EUROPEAN CENTRAL BANK

EUROSYSTEM

Christine LAGARDE
President

Mr Sven Giegold
Member of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt am Main, 28 May 2021

L/CL/21/123

Re: Your letters (QZ-019 & QZ-020)

Honourable Member of the European Parliament, dear Mr Giegold,

Thank you for both of your letters, which were passed on to me by Ms Irene Tinagli, Chair of the Committee on Economic and Monetary Affairs, accompanied by a cover letter dated 31 March 2021. As the topic of both is the targeted longer-term refinancing operations (TLTROs), I will address your questions in a single reply.

Before doing so, let me reiterate that the TLTROs are a crucial component of the ECB's set of monetary policy instruments and an essential part of the monetary policy response to the coronavirus (COVID-19) crisis. As a monetary policy instrument, they are intended to reinforce the ECB's accommodative monetary policy stance and strengthen the transmission of monetary policy. The TLTROs achieve this objective by supporting bank lending to households and firms on very favourable lending terms. Since March 2020 the operations have been recalibrated to increase their impact on banks' incentives and ability to lend to the real economy, particularly during the pandemic. This has ensured the availability of abundant liquidity at low rates for banks on the condition that they keep lending to non-financial corporations and households. This, in turn, has significantly boosted bank lending volumes to the real economy.[1]

Regarding your question on the net reduction in bank funding costs as a result of TLTROs, please note that the TLTROs affect these costs in two ways. First, more costly and shorter-term bank funding sources are

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[1] See euro area bank lending survey replies, available at: https://www.ecb.europa.eu/stats/ecb_surveys/bank_lending_survey/html/ecb.blssurvey2021q1~5ab71bda59.en.html#toc28; and Altavilla, C., Barbiero, F., Boucinha, M. and Burlon, L. (2020), "The great lockdown: pandemic response policies and bank lending conditions", *ECB Working Paper*, No 2465, available at: https://www.ecb.europa.eu/pub/pdf/scpwps/ecb.wp2465~c0502b9e88.en.pdf.

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replaced with lower-cost and longer-term Eurosystem funding. Second, TLTROs also lower funding costs for banks not directly participating in the operations. This is because replacing market debt with TLTRO funding leads to a decrease in the overall supply of debt securities in the market, inducing downward pressure on their yields. The reduction in bank funding costs obtained through both of these effects has contributed to avoiding an increase in bank lending rates that would have otherwise occurred, thereby preserving favourable financing conditions for firms and households.[2]

With respect to your question on how funding costs for banks have developed as a result of the TLTROs and other non-standard measures introduced by the ECB since June 2014, the composite cost of debt financing for banks has decreased markedly (by around 100 basis points) across euro area countries, and the cross-country dispersion of this cost has continued to decline.[3] As per your request, Table 1 in the Annex contains published data on the composite cost of debt financing for banks for the euro area and for the larger euro area countries between January 2014 and January 2021. The results of the April 2021 euro area bank lending survey (BLS) indicate that banks mainly used the funds borrowed from the TLTROs to extend loans (a net percentage of 65%). In addition, they show that banks also used TLTRO funding to replace maturing debt securities (a net percentage of 17%), interbank borrowing and other Eurosystem operations (a net percentage of 36%). In addition to lowering the cost of funding, the funding substitution that has taken place as a result of the first two rounds of the TLTRO programme resulted in an extension of the maturity of banks' liabilities. This extension provided banks with funding certainty over a longer horizon. This, in turn, allows banks to better match the maturity of their liabilities with that of their assets, such as loans to firms and households, thereby supporting lending to the real economy.

Turning to your question on the development of euro area bank profits, they increased on aggregate between 2014 and the start of the COVID-19 crisis. The main driver of this increase was the decline in loan loss provisions, which to a large extent reflected the positive impact of our monetary policy on the macroeconomic outlook. Net interest income remained broadly stable over the same period.[4] The BLS indicates that a net percentage of 46% of banks associate the TLTROs with improvements in their funding costs. Importantly, and in line with the aim of the operations, 45% associate them with an increase in the volume of their lending to firms. Several empirical analyses confirm the substantial support that TLTROs

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2 Please note that the net funding benefit owing to TLTROs is not directly observable through changes in a specific variable. It also depends on the funding sources that TLTROs replaced and on how market funding conditions would have developed in the absence of the operations. However, it is ultimately reflected in funding costs, on which data is provided in Table 1 in the Annex.

