to firms rated using the Banco de España's in-house rating system, called ICAS BE.
- There is ample scope to increase the volume of pledged loans with an ICAS BE rating, especially in the case of loans to SMEs.
- Spanish firms' ICAS BE credit ratings have remained relatively stable in the past year, except in the sectors most affected by the COVID-19 pandemic, which have seen a notable improvement.

Keywords

Monetary policy, collateral, loans, ICAS, non-financial corporations, credit rating.

JEL classification

E44, E52, E58, G21, G28.

Authors:

Sergio Gavilá
Financial Risk Department
Banco de España

Lola Morales
Financial Risk Department
Banco de España

Introduction

The framework of eligible collateral assets for the Eurosystem's monetary policy operations is mainly aimed at protecting its balance sheet from potential losses arising from the failure of a counterparty that has received financing (typically, a credit institution). This framework currently comprises a wide range of both marketable and non-marketable assets. Loans granted by counterparties play a large role in both types of assets, as they can be pledged directly (non-marketable assets) or indirectly as underlying assets of covered[1] and securitised bonds (marketable assets).

The Banco de España has an in-house credit assessment system (ICAS)[2] for non-marketable assets that assesses the credit quality of public and private Spanish non-financial corporations[3] (hereafter, firms), with the main purpose of making it possible for loans to such firms to be used as collateral in its monetary policy credit operations.

The ICAS BE may currently rate Spanish firms of any size. It rates the most important large firms[4] (around 500 firms) using the Full-ICAS (F-ICAS) system, which comprises a statistical model and an expert model consisting of a firm-by-firm review by an analyst. As for SMEs, the ICAS BE rates some 900,000 firms using a system called Statistical ICAS (S-ICAS), which assigns a rating automatically without the need for an analyst to be involved.

Section 2 of this article looks at the current and recent prominence of non-marketable assets pledged as collateral by Spanish counterparties in traditional monetary policy operations, paying particular attention to the contribution of the ICAS BE. Section 3 includes an assessment of the degree to which the ICAS BE could be used, based on an estimation of the volume of ICAS BE-rated loans that could potentially be mobilised. Finally, Section 4 examines the distribution of ICAS BE ratings, broken down by firm size and sector,

Effective use of loans and the ICAS BE under the Eurosystem's collateral framework

Assets eligible as collateral for Eurosystem credit operations are divided into marketable assets and non-marketable assets. Spanish counterparties mainly pledge marketable assets as

1 The term "covered bond" refers to a debt instrument that has a dual recourse: a) directly or indirectly to a credit institution, and b) to a dynamic cover pool of underlying assets, and for which there is no tranching of risk (Article 2(12) of Guideline (EU) 2015/510 of the ECB). In Spain, covered bonds include Spanish mortgage covered bonds, Spanish public-sector covered bonds and internationalisation covered bonds.

2 Gavilá, Maldonado and Marcelo (2020).

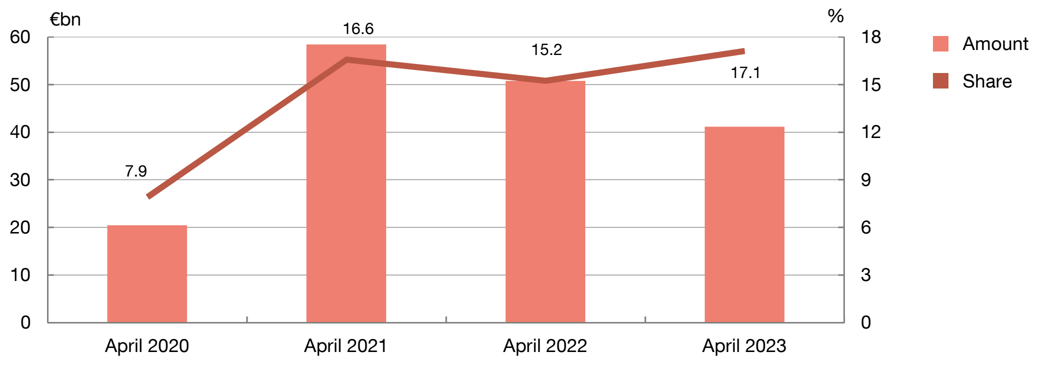
3 Classified within the non-financial corporations institutional sector as defined in the ESA2010 manual.

