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# Transparency Taskforce

## Reform of the Finance Industry in Europe

Bob Lyddon – 29 April 2021

# EU/Eurosystem interventions in the pandemic

€1.85 trillion Pandemic Emergency Purchase Programme (to add to the existing €2.9 trillion APP, or bond buying)

€1.5 trillion Targeted (aka scattergun) Longer-Term Refinancing Operation Series III

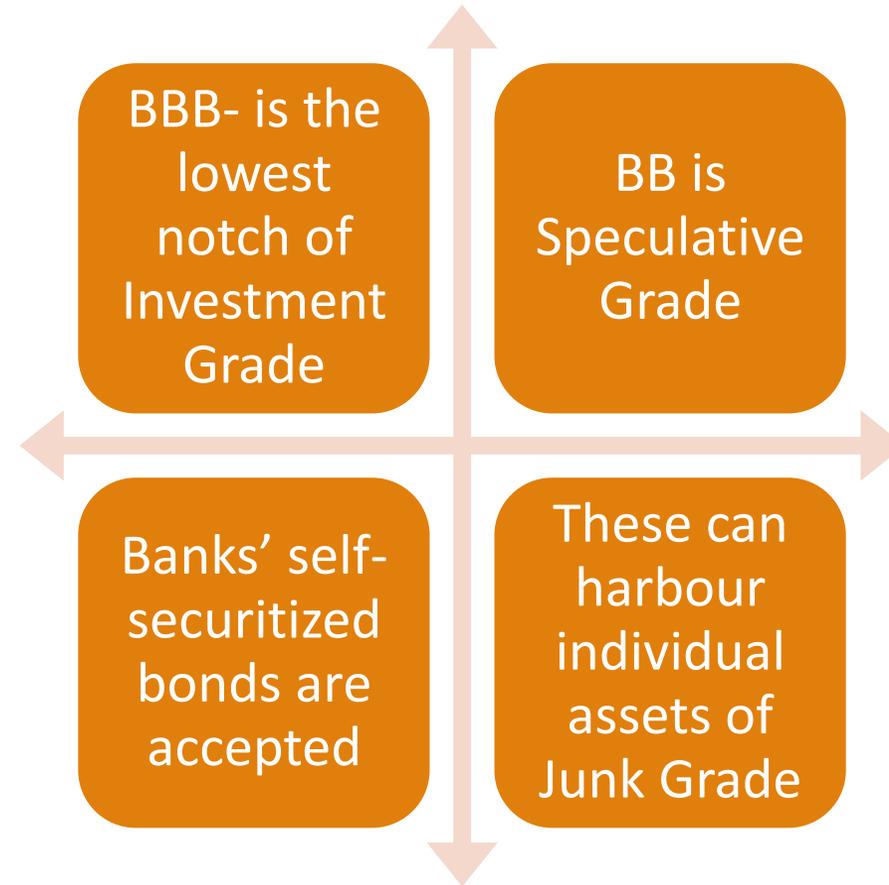
Eurosystem balance sheet now 94% of 2019 Eurozone GDP – not including TLTRO III.7 of €330.5 bn or the TARGET2 balances

€750 billion Coronavirus Recovery Fund as part of 2021-27 Multiannual Financial Framework

Weakening of Eurosystem collateral criteria and TLTRO is not collateralized at all