3 See Altavilla, C., Andreeva, D.C., Boucinha, M. and Holton, S. (2019), "Monetary policy, credit institutions and the bank lending channel in the euro area", *ECB Occasional Paper*, No 222, available at: https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op222~834b5fece7.en.pdf.

4 For more information on the evolution of bank profitability since 2014, see ibid, chapter 4.

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have provided to bank funding costs and, as a result, to lending volumes and the real economy.[5]

Regarding your question on the fraction of loan volumes and participating institutions eligible for the most favourable rates under the third TLTRO series, TLTRO III, let me point out that the interest rates applied under TLTRO III are not known at this time, as they will depend on banks' lending performance up to 31 December 2021.[6] However, considering the large lending flows observed at the start of the pandemic, a considerable number of institutions are expected to be eligible for the most favourable interest conditions up to June 2021, based on their lending performance between 1 March 2020 and 31 March 2021. It is too early to speculate about banks' ability to obtain the most favourable rate in the period from June 2021 to June 2022 as this will depend on their lending performance between 1 October 2020 and 31 December 2021.

With respect to the impact of TLTROs on bank profits, to quantify this properly we must assess the situation that banks and the real economy would be in if the measure had not been introduced. In such a scenario, bank funding costs would have been significantly higher, increasing pressure on banks' net interest margins and ultimately leading to worse financing conditions for euro area firms and households. Moreover, the economic crisis would have been deeper and more prolonged, leading to higher unemployment and more firm bankruptcies and, consequently, to increased loan losses for banks with negative effects on bank lending. As mentioned above, there is ample evidence that at the individual level, banks are using a significant part of the funds borrowed from the TLTROs to extend loans to firms and households rather than fully retaining these funds in deposits with the Eurosystem. At the same time, on aggregate the liquidity injected through the TLTROs mechanically shows up as additional deposits of banks with the Eurosystem, as it can only circulate among the closed system of euro area banks and the very limited number of other entities that can hold such accounts. The banking system as a whole cannot reduce its deposits with the Eurosystem by extending loans to firms and households.

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[5] For more information and data, see Altavilla, C., Barbiero, F., Boucinha, M. and Burlon, L. (2020), "The great lockdown: pandemic response policies and bank lending conditions", *ECB Working Paper*, No 2465, available at: https://www.ecb.europa.eu/pub/pdf/scpwps/ecb.wp2465~c0502b9e88.en.pdf; Balfoussia, H. and Gibson, H. D. (2016), "Financial conditions and economic activity: the potential impact of the targeted long-term refinancing operations (TLTROs)", *Applied Economics Letters*, Vol. 23(6), pp. 449-456, available at: https://www.tandfonline.com/doi/full/10.1080/13504851.2015.1080799; Benetton, M. and Fantino, D. (2018), "Competition and the pass-through of unconventional monetary policy: evidence from TLTROs", *Working Papers*, No 1187, Banca d'Italia, available at: https://www.bancaditalia.it/pubblicazioni/temi-discussione/2018/2018-1187/index.html?com.dotmarketing.htmlpage.language=1; Boeckx, J., de Sola Perea, M. and Peersman, G. (2020), "The transmission mechanism of credit support policies in the euro area", *European Economic Review*, Vol. 124, available at: https://www.sciencedirect.com/science/article/pii/S0014292120300350; Gibson, H. D., Hall, S. G., Petroulas, P. and Tavlas, G. S. (2020), "On the effects of the ECB's funding policies on bank lending", *Journal of International Money and Finance,* Vol. 102, Article 102112, available at: https://www.sciencedirect.com/science/article/pii/S0261560619305844; Rostagno, M., Altavilla, C., Carboni, G., Lemke, W., Motto, R., Saint Guilhem, A. and Yiangou, J. (2019), "A tale of two decades: the ECB's monetary policy at 20", *ECB Working Papers*, No 2346, available at: https://www.ecb.europa.eu/pub/pdf/scpwps/ecb.wp2346~dd78042370.en.pdf.

[6] In TLTRO III, the interest rate to be applied is linked to the participating banks' lending patterns. The more attractive interest rates on TLTRO III borrowings are available only for banks meeting the lending benchmarks, defined in terms of loans to non-financial corporations and households (except loans to households for house purchases). Borrowing rates in these operations can be as low as 50 basis points below the average interest rate on the deposit facility over the period from 24 June 2020 to 23 June 2022, and as low as the average interest rate on the deposit facility during the rest of the life of the respective TLTRO III. See https://www.ecb.europa.eu/mopo/implement/omo/tltro/html/index.en.html.