4 A large firm is one that does not fall under the European Commission's definition of SME (Recommendation 2003/361/EC, Annex, Article 2): "The category of micro, small and medium-sized enterprises (SMEs) is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding €50 million, and/or an annual balance sheet total not exceeding €43 million".

Chart 1

The importance of non-marketable assets has grown significantly since the COVID-19 crisis

1.a Change in non-marketable assets



SOURCE: Banco de España.

DOWNLOAD

collateral, although non-marketable assets have gained prominence in recent years, particularly after the emergency measures adopted by the ECB Governing Council in response to the COVID-19 crisis[5] (see Chart 1.a). This greater prominence reinforces the idea that non-marketable assets are particularly attractive in moments of financial stress, during which credit institutions often face greater liquidity needs.

As at April 2023 the volume of non-marketable assets pledged as collateral stands slightly above €40 billion, which accounts for slightly over 17.1% of the total, somewhat more than twice the figure at the start of the COVID-19 crisis (7.9% in April 2020). The fact that the share of non-marketable assets remains stable at levels similar to those reached after the most acute phase of the pandemic may point to a persistent increase in this figure. This could be a step towards convergence with the higher levels of direct use of loans in the rest of the Eurosystem.[6]

The credit assessment sources for non-marketable assets pledged by Spanish counterparties are external credit assessment institutions (ECAIs) and the ICAS BE. The ratings assigned by the ECAIs are used to assess the credit quality of public sector entities, based on the specific rating of the entity itself or, in the absence of such a rating, the rating implicitly derived from that of the central government of the jurisdiction in which they are established (public sector entity (PSE) rule).[7] Meanwhile, ICAS BE has been selected by all Spanish counterparties as the primary source of credit ratings for loans to non-financial corporations.

ECAI-rated mobilised loans account for most of the non-marketable assets pledged as guarantees (67.8% in April 2023). The remainder (32.2%) relates to loans to non-financial corporations pledged

5 Escolar and Yribarren (2021).

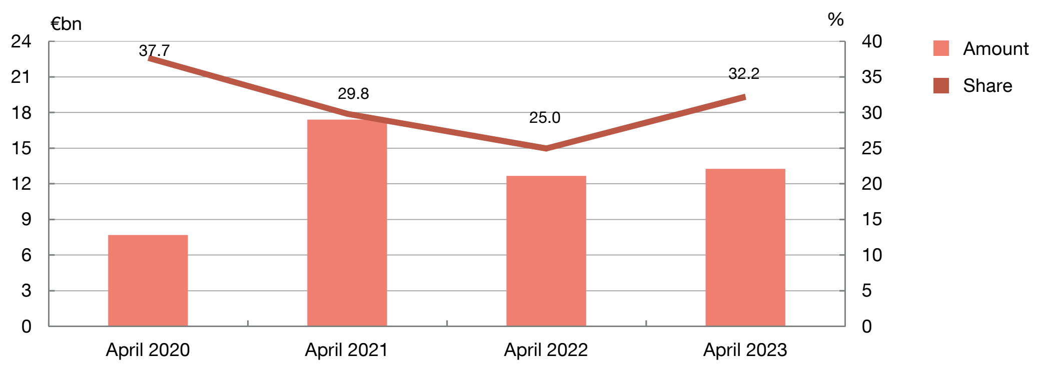
6 Gavilá, Maldonado and Marcelo (2020).

7 Additionally, and as part of the temporary measures approved by the ECB Governing Council during the pandemic, the Spanish central government rating is valid to assess the part of the loans to non-financial corporations and sole proprietors that is guaranteed by the public guarantee facility of the Official Credit Institute (ICO) established by the government under Royal Decree-Law 8/2020.