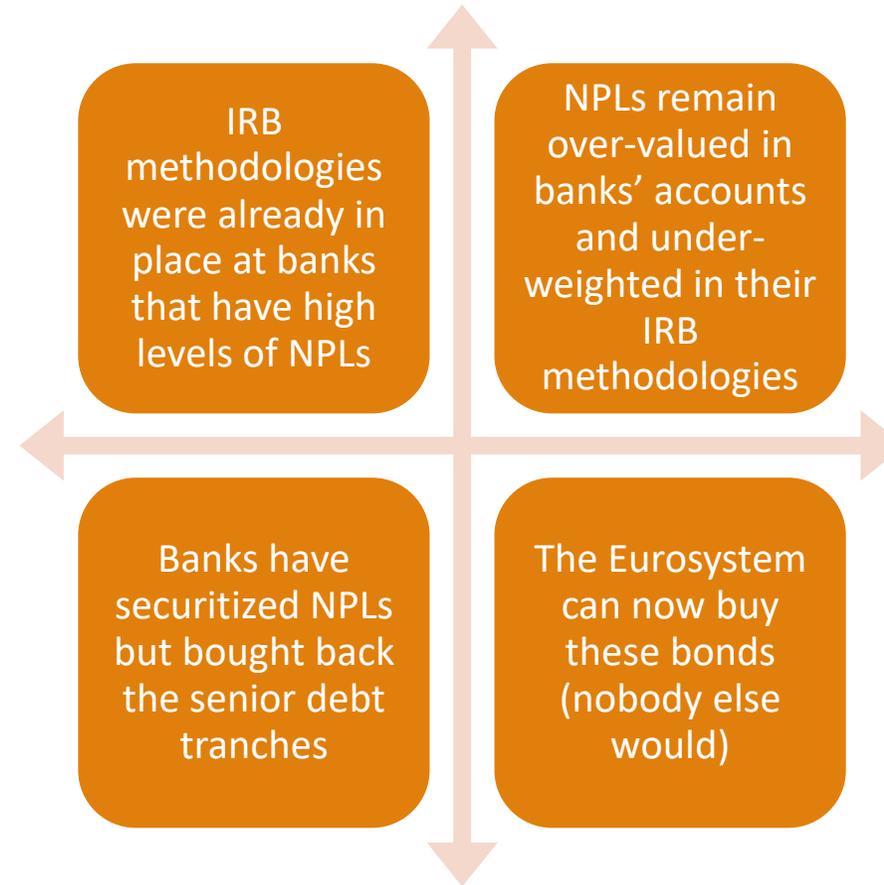
# Compromising of credit quality standards

- The normal Credit Quality standards for Eurosystem operations have been relaxed from Credit Quality Step 3 (BBB-) to Credit Quality Step 5 (BB)
- Issuers are viewed with their ratings as they were in April 2020
- Bonds only have to be sold if they are downgraded to BB-...but who will buy them?



# Banks' Internal Ratings-Based Methodologies

- Self-securitized bonds will be backed by “credit claims”
- The “credit claims” could be any sort of loan and even Non-Performing Loans (NPLs)
- These bonds do not have to have a public credit rating
- Instead an assessment based on a bank’s Internal Ratings-Based (IRB) methodology is good enough if that internal rating is at the level of an acceptable public rating



# Characteristics of Eurosystem operations

## Safety

- Based on public credit ratings but compromised by EU control of rating agencies, and by missing amounts of debt
- Can buy and hold bonds of Speculative Grade down to BB
- Can buy bonds backed by banks' "credit claims" without their having a public rating

## Liquidity

- A series of Buy-and-Hold operations
- The Eurosystem owns over half of the supply
- Large blocks of stock do not trade
- Private and speculative investors no longer participate in the market
- There is one major buyer – the Eurosystem

