eurofinas

SPECIALISED CONSUMER CREDIT PROVIDERS IN EUROPE

Eurofinas response to the European Commission's Green Paper on Shadow Banking

May 2012

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

Eurofinas AISBL
Boulevard Louis Schmidt, 87
1040 Brussels

RPM Bruxelles 0408.299.625

ABOUT EUROFINAS

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 finance houses, specialised banks, universal banks and captive finance companies of car, equipment, etc. manufacturers. 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 320 billion Euros worth of new loans during 2010 with outstandings reaching about 820 billion Euros at the end of the year.

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

I. Introductory Observations

Eurofinas, the voice of consumer credit providers at European level welcomes the opportunity to respond to the European Commission's Green Paper on Shadow Banking.

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:

- Motor vehicles (cars, motorbikes, caravans)
- White goods (for example, large household appliances such as ovens and refrigerators)
- Brown goods (for example, audio/visual and electronic products such as televisions, radios and stereo sets)
- Home improvements (for example, in view of energy savings or large repairs)
- Education (student loans)

It is estimated that together Eurofinas members financed over 320 billion Euros worth of new loans during 2010 with outstandings reaching 820 billion Euros at the end of the year.

Structure of the market

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 supervisory and prudential regulatory treatment of consumer credit providers may vary.

The degree and nature of competition varies across EU Member States. In general the consumer credit market is a highly competitive business environment where different types of players operate. In Europe, the market is mainly composed of consumer credit firms with local activities. A number of consumer credit lending institutions have a pan-European business. The latter is principally carried-out through mergers/acquisitions and the establishment of branches or subsidiaries in other EU countries.

It is worth highlighting here that the bulk of the European consumer credit business, both in terms of outstandings and new loans, is carried out in the following markets: France, Germany, Italy, Spain and the United Kingdom.

It is also important to stress that consumer credit markets are some of the most dynamic markets in financial services. The identification and understanding of consumers' needs and wants is at the heart of consumer credit lending institutions innovation schemes. Innovation is a vital component of consumer credit providers' strategies. In our sector, innovation can consist in i) identifying and targeting market segments, ii) developing or optimising cumulative or alternative use of direct and indirect distribution channels, iii) developing or adapting consumer credit products and services to the latest technological changes and, iv) marketing campaigns and co-branding of consumer credit products. Local regulatory frameworks play a major role in the development of new innovative projects. Innovation would therefore be considerably limited in overregulated markets.

Unless explicitly mentioned otherwise, the Eurofinas response to the European Commission's Green Paper on Shadow Banking focuses on the activities and the supervisory and regulatory treatment of consumer credit lending institutions. It does not prejudge the Federation's position on other entities or activities listed in the Green Paper.

II. Definition of shadow banking

a) Do you agree with the proposed definition of shadow banking?

b) Do you agree with the preliminary list of shadow banking entities and activities? Should more entities and/or activities be analysed? If so, which ones?

The term "shadow banking" appears to catch a wide range of financial entities and activities.

Though we appreciate the Commission's intention to conduct an exhaustive identification of all financial activities currently not subject to international supervisory and prudential requirements, these entities and activities have very little in common. We recognise that this approach has been adopted intentionally in order to ensure that all areas (activities and entities) of relevance to the stability of the European (and global) financial system are appropriately identified and any risks they pose are adequately addressed. Nevertheless, we are concerned that the general nature of this definition could lead to misunderstanding.

In addition to being inherently pejorative, the term "shadow banking" is also not supported by any reliable existing legal concept.

To avoid any confusion, we ask the Commission that when referring to consumer credit lending institutions, the terms credit institutions and financial institutions be used. This is consistent with the Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions.

A <u>credit institution</u> means an undertaking the business of which is to receive deposits or other repayable funds from the public and to grant credits for its own account. A <u>financial institution</u> means an undertaking other than a credit institution, the principal activity of which is to acquire holdings or to pursue one or more of the activities listed in points 2 to 12 and 15 of Annex I of the Directive. Consumer credit providers fall within one of these two legal definitions.