Chart 2

The amount of ICAS BE pledged lending remains substantially higher than before the pandemic

2.a Change in ICAS BE pledged loans



SOURCE: Banco de España.

using an ICAS BE rating (see Chart 2.a). Changes in recent years in the proportion of non-marketable assets rated by the ICAS BE are closely related to partially government-guaranteed loan developments. In particular, the massive mobilisation of these loans during the COVID-19 crisis (around 35% of all pledged loans in April 2021) is behind the decline in the share of ICAS BE-rated mobilised loans (from 37.7% in April 2020 to 25% in April 2022). Likewise, the upcoming expiry[8] of the temporary measure that allows partially government-guaranteed loans to be pledged has led to their early removal from numerous counterparties' collateral pools,[9] giving rise to a substantial fall in their importance as a percentage of total pledged loans (12% in April 2023). This has pushed up the share of ICAS BE-rated loans (from 25% in April 2022 to 32.2% in April 2023).

In terms of the amount of the pledged loans, the importance of the ICAS BE increased substantially during the COVID-19 crisis (approximately €17.5 billion in April 2021 vs. less than €8 billion in April 2020). After the reduction in 2022 owing to credit institutions' lower liquidity needs, the amount has stabilised at around €13 billion, considerably higher than at the beginning of the COVID-19 crisis.

There are significant differences in the information described above when it is analysed individually for each counterparty. With respect to the type of asset, approximately half of the Spanish counterparties only pledge marketable assets (29 out of 55). For those that also pledge non-marketable assets, the share accounted for by these assets is mainly concentrated below 40%. Bearing in mind the size of the collateral pool, it can be seen that large institutions[10] generally mobilise non-marketable assets to a greater extent (see Chart 3.a).

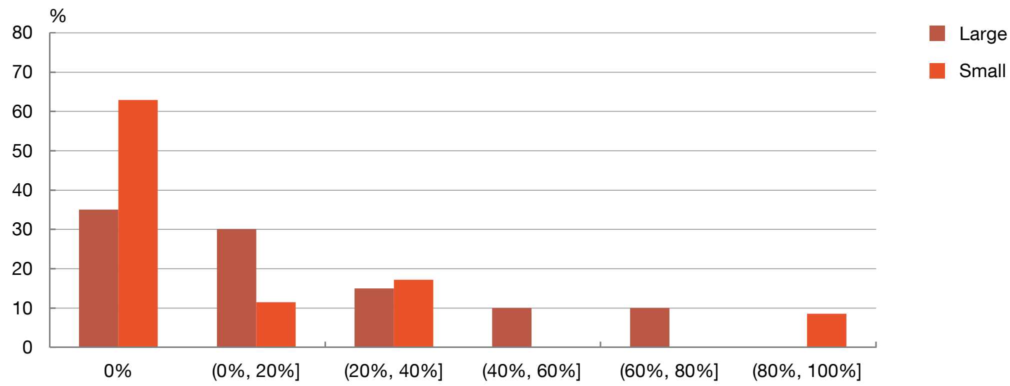
8 This measure will expire when Banco de España Technical Implementation 7/2023, repealing Technical Implementation 9/2022, enters into force on 29 June 2023.

9 "Collateral pool" refers to the account held by each counterparty at the Banco de España to which the collateral assets mobilised for Eurosystem credit operations are allocated.

