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SPECIALISED CONSUMER CREDIT PROVIDERS IN EUROPE

Eurofinas observations on the Commission's Proposal for a Directive *on the access to the activity and the prudential supervision of credit institutions* and investment firms (CRD IV) and accompanying Proposal for a Regulation on *prudential requirements for credit institutions and investment firms*

December 2011

Eurofinas is entered into the EC Register of Interest Representatives with ID N° 83211441580-56

Eurofinas AISBL
Boulevard Louis Schmidt 87
B-1040 Brussels

RPM Bruxelles 0408.299.625

ABOUT EUROFINAS

Eurofinas, the European Federation of Finance House Associations, is the voice of the specialised consumer credit providers in the EU. As a Federation, Eurofinas brings together associations throughout Europe that represent finance houses, specialised banks, captive finance companies of car, equipment, etc. manufacturers and universal banks. 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, studies, furniture, electronic appliances, etc. It is estimated that together Eurofinas members financed over 324 billion Euros worth of new loans during 2010 with outstandings reaching 824 billion Euros at the end of the year.

For further information about this Eurofinas position, please contact:
a.giraud@eurofinas.org

Introductory Observations

Eurofinas takes note of the publication of the Commission's Proposal for a Directive *on the access to the activity and the prudential supervision of credit institutions and investment firms* (CRD IV) and accompanying Proposal for a Regulation on *prudential requirements for credit institutions and investment firms*[1]. The Federation welcomes the Commission's objectives to improve the resilience of the global financial system and to ensure a level playing field across Europe.

Basel III requirements were created for large and international banks. It is therefore crucial that, when transposing these requirements into the European regulatory framework, members of the European Parliament's Economic and Monetary Affairs (ECON) Committee and Council representatives take due account of the diversity of the EU banking system. This will avoid a distortion of competition affecting European specialised financial activities. Against this backdrop, the Federation wishes to recall its willingness to contribute in a constructive manner to the work of European institutions in this field.

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 financed over 324 billion Euros worth of new loans during 2010 with outstandings reaching 824 billion Euros at the end of the year.

Consumer credit providers across Europe encompass a diversity of organisations of different legal nature (i.e. specialised banks, finance houses) and with various operational characteristics (independent companies, subsidiaries of banks, captive finance companies of car manufacturers). Depending on their activities, market location and structure, local prudential regulatory treatment of consumer credit providers may vary.

New European prudential requirements and their national interpretation are of key importance for Eurofinas' constituency. As previously mentioned, Basel III requirements were not primarily designed for small and specialised financial institutions. As a consequence, the current provisions of the proposed European framework fail to take into account the specificities of consumer credit providers' business models. The expected increase in the cost of capital and liquidity and changes to these organisations' structure and refinancing models will have a direct impact on the provision of finance to households. As such it will also have a direct impact on the economic growth of European markets which, in general, heavily rely on private consumption.

It is therefore critical to ensure a consistent and proportionate transposition of Basel 3 requirements into the European regulatory framework. Against this backdrop, Eurofinas would like to draw your attention to some selected issues, which we believe are essential

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[1] See COM (2011) 453 final, Proposal for a Directive *on the access to the activity of credit institutions and the prudential supervision of credit institutions* and COM 2011 (452) final, Proposal for a Regulation *on prudential requirements for credit institutions and investment firms*

to uphold the important specificities of European consumer credit providers when adopting the new regulatory prudential framework.

Specific Observations

1. Scope

The general prudential requirements laid down in the Commission's Proposal for a Regulation on prudential requirements for credit institutions and investment firms are restricted to institutions supervised under the Commission's *Proposal for a Directive on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.*

Institutions covered by the Commission's Directive Proposal include the following organisations:

- **Credit institutions** i.e. any undertaking the business of which is to receive deposits or other repayable funds from the public and to grant credits for its own account[2]

- **Investment firms** i.e. any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis[3]

Any undertaking the business of which is not to receive deposits or other repayable funds from the public are *de jure* excluded from the scope of the proposed supervisory and prudential requirements. This is consistent with the work of the Basel Committee.

In parallel, we believe that lending institutions' access to the European Central Bank's funding schemes should be independent from their inclusion within the scope of the European regulatory framework for prudential requirements. The adequate criterion to access ECB funding should be the nature of collateralised assets not the legal or supervisory status or operational characteristics of lending firms.