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 current European supervisory and prudential regulatory framework. However, when belonging to a banking group (as is the case for a significant share of European consumer credit lenders), these firms are indirectly subject to these rules through their application at consolidated level. This is consistent with the current Capital Requirements Directive and 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 and accompanying Regulation (CRD IV Package).

The exclusion of some institutions from the scope of European supervisory and prudential requirements does not mean that these institutions are not subject to an appropriate supervisory or prudential framework at national level. Implying that those institutions which are currently not subject to prudential frameworks developed at international/European level operate in a totally unregulated environment would not only be wrong but fundamentally misleading.

We believe that the entities listed in the Green Paper should be clearly distinguished on the basis of the following criteria:

- The nature of their activities/business (consumer credit lending institutions cannot reasonably be treated the same way as money market funds)

- The existence of pre-existing reliable European legal concepts (such as the definitions used in Directive 2006/48/EC)

- The existence, nature and levels of potential risks

In parallel, it is critical to identify those supervisory and prudential national rules currently applicable to financial institutions as well as their market share and operational characteristics.

The Federation takes the view that no further work can be conducted in terms of oversight and regulation of the consumer credit sector before a thorough market study is undertaken. In any case, evidence of a pan-European problem should first be provided before any further discussion takes place. Any proposed remedy shall be subject to a preliminary impact assessment and costs/benefits analysis.

III. Risks and Benefits

c) Do you agree that shadow banking can contribute positively to the financial system? Are there other beneficial aspects from these activities that should be retained and promoted in the future?

d) Do you agree with the description of channels through which shadow banking activities are creating new risks or transferring them to other parts of the financial system?

e) Should other channels be considered through which shadow banking activities are creating new risks or transferring them to other parts of the financial system?

All business activities in Europe, indeed worldwide imply a degree of risks.

We do not believe that the risks identified in the Green Paper apply to consumer credit financial institutions:

- Short-term funding is not a significant feature in our sector and,

- Lending by financial institutions was not designed to circumvent existing rules. Rather it came about as an additional offering at the point of sale to help individuals purchase goods and services. It is worth highlighting here that specialised consumer credit firms, established to help distribute manufactured goods existed way before many retail institutions.

Additionally, consumer credit activities do not pose any threats to depositors (as consumer credit providers generally do not receive deposits or repayable funds from the public). As regards the implications of their activities for their clients, it should be recalled that the Directive 2008/48/EC (the Consumer Credit Directive) already provides for a very comprehensive European regulatory framework. The Directive notably includes a duty for all consumer credit providers to assess the creditworthiness of applicant borrowers before the conclusion of any contract. The risk analysis of their clients is at the heart of consumer credit firms' business model.

As previously mentioned, we believe it is critical to identify the nature and levels of risks posed by consumer credit firms. There is currently no clear evidence that risks to the financial system arise from their activities. It is worth recalling here that there have been no Government's bail-outs for such companies in the past. Micro-level risks are extremely limited due to our interconnectedness with the banking sector whose investment and exposure in consumer credit firms' activities are already heavily regulated and constrained by international prudential requirements.

It is also worth stressing that the specialised nature of consumer credit firms means that they have a unique understanding of asset markets (a substantial part of credit agreements are linked to specific assets/services for e.g. motor finance) and are able to track the level of risk they are exposed to very carefully.

In 2010, more than €231 billion of goods, services and consumer vehicles were financed by Eurofinas members (based on a sample of 14 member countries). This figure underlines the importance of consumer credit to overall consumption within EU countries. Consumer credit supports the social and economic well-being of millions of consumers across Europe. It facilitates the purchase of vehicles, white or brown goods and home improvements. It also benefits:

- Manufacturers as a key tool to distribute their production
- Motor dealers for whom consumer credit is an indispensable tool for the sale of vehicles
- Retailers for whom consumer credit is a commercial tool and essential for items whether big or small ticket

Not only consumer credit financial institutions provide an alternative source of funding to traditional bank lending but they are also a key driver of the economic growth of European markets which, in general, heavily rely on private consumption. The recent financial crisis was followed by a reduction of credit activities by most banks. Within the European Union, there are currently few substitutes to help when banks apply more restrictive lending standards. Encouraging consumer credit activities and the business model of its providers should therefore be a major public policy objective.