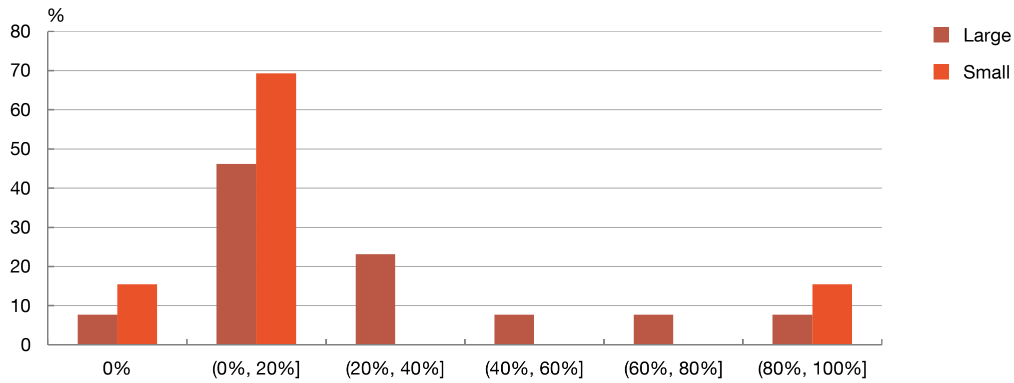
10 Defined as counterparties with a collateral pool exceeding €1 billion.

Chart 3
The use of non-marketable assets and the ICAS BE is highly heterogeneous across counterparties

3.a Distribution by counterparty of non-marketable assets as a share of total collateral (a) (b)



3.b Distribution by counterparty of ICAS BE-rated assets as a share of total non-marketable assets (a) (b)



SOURCE: Banco de España.

a Data as at April 2023.
b Institutions are considered large if their total collateral pool exceeds €1 billion and small otherwise.

DOWNLOAD

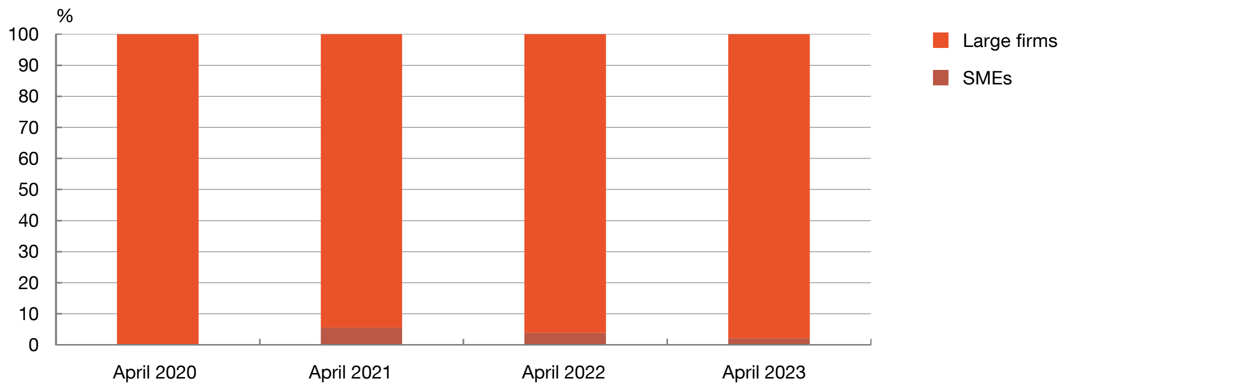
As regards the use of the ICAS BE, practically all the institutions that pledge non-marketable securities contribute loans assessed by the ICAS BE (23 out of 26), but their relative importance is highly variable, with levels ranging from below 20% to above 60% (see Chart 3.b). In general, the share of ICAS BE-rated assets in non-marketable assets as a whole is greater at large institutions, as it exceeds 20% in 45% of them and only in 15% of small institutions.

