BANCO DE ESPAÑA
Eurosistema

ECONOMIC BULLETIN
2024/Q3

The role of loans and the ICAS BE in the Eurosystem's collateral framework in 2024

https://doi.org/10.53479/37314

Article 03
05/07/2024

Rationale

This article analyses the developments over the last 12 months in the share of non-marketable assets (essentially bank loans) pledged as collateral in the Eurosystem's monetary policy credit operations, focusing in particular on the actual and potential contribution of the Banco de España's in-house credit assessment system (ICAS BE).

Takeaways

- Over the last 12 months the share of non-marketable assets in the collateral pledged by Spanish counterparties in Eurosystem financing operations has increased once again, marking a continuation of the upward trend that began after the onset of the COVID-19 crisis. The proportion of non-marketable assets that are loans to firms rated using the ICAS BE has also risen.
- Counterparties have ample scope to increase the volume of ICAS BE-rated pledged loans, especially in the case of loans to small and medium-sized enterprises.
- After improving for two years, Spanish firms' credit ratings assigned by the ICAS BE have deteriorated slightly compared with 2023, above all due to the increased interest burden firms are currently shouldering.

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

Rafael Vivó
Financial Risk Department
Banco de España

THE ROLE OF LOANS AND THE ICAS BE IN THE EUROSYSTEM'S COLLATERAL FRAMEWORK IN 2024

Introduction

The collateral framework for the Eurosystem's monetary policy operations is mainly aimed at protecting its balance sheet from potential losses arising from the failure of counterparties that have received financing (typically, credit institutions). 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 (marketable assets, such as underlying assets of covered[1] and securitised bonds).

The Banco de España has an in-house credit assessment system (ICAS BE)[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 enabling loans to such firms to be used as collateral in its monetary policy credit operations.

The ICAS BE can currently rate Spanish firms of any size. It rates the leading large firms[4] (around 500 firms) using the full ICAS (F-ICAS), which comprises a statistical model and an expert model consisting of a firm-by-firm review by an analyst. As for small and medium-sized enterprises (SMEs), the ICAS BE rates some 900,000 firms using a statistical ICAS (S-ICAS), which assigns a rating automatically without the need for an analyst to be involved.

The second section of this article looks at the current relevance 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 and how it has changed over the last 12 months. The third section includes an assessment of the current level of use of the ICAS BE, based on an estimation of the volume of ICAS BE-rated loans that could potentially be mobilised, and an analysis of how it has changed over the last 12 months. The final section examines the current distribution of the ratings assigned by the ICAS BE and its dynamics over the last 12 months.

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 and non-marketable assets. As in previous years, Spanish counterparties mainly pledge marketable

1 "Covered bonds" are debt instruments that have 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 European Central Bank). In Spain, they include mortgage covered bonds, public-sector covered bonds and internationalisation covered bonds.

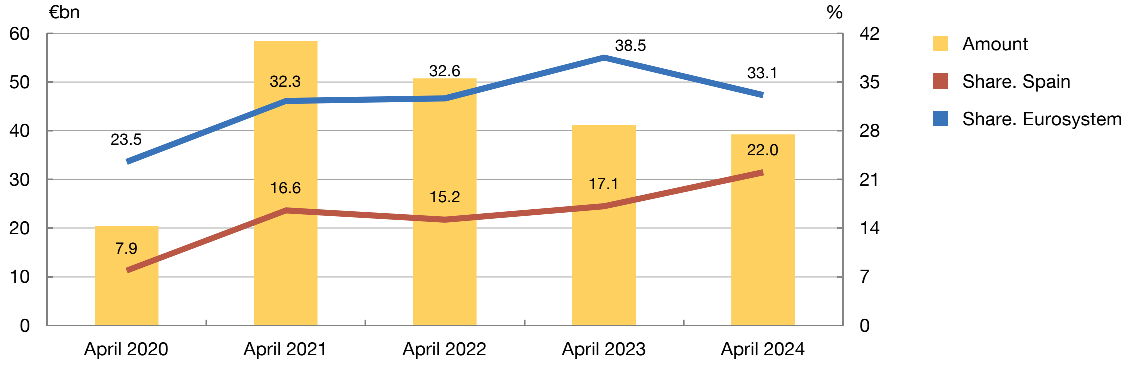
2 Gavilá, Maldonado and Marcelo (2020).

3 Classified within the non-financial corporations institutional sector as defined in ESA 2010.

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
Non-marketable assets have continued to grow in importance over the last 12 months

1.a Non-marketable assets



SOURCE: Banco de España.