IV. Supervisory and Regulatory challenges

f) Do you agree with the need for stricter monitoring and regulation of shadow banking entities and activities?

g) Do you agree with the suggestions regarding identification and monitoring of the relevant entities and their activities? Do you think that the EU needs permanent processes for the collection and exchange of information on identification and supervisory practices between all EU supervisors, the Commission, the ECB and other central banks?

h) Do you agree with the general principles for the supervision of shadow banking set out above?

i) Do you agree with the general principles for regulatory responses set out above?

j) What measures could be envisaged to ensure international consistency in the treatment of shadow banking and avoid global regulatory arbitrage?

Eurofinas agrees that relevant supervisory authorities should possess the appropriate knowledge on traders operating in their markets as well as on their activities. We also agree that supervision should always be performed at the appropriate level, be proportionate and take into account the existing supervisory expertise and capacity.

As it stands, there is no evidence of a need to reinforce the national supervisory structures of consumer credit institutions in Europe.

We take the view that a very first step should be for the European Central Bank to require the collection of relevant market data. This will enable all stakeholders to have a complete and accurate view of the size of the markets, types of operators, convergence of interest rates etc. Eurofinas would be happy to contribute in a constructive manner to this work.

In the field of consumer credit, the European Central Bank publishes a dataset of EU Monetary Financial Institutions' balance sheets. However, divergences in national and European statistical reporting frameworks (coverage of statistics and definitions of loans purpose) make it difficult to accurately size the European consumer credit market. Eurofinas is currently discussing this issue with the European Central Bank.

As to the content of a regulatory intervention in the field of consumer credit financial institutions, we believe this would be premature. As previously mentioned it would not make sense to start discussing potential rules without having first been able to size the market and identify concrete risks.

We take the views that, in general, Basel requirements were not primarily designed for small and specialised financial institutions. As a consequence, this framework fails to take into account the specificities of consumer credit providers' business models.

In particular, the CRD IV package should not be extended to apply to financial institutions. The expected increase in the cost of capital and liquidity and changes to these organisations' structure and refinancing models would have a direct impact on the provision of finance to households, which would also create a drag on European economic growth. Against this backdrop, Eurofinas welcomed the recognition in the Commission's CRD IV package that this set of requirements should only be applied to credit institutions as defined in Directive 2006/48/EC. This approach was recently endorsed by the European Parliament's Economic and Monetary Affairs (ECON) Committee.

Additionally, the CRD IV requirements do not fit the activities and business models of consumer credit providers who, primarily use banking funding and, in general, do not have trading books. Its provisions would 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 approach would go beyond what most consumer credit providers can withstand economically. The Federation warns against the major impact this would also have on market competition.

k) What are your views on the current measures already taken at the EU level to deal with shadow banking issues?

The European Commission has already taken an important number of steps to deal with some of the issues related to so-called shadow banking. In particular, we consider that the various revisions of the Capital Requirements Directive, including the EU implementation of Basel 3 requirements, will make a significant contribution to safeguarding the financial system, both directly (e.g. through stricter capital requirements related to securitisation) as well as indirectly (e.g. through the application of the current and revised prudential requirements at the consolidated level of banking groups, where subsidiaries of banks like consumer credit companies are included in the prudential consolidation scope, or through higher risk weights for exposures to unregulated financial institutions).

l) Do you agree with the analysis of the issues currently covered by the five key areas where the Commission is further investigating options?

m) Are there additional issues that should be covered? If so, which ones?

n) What modifications to the current EU regulatory framework, if any, would be necessary properly to address the risks and issues outlined above?

o) What other measures, such as increased monitoring or non-binding measures should be considered?

As previously mentioned, if in the future it is shown that prudential requirements are required for consumer credit firms, they should be designed to be proportionate and take the specificities of our activities into account, precisely as set out in the Green Paper's general principles for supervision and regulation. They should not be based on rules that are designed for large, international deposit taking institutions, particularly as the risks that these requirements aim to address do not exist within consumer credit firms.