Potential use of collateral assessed by the ICAS BE

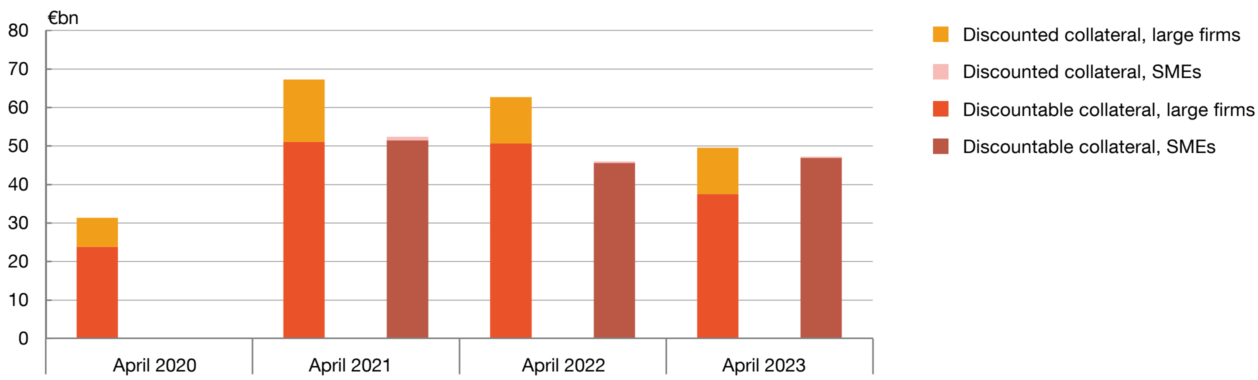
This section provides an in-depth analysis of ICAS BE-rated pledged collateral by firm size. Until May 2020, the ICAS BE was limited to rating large firms with an expert assessment system (F-ICAS). Its scope has since expanded to SMEs after obtaining the Eurosystem's authorisation to assess firms using a purely automated assessment system (S-ICAS). Most of the ICAS BE-rated loans currently pledged as collateral belong to large firms (98%, see Chart 4.a), with loans

Chart 4
There is ample room for increasing the amount of the loans pledged with the ICAS BE, especially in the case of SMEs

4.a Distribution by firm size of ICAS BE loans pledged



4.b Discounted and potentially discountable ICAS BE-rated collateral by firm size



SOURCE: Banco de España.

DOWNLOAD

to SMEs accounting for a very small share (2%). The percentages are similar to those observed since 2020, when the ICAS BE started to rate SMEs.

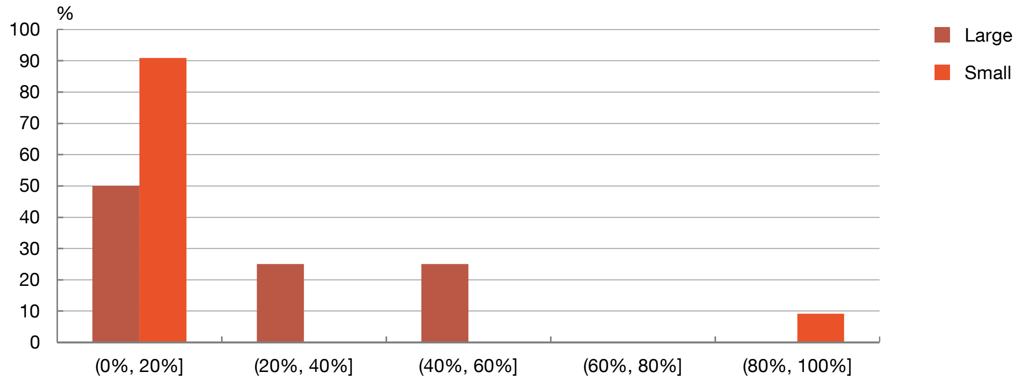
However, as Chart 4.b shows, there is considerable scope to increase the volume of loans pledged as collateral thanks to the ICAS BE, especially in the case of SMEs. The potential estimated volume of pledgeable loans with the ICAS BE is currently around €100 billion, evenly split between large firms and SMEs (around €50 billion each). The potential volume increased substantially after the onset of the COVID-19 crisis (from slightly over €30 billion in April 2020 to nearly €120 billion in April 2021)[11] largely as a result of the temporary measures adopted in response to the pandemic, including most notably the above-mentioned expansion of the ICAS BE's assessment perimeter

11 The reduction in the potential volume of loans to large firms between 2021 and 2023 was due to the expiration of the temporary authorisation granted by the Eurosystem in the context of the COVID-19 crisis for the ICAS BE to be able to rate such firms using the S-ICAS. Since January 2023 the S-ICAS BE only rates SMEs.