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Turning to your question on the remuneration of top managers at banks supervised under the Single Supervisory Mechanism (SSM), the ECB has observed the evolution of these banks' remuneration policies and practices under the set up and supervisory competencies given to the SSM. Since 2014 it has been observed that remuneration policies have been largely established in line with and within the limits defined in the Capital Requirements Directive (CRD) and the European Banking Authority's (EBA) Guidelines on sound remuneration policies.[7] An overall benchmarking of remuneration practices in the European Union is available in the reports published annually by the European Banking Authority to which the ECB contributes.[8] These reports provide details on, for example, trends in the remuneration of staff who have key roles and responsibilities within banks (referred to as material risk takers (MRTs), including high earners) and on management body remuneration (with no further breakdown for top managers). These trends show that both variable and total remuneration remained stable in the recent past for management bodies while there was an overall slight increase for MRTs[9].

More recently, in the context of COVID-19, the ECB recommended that credit institutions under direct European banking supervision should exceptionally adopt extreme moderation with regard to variable remuneration until 30 September 2021.[10] In particular, credit institutions are expected to primarily focus on maintaining a suitable amount of capital to absorb potential losses and to support the real economy by providing credit to households, small businesses and corporates. As a consequence of these expectations, the ECB has observed that banks under European banking supervision are putting in place conservative measures on remuneration, in line with the above-mentioned supervisory expectations and continuing a trend that has been ongoing since 2019.

Yours sincerely,

[signed]

Christine Lagarde

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[7] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, as amended from time to time, OJ L 176, 27.6.2013, p. 338, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32013L0036; Guidelines on sound remuneration policies under Articles 74(3) and 75(2) of Directive 2013/36/EU and disclosures under Article 450 of Regulation (EU) No 575/2013, EBA/GL/2015/22, 21 December 2015, available at: https://www.eba.europa.eu/regulation-and-policy/remuneration/guidelines-on-sound-remuneration-policies.

[8] See "Benchmarking of remuneration practices at the European Union level (2017 and 2018 data) and data on high earners (2018 data)", European Banking Authority (EBA/REP/2020/20), available at: https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Reports/2020/897301/Report%20on%20remuneration%20benchmarking%20and%20High%20Earners.pdf. The previous year's report is available at: https://www.eba.europa.eu/risk-analysis-and-data/remuneration-data.

[9] MRTs are staff members whose professional activities have a material impact on the institution's risk profile according to the criteria set out in Commission Delegated Regulation (EU) 604/2014 and, where appropriate, based on the institution's criteria.

[10] For more information, see "Remuneration policies in the context of the coronavirus (COVID-19) pandemic", available at: https://www.bankingsupervision.europa.eu/press/letterstobanks/shared/pdf/2020/ssm.201215_letter_remuneration_policies_in_the_context_of_the_coronavirus_COVID_19_pandemic.en.pdf?faa7519bf2c3bd5ee71d15a0f4fffb39.

Annex

Table 1 – Monthly data on the composite cost of debt financing for banks for the euro area and euro area countries (January 2014-January 2021)

(composite cost of deposit and unsecured market-based debt financing; percentages per annum)

