

TLTRO and Financial Intermediaries

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Introduction

The new European Central Bank Targeted Long-Term Refinancing Operations

The Targeted Long-Term Refinancing Operation (TLTRO) was first announced at the European Central Bank's (ECB) June 2014 monetary policy meeting where ECB Chief, Mario Draghi unveiled a slew of measures to tackle the high exchange rate and the threat of deflation in the Eurozone. The TLTRO has been designed to work on the same principles as of the Bank of England (BoE)'s "Funding for lending" scheme. Under this scheme, the BoE launched a funding process to help its banks to take loans from the BoE at low interest rates, provided that the banks were able to prove and show that they were lending money to their end customers.

The ECB's scheme works in two steps, with a first phase linked to the outstanding amount of bank loans to the non-financial private sector and a second phase linked to the flow of net lending.

Two TLTRO operations conducted in September and December 2014 allowed banks to borrow up to an initial allowance. The latter is defined as 7% of the amount of banks' outstanding loans to the euro area non-financial private sector (excluding households' mortgages) as of end-April 2014. Funds will have 4 years maturity and a fixed rate equal to the MRO (Main Refinancing Operations) rate +10 basis points.

Between March 2015 and June 2016, banks will be able to borrow additional amounts in a series of TLTROs conducted quarterly and depending on banks' net lending to the real economy. In fact, these additional amounts can cumulatively reach up to three times each bank's net lending to the euro area non-financial private sector (excluding households' mortgages) provided between 30 April 2014 and the respective allotment reference date in excess of a specified benchmark. The benchmark will be determined "by taking into account each counterparty's net lending recorded in the 12-month period up to 30 April 2014". The rate will again be fixed and equal to the MRO rate +10 basis points. This second component of TLTRO is very important because it allows "leveraging" of the measure beyond the initial allowances and it explicitly introduces a link with the flow of net lending.

A very important and delicate part of the scheme is that of the safeguard mechanism to ensure that the funds are actually used for the purpose they are intended to, i.e. lending to the real economy. According to this mechanism, banks will be required to pay back the funds borrowed under phase 1 of the TLTRO as early as September 2016 (i.e. 2 years before maturity), if their net lending will be below the benchmark during the period from 1st May 2014 to 30 April 2016 .

Leasing, factoring and consumer credit under the TLTRO scheme

1. Eligibility of the product

Leasing, factoring and consumer credit - as forms of lending to the euro area non-financial private sector - are under the scope of application of the TLTRO; leasing and factoring may also be eligible in the national additional credit claims (ACC) frameworks as collateral for the Eurosystem refinancing operations (according to ECB Board decision of December 8th, 2011).

2. Scope of application: participation in the TLTRO

Only a “credit institution” can participate in a TLTRO at individual or at group level. According to ECB “Modalities of the targeted longer-term refinancing operations” (July 3rd, 2014), only “loans and net lending” made directly by an eligible bank/group of banks can be included in the calculation of the borrowing limits (and possible mandatory early repayment), and of the additional amounts. Moreover, only lending transactions made by these subjects are eligible for the calculation of the net lending used as benchmark for the analysis on the correct use of the refinancing funds.

In Europe, many specialised financial companies are not banks, but financial intermediaries; most of them are credit institutions’ subsidiaries. Considering only Italy (country which ranks third in the consumer credit and factoring new business statistics ranking and fourth in the leasing one), financial intermediaries’ outstanding is above 50%¹ of the total for the leasing, factoring and consumer credit sectors. More specifically, in Italy *“financial intermediaries (i.e. intermediaries engaged in activities of granting credit to the public in the form, for example, of leasing, factoring and guarantee providing) are subject to the same rules as banks as the CRD IV/CRR are applied to them by virtue of national rules”*². As we will see, in other European countries similar supervision systems exist.

In this situation, TLTROs create a competitive disadvantage for many financial intermediaries as respect to their competitors who are banks (or banks’ branches) and as respect to the other financing products offered by their parent banks. The latter effect is due to the impossibility to

¹ Sources: official Leaseurope, Eurofinas and Official Assilea, Assifact, Assofin Joint Statistics (year 2013).