Chart 5

The vast majority of counterparties have much headroom to pledge as collateral a greater volume of ICAS BE-rated loans

5.a Distribution by counterparty of the percentage of the ICAS BE-rated loans used (a) (b)



SOURCE: Banco de España.

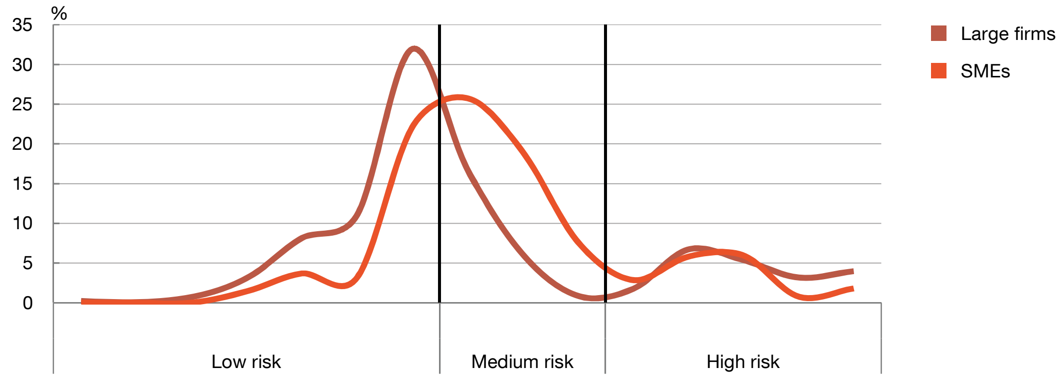
a Data as at April 2023.
b Institutions are considered large if their total collateral pool exceeds €1 billion and small otherwise.

DOWNLOAD

Chart 6

The distribution of ICAS BE ratings is concentrated in the low-risk segment for large firms and in the medium-risk segment for SMEs

6.a Distribution of ICAS BE ratings by firm size (a) (b)



SOURCE: Banco de España.

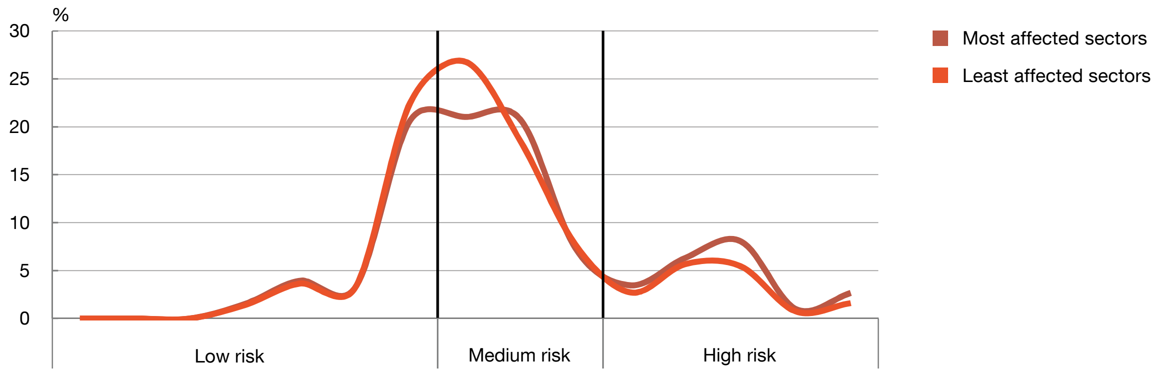
a Data as at April 2023.
b Firms whose probability of default on their credit obligations is below 1% are deemed low risk, between 1% and 5%, medium risk, and over 5%, high risk.

to include SMEs. This estimation of potential volume, compared with the amount effectively mobilised, shows that the percentage of the ICAS BE-rated loans used is lowest among SMEs (specifically 1%, compared with 25% in the case of large firms).