<u>Against this background, it is critical to</u>:

→ **Clarify in the Proposals' recitals that, in line with the scope of Basel 3 requirements, the proposed general prudential requirements are not designed for and should not apply to organisations other than credit institutions or investment firms as defined in the Directive**.

→ **Clarify in the Proposals' recitals that, the applicability of the proposed general prudential requirements is without prejudice to the access of credit and financial institutions to the European Central Bank's funding schemes.**

[2] See Article 4 (1), COM (2011) 452 final
[3] See Article 8, COM (2011) 452 final and Article 4 (1.1) of Directive 2004/39/EC on markets in financial instruments

2. Own Funds

Eurofinas expects the proposed new capital requirements to have a significant impact on the European credit market. We believe that concrete consequences may vary depending on countries and organisations but will generally include:

- An increase in the cost of capital for lending institutions
- A decrease of capital allocation by banking groups to non-deposit taking lenders

Capital allocation by banking groups is key to non deposit taking lenders. We therefore believe that both the restricted availability and increased cost of capital for non-deposit taking organisations will impact their overall lending ability. This, in turn, will affect the quantity and cost of lending to households.

Against this background, it is critical to:

→ **Limit the possibility for national regulators to impose further capital requirements**. Failing to do so will result in major competitive distortions across Europe.

→ **Allow all capital requirements and surcharges for subsidiaries to be included in the calculation of minority interests**.

→ **Clarify the treatment of Deferred Tax Assets (DTA)**. DTAs should be netted with deferred tax liabilities.

3. Leverage ratio

Eurofinas considers that the introduction of a leverage ratio should be limited to a Pillar II measure. We would therefore strongly oppose the introduction of a leverage ratio as a Pillar I measure which, in our view, would discriminate against low-risk business models.

In addition, we strongly believe that the observation/monitoring phase should be used to address the unsuitability of a hard leverage ratio to avoid encouraging low-risk models from shifting to riskier models.

Against this background, it is critical to:

→ **Keep the proposed leverage ratio only as a Pillar II measure**.

4. Liquidity

Proposed new liquidity requirements are of great concern for Eurofinas' constituency. In particular, the following elements are key for our industry:

- The scope of application of the new requirements on an individual basis or consolidated basis is crucial and remains unclear. Liquidity is managed in a centralised fashion by banking groups. The application of the requirements on an individual basis would therefore be extremely detrimental to European banking

groups having subsidiaries in several markets as no compensation would be allowed. The liquidity risk of an organisation is seen globally by investors and credit rating agencies in particular within the Eurozone. This should be reflected in the new regulatory framework.

- The new short term Liquidity Coverage Ratio (LCR) and long term Net Stable Funding Ratio (NSFR) will require both the constitution of a portfolio of high quality liquid assets and the use of more stable funding sources.

  The LCR does not fit the activities and business models of consumer credit providers who, primarily use banking and market funding and, in general, do not have trading books. The LCR will therefore require for consumer credit providers to completely rethink their refinancing sources and to constitute dedicated investment portfolios. It may even force consumer credit providers to collect deposits which is neither part of their traditional activities nor expertise. We believe that this new approach goes beyond what most consumer credit providers can withstand economically.

  In particular, the current provisions would lead to the constitution of significant bond portfolios that are disproportionate to the risks entailed and the length of credits granted to households.

  Liquidity requirements would be particularly inappropriate for non-deposit taking organisations.

Against this background, it is critical to:

→ **Clarify and strengthen the derogation from individual liquidity requirements** to allow exclusive application of requirements at consolidated level. In this context, the conditions for the application of liquidity requirements at consolidated level should be relaxed.

→ **Define marginal lending facilities to the European Central Bank as non risky liquid assets**. Assets eligible for refinancing with Central Bank should be considered as non risky liquid assets.

→ **Include all financing commitments given to institutions in the calculation of the relevant ratio**. Current provisions do not allow beneficiaries of financing commitments to sufficiently take these into account.

→ **Increase the recognition of short term commitments (i.e. of less than a year) in the ratio**. The Basel III framework does not take into account the real duration of a loan but refers to its risk weighting. It is paradoxical that a 20 years long mortgage loan is considered as more liquid than a 2 years long consumer credit.

In parallel, the Federation firmly believes that further analysis of the NSFR is warranted to adapt to those financial institutions involved in long term activities.