DOWNLOAD

assets as collateral. However, the last 12 months have seen a continuation of the growing prominence that non-marketable assets gained in the wake of the emergency measures adopted by the Governing Council of the European Central Bank (ECB) in response to the COVID-19 crisis[5] (see Chart 1.a).

As at April 2024, just under €40 billion of non-marketable assets were pledged directly as collateral, accounting for 22% of the total, up 5 percentage points (pp) on April 2023 (17.1%) and close to three times the figure at the start of the COVID-19 crisis (7.9% in April 2020). Amid a reduction in the financing granted in Eurosystem credit operations,[6] the higher share of non-marketable assets in the last 12 months is related to Spanish counterparties responding to the lower needs for collateral by mainly ceasing to pledge marketable assets (decrease of €60 billion, versus €2 billion in non-marketable assets), whose greater liquidity renders them more attractive for securing market financing operations. Compared with the Eurosystem, the share of non-marketable assets is lower in Spain (1.5 times lower in April 2024),[7] although since the onset of the COVID-19 crisis the difference has decreased (in April 2020 the share in Spain was 3 times lower than in the Eurosystem).

The credit assessment sources for the 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

5 Escolar and Yribarren (2021).

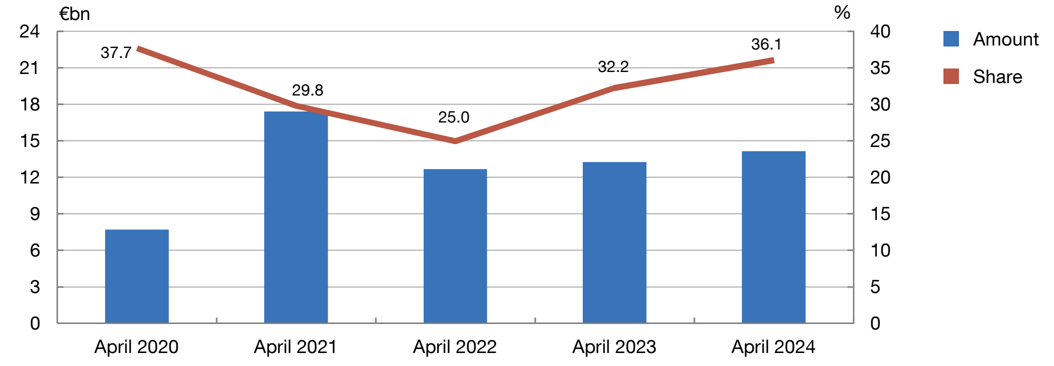
6 Castillo Lozoya, Esteban García-Escudero and Pérez Ortiz (2024).

7 The fall in the share of non-marketable assets at Eurosystem level in 2024 is mainly due to the Banque de France withdrawing the measure that allowed residential mortgage portfolios to be pledged as collateral. Indeed, if we exclude French counterparties from the calculation, the pattern is similar to that of Spain, as the share of non-marketable assets has also increased by 5 pp, from 29% in April 2023 to 34% in April 2024.

Chart 2

The amount and the share of ICAS BE-rated pledged loans have continued to grow over the last 12 months

2.a ICAS BE-rated pledged loans



DOWNLOAD

SOURCE: Banco de España.

central government of the jurisdiction in which they are established (public sector entity rule).[8] Meanwhile, the ICAS BE has been selected by all Spanish counterparties as the primary source of credit ratings for loans to firms.

ECAI-rated loans mobilised account for most of the non-marketable assets pledged as collateral (63.9% in April 2024). The remainder (36.1%) relates to loans to firms pledged using an ICAS BE rating (see Chart 2.a). Over the last 12 months the share of ICAS BE-rated non-marketable assets pledged has risen (from 32.2% in April 2023 to 36.1% in April 2024), as a result of an increase in the volume of ICAS BE-rated pledged loans[9] (from €13 billion to €14 billion) and a fall in the ECAI-rated loans mobilised (from €28 billion to €25 billion). This decline is mainly due to the expiration, in June 2023, of the temporary measure[10] that allowed partially government-guaranteed loans to be pledged. The announcement of the end of this measure a few months earlier also explained the rise in the share of the ICAS BE in 2023 (from 25% in April 2022 to 32.2% in April 2023), as it prompted numerous counterparties to withdraw early those loans from the collateral pools.[11]

A counterparty-by-counterparty analysis shows significant differences from the above-mentioned data. By asset type, approximately 60% (32 of 54) of Spanish counterparties only pledge marketable assets. Meanwhile, at those counterparties that also pledge non-marketable assets, the share of such assets is highly heterogeneous (see Chart 3.a). Compared with 2023, the

8 Additionally, and as part of the temporary measures approved by the ECB Governing Council during the pandemic, the Spanish central government rating was used to assess the part of the loans to firms and sole proprietors guaranteed by the public guarantee facility of the Official Credit Institute established by the Government under Royal Decree-Law 8/2020.