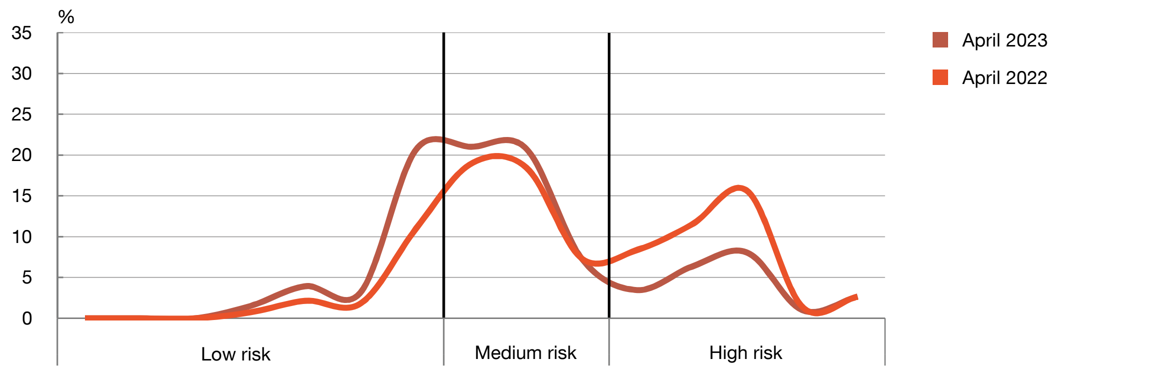
The mobilisation of loans to firms as collateral in monetary policy operations may be carried out individually or through a granular portfolio where the overall credit quality of the loans comprising

Chart 7
The sectors hardest hit by the pandemic continue to show a riskier profile, although their performance this year has been especially positive

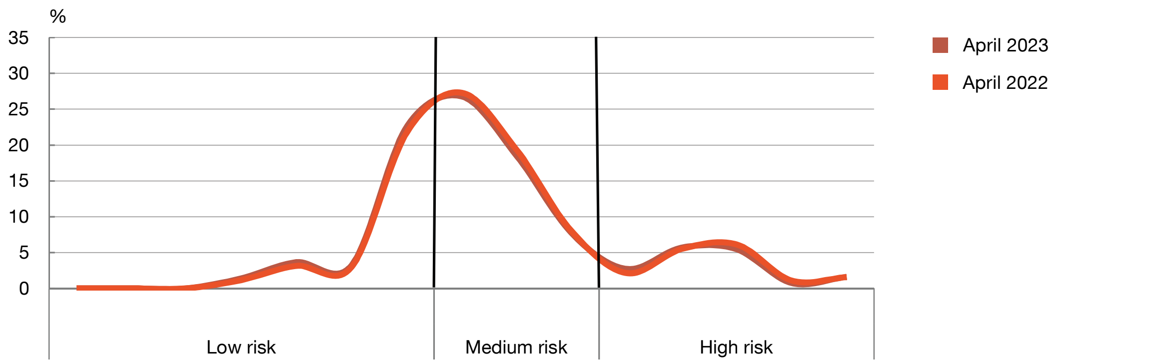
7.a Comparison of the distribution of ICAS BE ratings between the sectors most and least affected by the COVID-19 crisis (a) (b)



7.b Change in the distribution of ICAS BE ratings for the sectors most affected by the COVID-19 crisis (b)



7.c Change in the distribution of ICAS BE ratings for the sectors least affected by the COVID-19 crisis (b)



SOURCE: Banco de España.

a Data as at April 2023.
b Firms whose probability of default on their credit obligations is below 1% are deemed low risk, between 1% and 5%, medium risk and over 5%, high risk.

the portfolio is assessed.[12] The latter option has not been used to date by Spanish counterparties and could be particularly interesting in the case of SMEs, where the lower amount of the loans, compared with those of large firms, reduces incentives to pledge them individually and the existence of a high number of loans makes it easier to meet the regulatory diversification requirements for mobilising loan portfolios.