Month	Euro area	DE	ES	FR	IT	NL	AT	BE	FI	LU
Jan-14	1.41	1.21	1.16	1.58	1.95	1.46	1.78	0.45	0.20	7.95
Feb-14	1.35	1.18	1.09	1.51	1.83	1.37	1.98	0.46	0.21	7.96
Mar-14	1.30	1.17	1.00	1.47	1.69	1.40	1.87	0.44	0.19	8.02
Apr-14	1.24	1.09	0.94	1.43	1.56	1.37	1.65	0.43	0.20	7.84
May-14	1.16	1.07	0.90	1.36	1.51	1.23	1.54	0.40	0.21	7.90
Jun-14	1.10	0.96	0.82	1.30	1.40	1.23	1.32	0.39	0.19	8.03
Jul-14	1.09	0.96	0.80	1.26	1.37	1.16	1.34	0.37	0.19	1.88
Aug-14	1.04	0.92	0.76	1.18	1.34	1.11	1.42	0.33	0.19	2.16
Sep-14	0.98	0.88	0.66	1.13	1.22	1.02	1.35	0.31	0.18	1.99
Oct-14	0.98	0.89	0.64	1.13	1.27	0.97	1.33	0.31	0.16	2.03
Nov-14	0.93	0.82	0.59	1.07	1.22	0.94	1.24	0.30	0.16	2.12
Dec-14	0.88	0.82	0.59	1.02	1.22	0.85	1.35	0.25	0.15	2.69
Jan-15	0.89	0.78	0.58	1.02	1.16	0.84	1.77	0.25	0.16	2.93
Feb-15	0.81	0.72	0.53	0.90	1.07	0.81	1.80	0.23	0.17	2.80
Mar-15	0.75	0.69	0.50	0.84	1.01	0.79	1.90	0.21	0.15	2.65
Apr-15	0.74	0.65	0.50	0.86	1.00	0.44	1.68	0.18	0.14	2.65
May-15	0.79	0.67	0.52	0.93	1.09	0.43	1.69	0.17	0.13	2.58
Jun-15	0.86	0.78	0.58	0.98	1.17	0.43	1.76	0.17	0.13	2.64
Jul-15	0.85	0.81	0.55	1.01	1.13	0.41	1.69	0.16	0.13	2.60
Aug-15	0.80	0.76	0.50	0.95	1.08	0.41	1.66	0.16	0.13	2.57
Sep-15	0.84	0.80	0.54	0.96	1.12	0.41	1.64	0.15	0.14	2.53
Oct-15	0.81	0.72	0.54	0.92	1.09	0.40	1.55	0.14	0.14	2.53
Nov-15	0.75	0.62	0.50	0.88	1.02	0.38	1.44	0.14	0.14	2.53
Dec-15	0.75	0.59	0.49	0.86	1.09	0.35	1.51	0.14	0.13	2.59
Jan-16	0.78	0.61	0.49	0.90	1.26	0.33	1.58	0.13	0.11	2.58
Feb-16	0.79	0.68	0.51	0.85	1.31	0.33	1.73	0.10	0.11	2.46
Mar-16	0.70	0.51	0.46	0.79	1.18	0.27	1.61	0.10	0.11	2.40
Apr-16	0.66	0.47	0.44	0.73	1.08	0.29	1.62	0.07	0.09	2.43
May-16	0.63	0.44	0.44	0.71	1.04	0.28	1.46	0.07	0.09	2.54
Jun-16	0.63	0.43	0.44	0.67	1.10	0.26	1.41	0.07	0.09	2.53
Jul-16	0.61	0.41	0.41	0.63	1.15	0.24	1.28	0.10	0.08	2.64
Aug-16	0.55	0.40	0.35	0.55	1.08	0.25	1.18	0.09	0.08	1.20
Sep-16	0.53	0.38	0.32	0.54	1.09	0.22	1.09	0.09	0.08	1.15
Oct-16	0.55	0.45	0.31	0.56	1.12	0.21	0.98	0.09	0.08	1.14
Nov-16	0.60	0.46	0.35	0.60	1.27	0.20	0.95	0.09	0.08	1.22
Dec-16	0.62	0.45	0.33	0.62	1.41	0.17	0.91	0.09	0.07	1.40
Jan-17	0.55	0.44	0.31	0.62	1.05	0.16	0.83	0.09	0.07	1.33
Feb-17	0.55	0.43	0.31	0.63	1.05	0.16	0.79	0.09	0.07	1.28
Mar-17	0.56	0.41	0.31	0.65	1.06	0.14	0.70	0.08	0.06	0.89
Apr-17	0.51	0.35	0.29	0.60	0.98	0.14	0.62	0.08	0.06	0.90
May-17	0.49	0.36	0.27	0.56	0.94	0.14	0.61	0.08	0.06	0.86
Jun-17	0.46	0.35	0.28	0.53	0.90	0.13	0.57	0.08	0.06	0.80
Jul-17	0.43	0.35	0.26	0.53	0.72	0.13	0.61	0.08	0.06	0.70