9 Before valuation haircuts, the increase in the volume of ICAS BE-rated pledged loans was greater because such haircuts rose with the entry into force on 29 June 2023 of Banco de España Technical Implementation 7/2023 (Banco de España, 2023a).

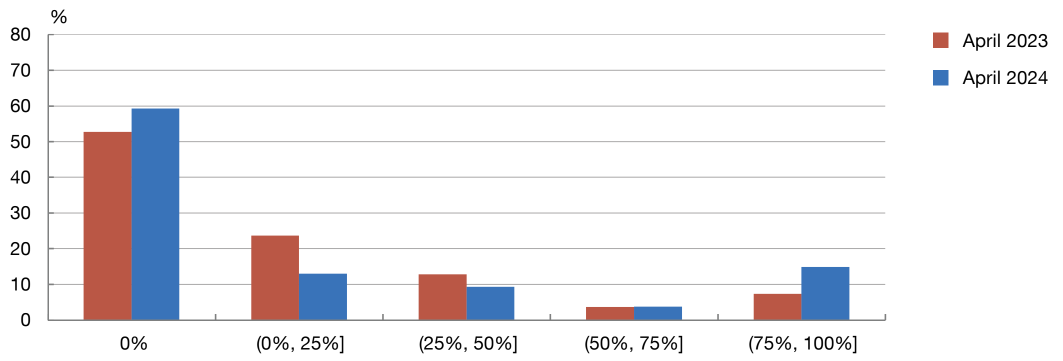
10 This measure expired when Banco de España Technical Implementation 7/2023, repealing Technical Implementation 9/2022, entered into force on 29 June 2023 (Banco de España, 2023a).

11 "Collateral pools" are the accounts held by each counterparty at the Banco de España to which the collateral assets mobilised for Eurosystem credit operations are allocated.

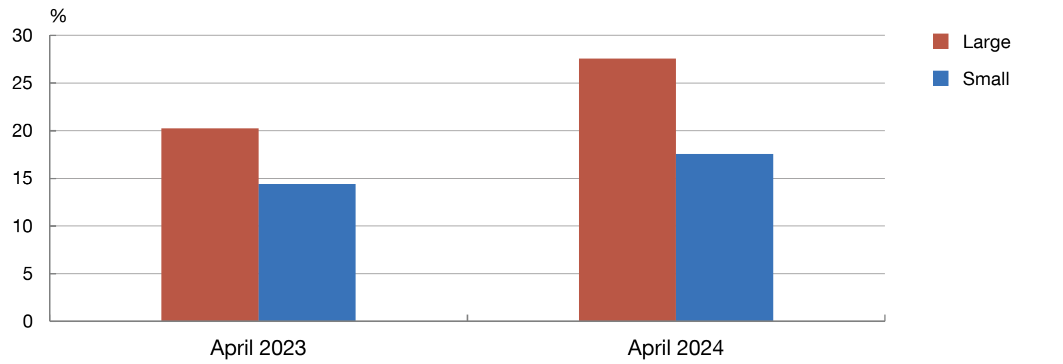
Chart 3

The use of non-marketable assets and the ICAS BE remains highly heterogeneous across counterparties

3.a Distribution of non-marketable assets as a share of total collateral, by counterparty



3.b Average share of non-marketable assets in total collateral, by counterparty size (a)



SOURCE: Banco de España.

a Counterparties are considered large if their collateral pool exceeds €1 billion and small otherwise.

DOWNLOAD

distribution of counterparties has shifted to the extremes, with those that do not pledge non-marketable assets as collateral[12] and those for which they account for more than 75% of the assets pledged both increasing. Taking into account the size of the pool, we observe that on average large counterparties[13] mobilise non-marketable assets more and that over the last 12 months the share of non-marketable assets has increased more at large counterparties than at small ones (see Chart 3.b).