² Only limited exemptions or derogations are provided i.e.: (1) intermediaries that do not collect funds from the public (via deposit or other debt instruments) are subject to a lower total capital ratio (6%); (2) for the purpose of capital requirements for credit risk under the standardised approach and, coherently, for large exposures purposes, factoring firms may consider the exposure to the sold debtor instead of to the selling firm provided that they fulfil a set of conditions analogous to the ones provided for firms under the IRB approach even though they are using the standardised approach; (3) a transitional phase for the full implementation of large exposure rules has been provided. During the transitional phase the portion of exposure exceeding the limits shall be covered by additional own funds. Source: EBA’s Report to the European Commission on the perimeter of credit institutions established in the Member States (November 2014).

include the lending transactions made by the subsidiaries into the perimeter for the calculation of the initial allowance (and possible mandatory early repayment) for the parent bank and for the calculation of the net lending used as benchmark. The parent company has no convenience in investing the BCE refinancing funding into new leasing, factoring and consumer credit transactions, as the latter ones are not counted neither in initial allowance nor in the flow net lending benchmark. In this context, there is a significant bias within the banking and financial market for the banks that chose to offer leasing, factoring and consumer credit through divisions or specialized banks and against those banks that chose to provide the same lending facilities through a non-banking, specialized financial company, as allowed by some National regulations, which also often provide a supervision regime equivalent to that of banks.

This framework, if replicated also in future similar ECB initiatives, will definitely lead to a loss of competitiveness for such intermediaries and therefore there is the concrete risk that this framework could lead parent companies (both banks and “industrial” parent companies) to transform their subsidiaries from financial intermediaries into banks. This would not be consistent with the current tendency observed in important countries (e.g. Italy, France, Spain) to create a specific regulation framework for financial intermediaries. Besides these effects on the credit supply side, it is easy to argue that this situation will also eventually hinder the very achievement of the TLTRO's aims, as factoring, leasing and consumer credit are widely used by the European businesses and households.

Why to exclude supervised financial intermediaries?

Three are the main reasons presented by the Supervision Authorities and by the ECB in order to justify the exclusion of financial intermediaries (even when they are subsidiaries of banks) from the scope of application of the TLTROs:

- the “credit institution” definition does not include financial intermediaries that have not the “banking licence” to take deposits or other repayable funds from the public;
- financial intermediaries are not subject to the Eurosystem’s minimum reserves;
- Eurosystem does not have sufficient information on their financial soundness.

We understand the reasons why participation to the Eurosystem refinancing operations is restricted to the banks, yet we maintain that the lending granted by the banks through non-banking, specialized financial intermediaries being part of their banking group should be included into the perimeter for the calculation of the initial allowance (and possible mandatory early repayment) and for the calculation of the net lending used as benchmark, at least when such intermediaries are subject to supervision by the competent Supervision Authority according to

their National law. In the following paragraphs we present possible arguments regarding these issues/requirements.

“Credit institution” definition

The “credit institution” definition is fixed at an European level and the banking licence is a requirement for the participation to Eurosystem refinancing operations and also to the TLTRO. Nevertheless, enlarging the TLTRO perimeter to the financial intermediaries which are banks subsidiaries, if they are supervised, would be consistent with the banks’ supervision perimeter.

In the recent EBA’s Opinion on matters relating to the perimeter of credit institutions (November 2014) it was observed that *“although some entities carrying on bank-like activities may not be subject to solo prudential requirements, where they are part of a banking group they may fall within the scope of regulatory consolidation (e.g. where they are considered ‘financial institutions’) ... the EBA observes that a necessary element of any future work in relation to the shadow banking sector would be to ensure that the perimeter of ‘credit institution’ (and other relevant terms such as ‘financial institution’) is clearly defined.”* More particularly, the EBA’s Report on the perimeter of credit institutions established in the Member States, shows how *“in some Member States finance, factoring and leasing companies are subject to solo prudential requirements (for example ES, FR, IT and PT).”*

We also remind that, in another country (i.e. UK), in April 2013 the BoE’s “funding for lending” scheme was expanded to count lending by banking groups involving financial leasing corporation and factoring corporations, which *“can be important sources of finance to some SMEs...”* (BoE’s press release of April 2013).

Therefore, we think that – notwithstanding the current definition of “credit institutions” and, in the light of the recent EBA’s Opinion on matters relating to the perimeter of credit institutions - there are all the elements to justify the inclusion of financial intermediaries’ activity in the perimeter of the TLTRO. This, at least, in those countries where financial intermediaries are supervised at an individual and/or at a consolidated level.