## Yield

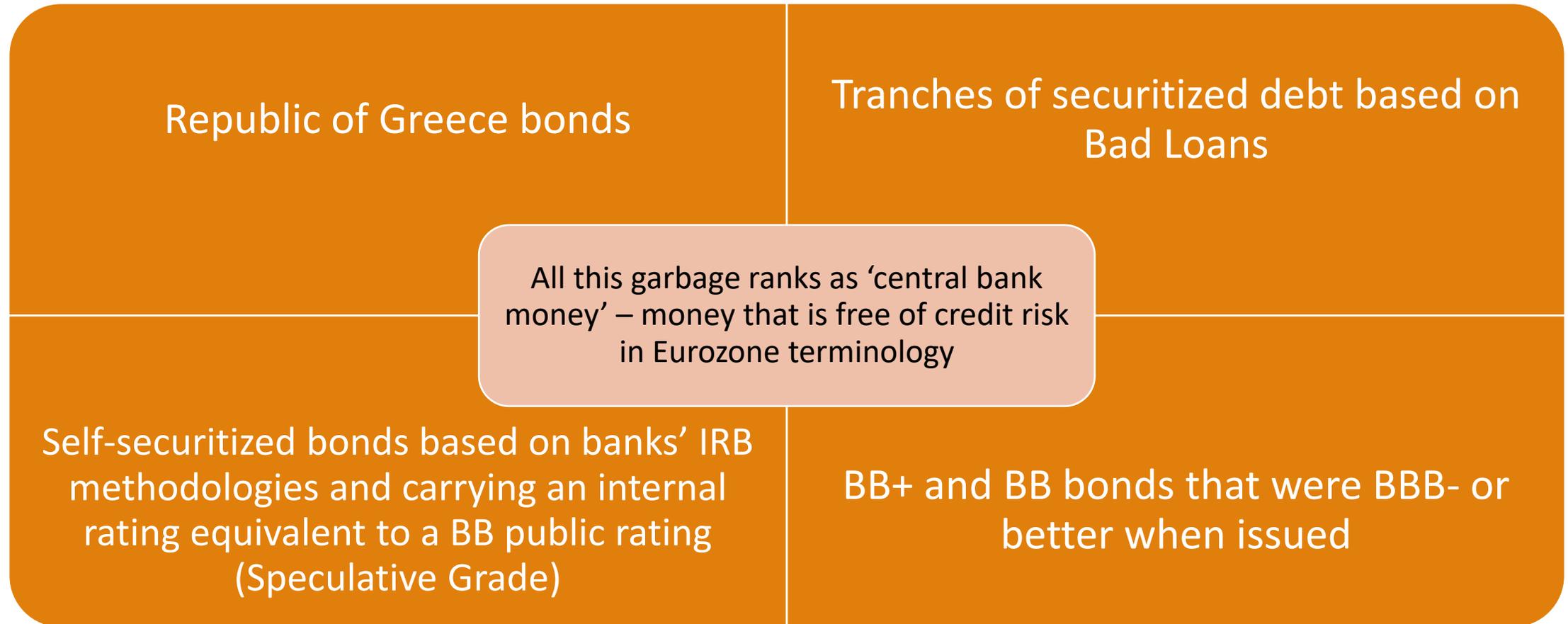
- Low or even negative
- Kept there by Eurosystem intervention
- Who else would buy the paper?
- Who else could the Eurosystem sell it to?
- Spares Member States billions in debt interest

# Breaches of applicable law

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Programme/mechanism	Breach
Coronavirus Recovery Fund	Breaches the Lisbon Treaty by manipulating the meaning of an article that justifies EU intervention in the case of a natural disaster affecting a single member state
Pandemic Emergency Purchase Programme	Breaches the limitation on the Eurosystem from providing member states with direct monetary financing
Pandemic Emergency Purchase Programme and Targeted Longer-Term Refinancing Operation	Eurosystem intervention justified by its self-awarded mandate to keep inflation at 2%, and to intervene to keep inflation <u>up to</u> - as opposed to <u>down to</u> – this level
Pandemic Emergency Purchase Programme and Targeted Longer-Term Refinancing Operation	Expands definition of eligible assets well beyond ones that can plausibly be claimed to be ‘central bank money’ i.e. free of credit risk

# The ECB recycles waste into central bank money



# How do you “reform” that?

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- The UK is 2 miles up the creek, but it has a paddle: sovereign control over its own currency
- This does not mean the UK is not heading in the wrong direction
- The EU/Eurozone is 20 miles up the creek with no paddle
- At least it could require that the banks who fall under the Single Supervisory Mechanism should stop using Internal Ratings-Based methodologies (which played a major role in the Archegos debacle)...
- ...and it should produce a comprehensive accounting of public sector debts, including within TARGET2, InvestEU, its supranationals (EU/EIB/EIF/ESM), and the public sector entities whose debts are not counted by Eurostat within “General government gross debt”

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**Close of presentation**

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