As regards the level of use of the ICAS BE, the great majority of counterparties that pledge non-marketable assets contribute ICAS BE-rated loans (17 out of 22), although the proportion differs considerably by counterparty (see Chart 3.c). Over the last 12 months the number of counterparties that use the ICAS BE as their main source of pledge for non-marketable assets increased

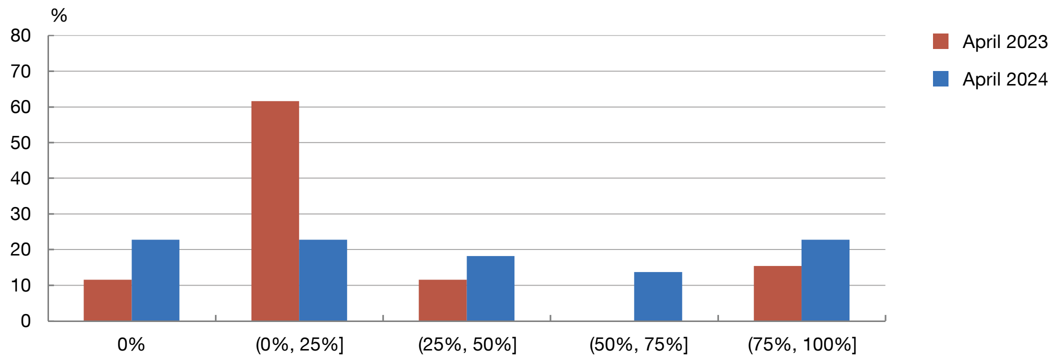
12 This is partly explained by counterparties at which the only type of non-marketable assets pledged as at April 2023 were partially government-guaranteed loans, which ceased to be eligible on 29 June 2023 (see footnote 10).

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

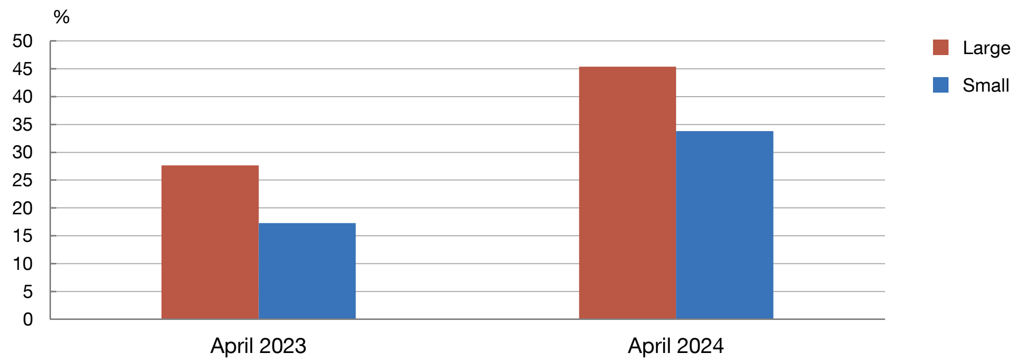
Chart 3

The use of non-marketable assets and the ICAS BE remains highly heterogeneous across counterparties (cont'd)

3.c Distribution of the share of ICAS BE-rated loans pledged in total non-marketable assets, by counterparty



3.d Average share of ICAS BE-rated loans in total non-marketable assets, by counterparty (a)



SOURCE: Banco de España.

a Counterparties are considered large if their collateral pool exceeds €1 billion and small otherwise.

significantly[14] (the ICAS BE accounts for more than 50% of the total for 36% of counterparties, compared with 15% a year earlier). On average, the larger counterparties have a higher share of ICAS BE-rated assets as a proportion of non-marketable assets overall, although the share grew in the year at a similar pace at all counterparties irrespective of size (see Chart 3.d).

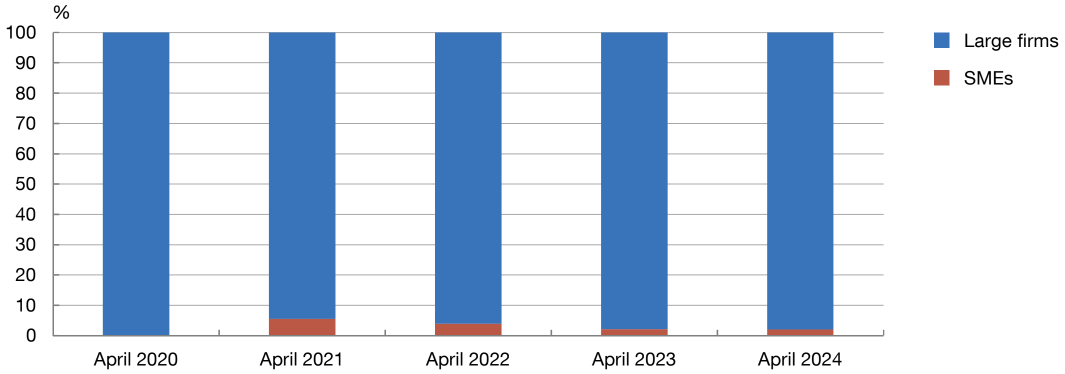
Potential use of collateral assessed by the ICAS BE