Supervised financial intermediaries are not subject to the Eurosystem’s minimum reserves

The Eurosystem’s minimum reserve requirement, which applies to credit institutions as well as specialized independent banking institutions and specialized banks belonging to banking group and branches of credit institutions, does not apply to supervised financial intermediaries. It could

be argued that if the bank operates exclusively in the medium-term, as with banks specialized in leasing, it is not mandatory for the bank to hold any required reserves with the Eurosystem.

In accordance with art. 4 of the EC Regulation N.1745/2003 and subsequent amendments, the required reserve ratio is equal to zero in the case of:

- a) deposits with agreed maturity over two years;
- b) deposits redeemable at notice over two years;
- c) repos;
- d) debt securities issued with an agreed maturity over two years.

This implies that, if the bank specialized in leasing meets the above mentioned requirements, although not holding reserves with the Eurosystem, it won't be excluded from the TLTRO scheme.

Similarly, it is not clear why the financial intermediaries, supervised on an individual level and subject to consolidated supervision on a group level, should be excluded from the TLTRO scheme for the only reason of not being subject to the minimum reserves regulation.

We can also consider two main aspects:

- specialised financial intermediaries do not have the banking licence because they do not take deposits or other repayable funds from the public;
- they do not present a systemic risk. In Europe, around 1,775 billion euro is the total outstanding of leasing, factoring and consumer credit (December 2013 data)³, while the Euro Area total banking portfolio is above 29,600 billion euro. For the specific features of these financial products, a different treatment was also provided for leasing, factoring, motor finance and consumer credit under the recent EC's LCR delegated act (October 2014).

Finally, the minimum reserve is also required as an important instrument to check the transmission of the monetary policies. Nevertheless, the safeguard mechanism introduced in the TLTRO with the check on the net lending, is itself an adequate instrument to quantify the effects of this initiative.

Eurosystem does not have sufficient information on their financial soundness

According to the above mentioned EBA's Report on the perimeter of credit institutions established in the Member States, there are countries (e.g. France and Italy) where supervised financial intermediaries are subject to the same/equivalent reporting requirements as CRR institutions. The

³ Sources: official statistics from Leaseurope, Eurofinas, EU Federation for the Factoring and Commercial Finance Industry.

data are collected by the National Authorities and/or directly by the Eurosystem at a consolidated and/or at an individual level. In those cases, the Eurosystem has adequate information on their financial soundness.

Conclusions

As reported in two recent ECB publications (Financial Integration in Europe, of April 2014 and Monthly Bulletin of July 2014), leasing, factoring and consumer credit play an important role in the SMEs financing. Therefore, including into the TLTROs perimeter also leasing, factoring and credit consumer transactions made by supervised financial intermediaries consolidated in a banking group, would facilitate SMEs' access to finance; this would also improve competitiveness among the different financial institutions, without any discrimination based on the different banking model adopted by the group. It should be included in the non conventional measures of the ECB to sustain the European economic growth.

About Us

The EU Federation for the Factoring and Commercial Finance Industry (EUF) is the Representative Body for the Factoring and Commercial Finance Industry in the EU. The EUF is composed of national and international associations for the factoring and commercial finance industry that are active in the EU. Its members represent over 97% of the factoring industry's turnover, which amounted to 1.26 trillion Euros in 2013 and can therefore be seen as an increasingly important mechanism for the funding of the real economy and especially of SMEs. More information at www.euf.eu.com

Eurofinas, the European Federation of Finance House Associations, is the voice of consumer credit providers in the EU. As a Federation, Eurofinas brings together associations throughout Europe that represent consumer credit providers. The scope of products covered by Eurofinas members includes all forms of consumer credit products such as personal loans, linked credit, credit cards and store cards. Consumer credit facilitates access to assets and services as diverse as cars, furniture, electronic appliances, education etc. It is estimated that together Eurofinas members granted over 321.7 billion Euros worth of new loans during 2013. More information at www.eurofinas.org

Leaseurope brings together 44 member associations representing the leasing, long term and/or short term automotive rental industries in the 33 European countries in which they are present. The scope of products covered by Leaseurope members' ranges from hire purchase and finance leases to operating leases of all asset categories (automotive, equipment and real estate). It also includes the short term rental of cars, vans and trucks. It is estimated that Leaseurope represents approximately 92% of the European leasing market and in 2013, total new leasing volumes worth 251.9 billion Euros were granted by the firms represented through Leaseurope's members. More information at www.leaseurope.org