Aug-17	0.38	0.32	0.25	0.45	0.66	0.12	0.51	0.08	0.06	0.64
Sep-17	0.37	0.30	0.25	0.48	0.60	0.12	0.51	0.08	0.06	0.61
Oct-17	0.37	0.29	0.27	0.49	0.57	0.11	0.44	0.07	0.06	0.58
Nov-17	0.34	0.30	0.25	0.44	0.56	0.10	0.37	0.07	0.05	0.52
Dec-17	0.34	0.29	0.23	0.44	0.51	0.10	0.36	0.08	0.06	0.46
Jan-18	0.36	0.31	0.22	0.48	0.51	0.11	0.36	0.08	0.06	0.45
Feb-18	0.39	0.37	0.24	0.54	0.54	0.10	0.38	0.08	0.05	0.44
Mar-18	0.40	0.40	0.26	0.54	0.56	0.10	0.41	0.07	0.05	0.44
Apr-18	0.40	0.41	0.25	0.54	0.57	0.10	0.41	0.07	0.05	0.45
May-18	0.43	0.43	0.29	0.56	0.63	0.09	0.45	0.07	0.04	0.49
Jun-18	0.49	0.46	0.33	0.58	0.74	0.10	0.58	0.07	0.04	0.69
Jul-18	0.47	0.44	0.31	0.58	0.74	0.10	0.55	0.07	0.05	0.68
Aug-18	0.47	0.44	0.30	0.57	0.77	0.10	0.51	0.07	0.04	0.70
Sep-18	0.49	0.45	0.31	0.60	0.75	0.10	0.49	0.07	0.05	0.71
Oct-18	0.52	0.48	0.33	0.59	0.87	0.09	0.47	0.07	0.04	0.75
Nov-18	0.54	0.52	0.36	0.62	0.91	0.09	0.49	0.07	0.04	0.88
Dec-18	0.55	0.56	0.39	0.62	0.85	0.09	0.52	0.07	0.04	0.83
Jan-19	0.55	0.57	0.35	0.66	0.81	0.09	0.52	0.06	0.04	0.07
Feb-19	0.49	0.51	0.33	0.57	0.76	0.09	0.44	0.06	0.03	0.04
Mar-19	0.44	0.46	0.31	0.52	0.68	0.09	0.46	0.06	0.04	0.04
Apr-19	0.39	0.41	0.25	0.48	0.64	0.10	0.39	0.06	0.03	0.06
May-19	0.40	0.40	0.26	0.46	0.72	0.09	0.33	0.06	0.03	0.05
Jun-19	0.36	0.35	0.22	0.42	0.69	0.09	0.30	0.06	0.03	0.04
Jul-19	0.29	0.27	0.16	0.34	0.58	0.09	0.23	0.06	0.03	0.03
Aug-19	0.25	0.21	0.14	0.30	0.59	0.07	0.19	0.06	0.03	0.03
Sep-19	0.26	0.25	0.15	0.31	0.53	0.08	0.20	0.06	0.03	0.04
Oct-19	0.27	0.25	0.14	0.32	0.53	0.07	0.22	0.06	0.03	0.03
Nov-19	0.28	0.24	0.16	0.35	0.54	0.06	0.22	0.05	0.03	0.04
Dec-19	0.28	0.22	0.17	0.33	0.54	0.06	0.23	0.06	0.03	0.03
Jan-20	0.27	0.21	0.14	0.33	0.52	0.06	0.22	0.05	0.02	0.03
Feb-20	0.23	0.16	0.11	0.26	0.49	0.06	0.18	0.05	0.02	0.03
Mar-20	0.58	0.55	0.39	0.60	0.87	0.05	0.51	0.05	0.03	0.02
Apr-20	0.63	0.63	0.44	0.58	0.94	0.04	0.62	0.04	0.03	0.03
May-20	0.55	0.51	0.41	0.49	0.87	0.04	0.51	0.05	0.03	0.02
Jun-20	0.40	0.36	0.31	0.37	0.67	0.04	0.39	0.04	0.02	0.03
Jul-20	0.33	0.29	0.25	0.32	0.60	0.04	0.32	0.04	0.02	0.02
Aug-20	0.29	0.23	0.21	0.29	0.57	0.04	0.30	0.05	0.02	0.03
Sep-20	0.26	0.21	0.17	0.25	0.54	0.04	0.23	0.05	0.01	0.03
Oct-20	0.24	0.17	0.14	0.24	0.52	0.03	0.21	0.04	0.01	0.02
Nov-20	0.21	0.14	0.11	0.21	0.48	0.03	0.17	0.04	0.00	0.02
Dec-20	0.17	0.10	0.08	0.18	0.43	0.03	0.15	0.04	0.00	0.01
Jan-21	0.17	0.11	0.08	0.19	0.43	0.03	0.13	0.04	0.00	0.02

Notes: The composite cost of deposits is calculated as an average of new business rates on overnight deposits, deposits with an agreed maturity and deposits redeemable at notice, weighted by their corresponding outstanding amounts. Bank bond yields refer to monthly averages of senior-tranche bonds.

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