This section provides an in-depth analysis of ICAS BE-rated pledged collateral by firm size. Until May 2020, the ICAS BE only rated large firms using an F-ICAS. Its scope was subsequently expanded to SMEs, after obtaining the Eurosystem's authorisation to assess firms using a purely

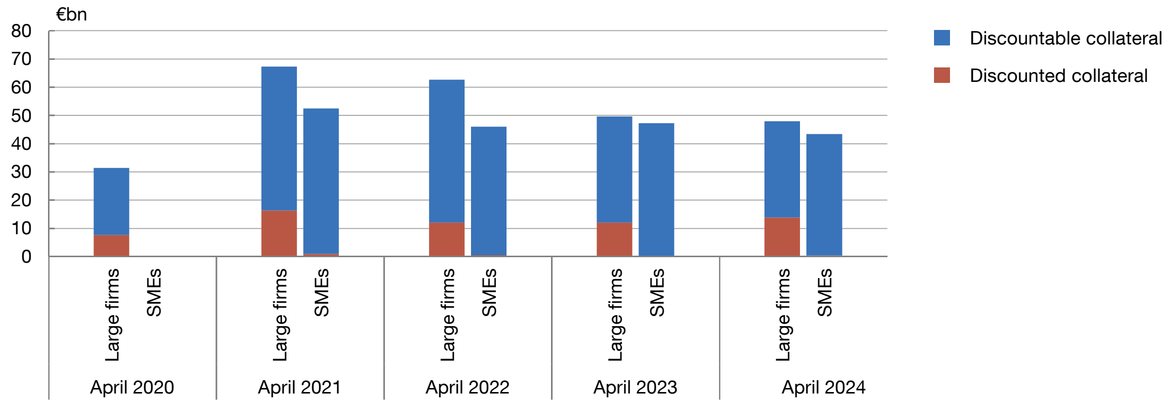
14 There is also a small number of counterparties that have ceased to use the ICAS BE as a source of assessment, because as at April 2023 they used it solely to assess the portion of loans that was not government guaranteed, which ceased to be eligible on 29 June 2023 (see footnote 10).

Chart 4
There is still ample scope to increase the volume of ICAS BE-rated pledged loans, especially in the case of loans to SMEs

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



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



SOURCE: Banco de España.

DOWNLOAD

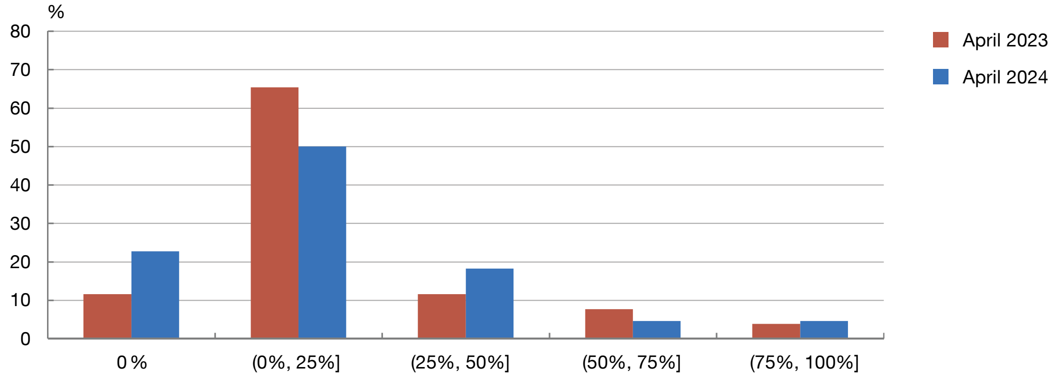
automated assessment system (S-ICAS). The great majority of the ICAS BE-rated loans pledged as collateral over the last 12 months belong to large firms (98%, see Chart 4.a), with only a very small share for SMEs (2%). The percentages are similar to those observed since 2020, when the ICAS BE started to rate SMEs.

