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Quantitative Easing and Credit Rating Agencies
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ABSTRACT: This paper investigates the behaviour of credit rating agencies using a natural experiment in monetary policy. We exploit the corporate QE of the Eurosystem and its *rating-based* specific design which generates exogenous variation in the probability for a bond of becoming eligible for outright purchases. We show that after the launch of the policy, rating activity was concentrated precisely on the territory where the incentives of market participants are expected to be more sensitive to the policy design. Our findings contribute to better assessing the consequences of the explicit reliance on CRAs ratings by central banks when designing monetary policy. They also support the Covid-19 monetary stimulus, and in particular the waiver of private credit rating eligibility requirements applied to recently downgraded issuers.

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Quantitative Easing and Credit Rating Agencies

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This paper investigates the behaviour of credit rating agencies using a natural experiment in monetary policy. We exploit the corporate QE of the Eurosystem and its *rating-based* specific design which generates exogenous variation in the probability for a bond of becoming eligible for outright purchases. We show that after the launch of the policy, rating activity was concentrated precisely on the territory where the incentives of market participants are expected to be more sensitive to the policy design. Our findings contribute to better assessing the consequences of the explicit reliance on CRAs ratings by central banks when designing monetary policy. They also support the Covid-19 monetary stimulus, and in particular the waiver of private credit rating eligibility requirements applied to recently downgraded issuers.

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"The ratings [...] are and must be construed solely as, statements of opinion and not statements of fact or recommendations to purchase, sell, or hold any securities." (Rating Agency Disclaimer)

I. Introduction

The statement above has been consistently repeated by credit rating agencies (CRAs) during the global financial crisis of 2008. Nevertheless, a large set of investors continue to rely, directly or indirectly, on the ratings of CRAs to "purchase, sell, or hold securities". Directly, some market participants place restrictions on investing in non investment-grade bonds. Indirectly, most bond benchmarks employed by investors are constructed with underlying CRAs ratings.[1] What is less known is that major central banks around the world (e.g. Federal Reserve, European Central Bank, Bank of England, Bank of Japan) also rely on CRAs for the conduct of their monetary policy operations. As a matter of fact, the assessment of eligible assets to be purchased under their asset purchase programmes – commonly referred to as quantitative easing (QE) – was based, *inter alia*, on ratings from private agencies.

The recent Covid-19 pandemic has put at the forefront the importance of unconventional monetary policies and the critical role of private credit agencies. Indeed, the spread of the virus throughout the world was accompanied by a rapid deterioration of market conditions and falling prices of risky assets, with bond markets being no exception. Firms deprived of their primary source of cash-flows struggled to meet their financial obligations and faced imminent risk of default, which was often unrelated to the true soundness of their business. In this situation, the economy was at risk of losing valuable productive forces with a long-lasting effect on productivity. These developments prompted an immediate reaction by central banks, especially after the significant credit rating

[1]In October 2010, the Financial Stability Board (FSB) issued Principles for Reducing Reliance on CRA Ratings. The goal of the FSB Principles was to end the mechanistic reliance on CRAs ratings by banks, institutional investors and other market participants. Importantly, the FSB Principles recognized that CRAs ratings played an important role and can appropriately be used as an input to agents' own judgment as part of internal credit assessment processes.