This ample room for an increased use of the ICAS BE also applies at counterparty level. The percentage of the ICAS BE amount used is below 20% in most counterparties that pledge ICAS BE-rated loans, and below 60% in practically all of them (see Chart 5.a). The potential to increase pledged loans to firms with an ICAS BE rating is even higher in the case of small institutions,[13] since they use an even smaller percentage of the ICAS BE amount.

Distribution of ICAS BE ratings

The credit ratings assigned by the ICAS BE show differences based on firm size and sector. As regards size, the distribution of ICAS BE ratings evidences that large firms, as a whole, have a better risk profile (see Chart 6.a). In particular, large firms are concentrated in the low-risk segment (55% of cases) while SMEs are in the medium-risk segment (52% of cases).[14]

Meanwhile, firms whose activity focuses on the sectors most affected by the pandemic[15] currently continue to have a worse risk profile, with high-risk firms accounting for 6 pp more (22%, compared with 16% in other sectors, see Chart 7.a). However, the difference between sectors was significantly greater in 2022 (24 pp more high-risk firms), which shows that the sectors hardest hit by COVID-19 have substantially improved their credit quality in the past year. Specifically, the percentage of high-risk firms in these sectors has declined in the past year from 40% to 22% (see Chart 7.b), while the distribution of ratings for the rest of the sectors has remained relatively stable (see Chart 7.c).

REFERENCES

Auria, Laura, Markus Bingmer, Carlos Mateo, Caicedo Graciano, Clémence Charavel, Sergio Gavilá, Alessandra Iannamorelli, Aviram Levy, Alfredo Maldonado, Florian Resch, Anna Maria Rossi and Stephan Sauer. (2021). "Overview of central banks' in-house credit assessment systems in the euro area". Occasional Paper Series, No. 284, October 2021, European Central Bank. https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op284~bbce5257bf.en.pdf

Banco de España. (2023). "Technical implementation 7/2023. Additional collateral for operations and risk control measures" (available only in Spanish). https://www.bde.es/f/webbe/INF/MenuVertical/SistemasDePago/ficheros/es/AT72023Activosadicionalesdegarantia.pdf

12 See Technical Implementation 7/2023 of the Banco de España.

13 Defined as counterparties with a collateral pool exceeding €1 billion.

14 To this effect, firms whose probability of default on their credit obligations within one year is below 1% are deemed low risk, between 1% and 5%, medium risk, and over 5%, high risk.

15 The hardest-hit sectors are deemed to be those with a fall in turnover of more than 15% in 2020, according to the data published by the tax authorities. Specifically, these sectors include hospitality, manufacture of coke and refined petroleum products, social and cultural services, transportation and storage, manufacture of transport equipment and manufacture of textiles, clothing and footwear. The less affected sectors include all other industries.

Escolar, Jorge, and José Ramón Yribarren. (2021). "European Central Bank and Banco de España measures against the effects of COVID-19 on the monetary policy collateral framework, and their impact on Spanish counterparties". Occasional Papers, 2128, Banco de España. https://repositorio.bde.es/bitstream/123456789/19235/1/do2128e.pdf

European Central Bank. (2014). "Guideline (EU) 2015/510 of the European Central Bank of 19 December 2014 on the implementation of the Eurosystem monetary policy framework (ECB/2014/60)". https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014O00060&from=CS

Gavilá, Sergio, Alfredo Maldonado and Antonio Marcelo. (2020). "The Banco de España in-house credit assessment system". Financial Stability Review - Banco de España, No. 38, spring. https://repositorio.bde.es/handle/123456789/13555

How to cite this document

Gavilá, Sergio and Lola Morales. (2023). "The role of loans and the ICAS BE in the Eurosystem's collateral framework in 2023". *Economic Bulletin - Banco de España*, 2023/Q2, 06. https://doi.org/10.53479/30149

ISSN 1695-9086 (online edition)