However, as Chart 4.b shows, there is still considerable scope to increase the volume of loans pledged as collateral thanks to the ICAS BE, especially in the case of SMEs. This year the estimated potential volume of ICAS BE-rated pledged loans is around €90 billion,[15] evenly split between large firms and SMEs (some €45 billion each). Over the last 12 months the main factor driving the potential volume has been the end of several of the temporary measures adopted in response to the COVID-19 pandemic. The expiration of these measures had both positive and

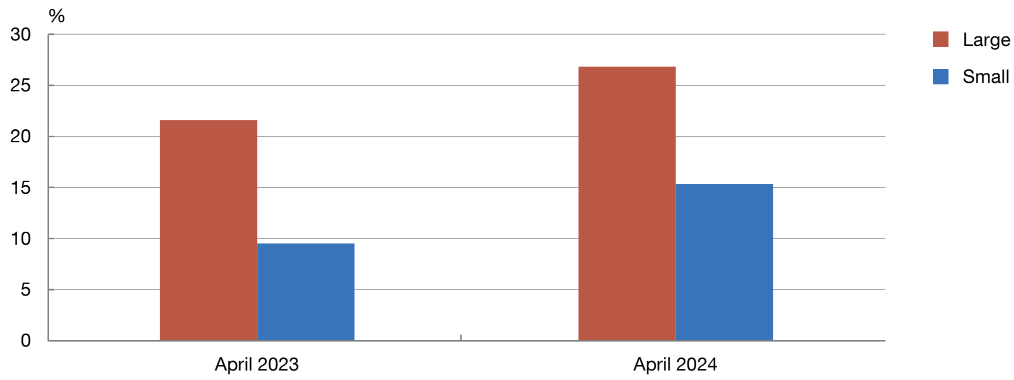
15 This calculation is consistent with Technical Implementation 5/2024 which entered into force on 6 May 2024 (Banco de España, 2024a).

Chart 5
The vast majority of counterparties still have much headroom to pledge a greater volume of ICAS BE-rated loans as collateral

5.a Distribution of the percentage of use of the ICAS BE, by counterparty



5.b Average percentage of use of the ICAS BE, by counterparty size (a)



SOURCE: Banco de España.

a Counterparties are considered large if their collateral pool exceeds €1 billion and small otherwise.

DOWNLOAD

negative effects on potentially discountable collateral,[16] resulting in a net decrease of approximately €6 billion. Estimating the potentially discountable collateral, compared with the amount actually mobilised, shows that the percentage of use is lower among SMEs, specifically 1%, compared with 29% for large firms. For SMEs these figures are similar to those observed as at April 2023, while for large firms they are around 5 pp higher.

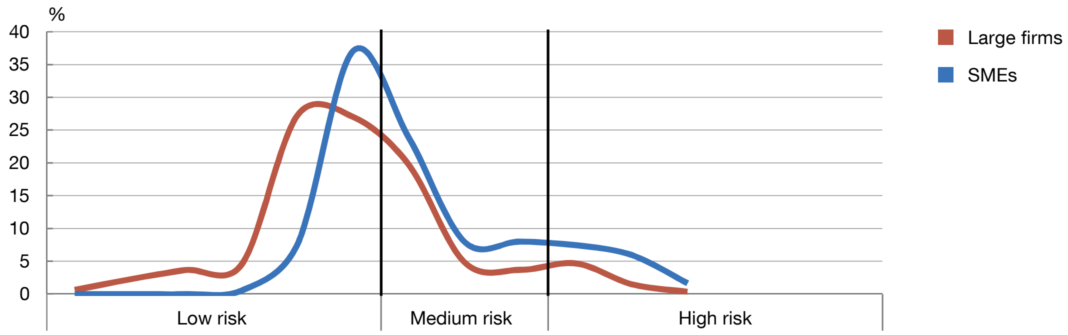
Loans to firms can be mobilised as collateral in monetary policy operations individually or through a granular portfolio in which the overall credit quality of the loans in the portfolio is assessed.[17]

16 Noteworthy on the negative side is the increase in the haircuts applied to asset values and the withdrawal of reverse factoring agreements and of loans with outstanding amounts under €25,000. By contrast, the withdrawal of the measure that allowed the central government rating to be used to pledge the part of loans backed by government guarantee had a positive effect, as since then those loans can only be pledged using the ICAS BE.

17 Banco de España (2023a).

Chart 6
The distribution of ICAS BE ratings is concentrated in the low-risk segment, especially for large firms

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



SOURCE: Banco de España.

a Data as at April 2024.
b Firms are deemed low risk when their probability of default on their credit obligations is below 1%, medium risk when it is between 1% and 5% and high risk when it is over 5%.

So far, Spanish counterparties have not made use of this second option, which could be particularly interesting for SMEs, as the lower amount of their loans (compared with those of large firms) reduces the incentives to use them individually as collateral, while the existence of a high number of loans makes it easier to meet the regulatory diversification requirements for mobilising loan portfolios.

There is still also ample room for an increased use of the ICAS BE at counterparty level, given that the percentage of use is under 25% in most cases (see Chart 5.a). However, over the last 12 months the proportion of counterparties with a percentage of use between 25% and 50% has risen. Taking into account counterparty size, the average percentage of use remains higher at large counterparties (27%, compared with 15% at small ones), with both groups recording a similar increase in the period (see Chart 5.b). In consequence, there is still more potential for small counterparties to increase loans to firms pledged with an ICAS BE rating.

Distribution of ICAS BE ratings[18]

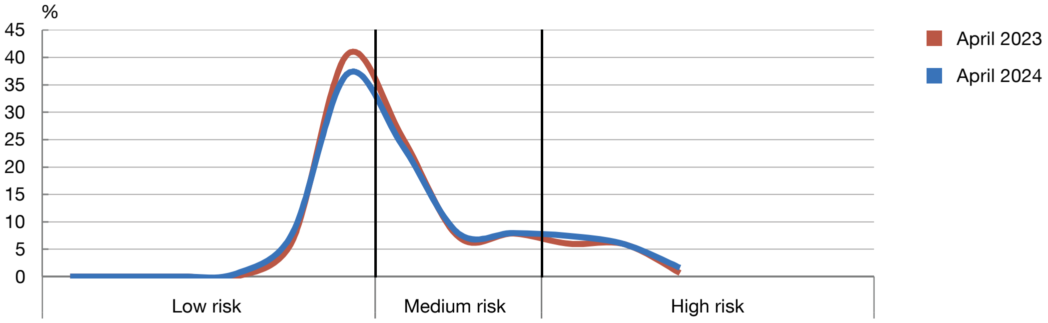
The credit ratings assigned by the ICAS BE in 2024 show differences according to firm size, with a better risk profile for large firms (see Chart 6.a). Specifically, the distribution shows that

18 The ICAS BE ratings used in this section are not official ratings for monetary policy purposes, as they do not include the assessment of the set of areas included in the ICAS BE, but only the assessment of the firm's financial risk profile (for instance, excluding the business risk profile or implicit support in the case of subsidiaries). In addition, the financial risk profile used in this section is assessed on the basis of the financial statement prepared by the firm for the year prior to the date of the analysis, except in the last year (April 2024) when the financial statement for 2023 estimated using the projection tool designed internally by the ICAS BE is used, as the vast majority of these financial statements are received only in 2024 H2.

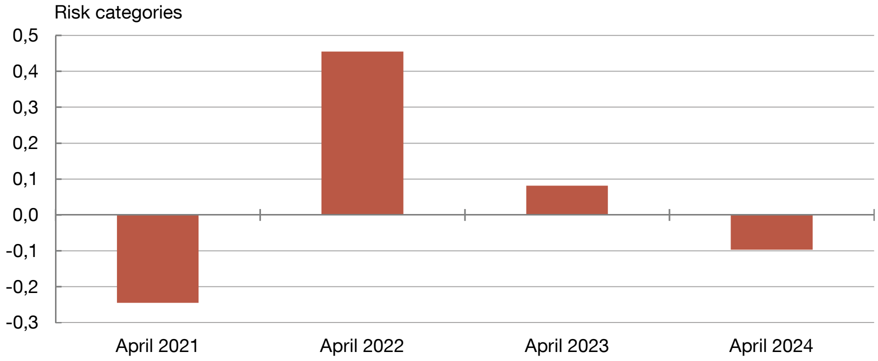
Chart 7

For the first time since the pandemic, the ratings have deteriorated slightly over the last 12 months, due mainly to the tightening of financing conditions

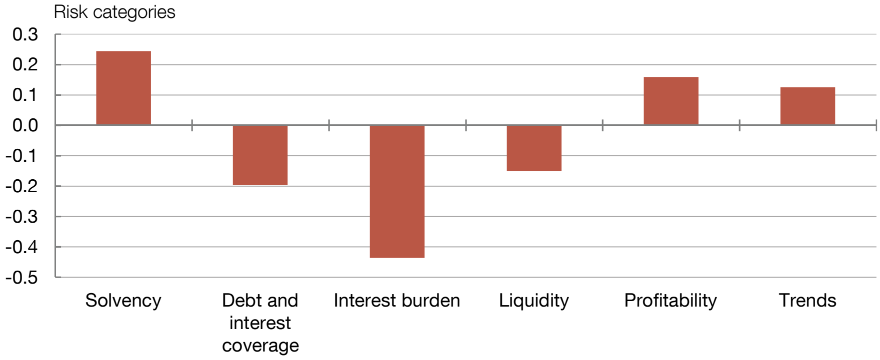
7.a Change in the distribution of ICAS BE ratings over the last 12 months (a)



7.b Change over time in the average ICAS BE ratings



7.c Change over the last 12 months in the main determinants of the ICAS BE ratings (b)



SOURCE: Banco de España.

a Firms are deemed low risk when their probability of default on their credit obligations is below 1%, medium risk when it is between 1% and 5% and high risk when it is over 5%.
b Data as at April 2024.

DOWNLOAD

large firms have a significantly higher concentration in the low-risk segment[19] (65%) than SMEs (45%).

Over the last 12 months the rating distributions have deteriorated somewhat. The percentage of firms in the high-risk segment has risen slightly, from 13% to 15% (see Chart 7.a). At the same time the average rating has dropped a little (-0.1 risk categories),[20] after improving for two consecutive years, mainly thanks to the growth in firms' turnover and profit in the years following the COVID-19 pandemic[21] (see Chart 7.b). In any event, the deterioration observed in 2024 is lower than that caused by the COVID-19 crisis (-0.1 risk categories in 2024, compared with -0.25 in 2021) (see Chart 7.b).

One of the main factors behind the deterioration in 2024 is the higher interest burden currently borne by firms as a result of the tighter financing conditions[22] (-0.4 risk categories) (see Chart 7.c). Other determinants of the financial profile of firms have been adversely affected, such as debt and interest coverage levels, which have declined, and liquidity, which has decreased (by around -0.2 risk categories). As a counterpoint, firms' profitability and solvency have continued to grow, albeit at a slower pace than in previous years.[23]

REFERENCES

Banco de España. (2023a). "Aplicación Técnica n.º 7/2023. Activos adicionales de garantía de operaciones y medidas de control de riesgos". https://www.bde.es/f/webbe/INF/MenuVertical/SistemasDePago/ficheros/es/AT72023Activosadicionalesdegarantia.pdf

Banco de España. (2023b). *Central Balance Sheet Data Office. Annual results of non-financial corporations 2022.* https://www.bde.es/wbe/en/publicaciones/informacion-estadistica/central-balances/central-de-balances--resultados-anuales-de-las-empresas-no-financieras-2022.html

Banco de España. (2024a). "Aplicación Técnica n.º 5/2024. Activos adicionales de garantía de operaciones y medidas de control de riesgos". https://www.bde.es/f/webbe/INF/MenuVertical/SistemasDePago/ficheros/es/AT_5_2024_Activos_adicionales_de_garantia_de_operaciones_y_medidas_control_riesgos.pdf

Banco de España. (2024b). "Quarterly report and macroeconomic projections for the Spanish economy: March 2024". *Economic Bulletin - Banco de España,* 2024/Q1. https://repositorio.bde.es/handle/123456789/36150

Banco de España. (2024c). *Principales indicadores económico-financieros de las empresas no financieras en el año 2023* (Nota de prensa estadística). https://www.bde.es/f/webbe/GAP/Secciones/SalaPrensa/NotasInformativas/24/presbe2024-20.pdf

Castillo Lozoya, M.ª Carmen, Enrique Esteban García-Escudero and M.ª Luisa Pérez Ortiz. (2024). "El efecto de la amortización de las TLTRO III en el balance de las entidades de crédito españolas". *Boletín Económico - Banco de España,* 2024/T2, 02. https://www.bde.es/f/webbe/SES/Secciones/Publicaciones/InformesBoletinesRevistas/BoletinEconomico/24/T2/Fich/be2402-art02.pdf

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". Documentos Ocasionales, 2128, Banco de España. https://repositorio.bde.es/handle/123456789/19235

19 For these purposes, firms are deemed low risk when their 12-month probability of default on their credit obligations is below 1%, medium risk when it is between 1% and 5% and high risk when it is over 5%.

20 These "risk categories" are the different values a rating can take. Each risk category translates into a probability of default on credit obligations.

21 Banco de España (2023b).

22 Banco de España (2024b).

23 Banco de España (2024c).

Gavilá, Sergio, Alfredo Maldonado and Antonio Marcelo. (2020). "The Banco de España in-house credit assessment system". *Financial Stability Review - Banco de España,* 38. https://repositorio.bde.es/handle/123456789/13555

How to cite this document

Gavilá, Sergio, Lola Morales and Rafael Vivó. (2024). "The role of loans and the ICAS BE in the Eurosystem's collateral framework in 2024". *Economic Bulletin - Banco de España*, 2024/Q3, 03. : https://doi.org/10.53479/37314

ISSN 1695-9086 (online edition)