Interview with Il Sole 24 Ore

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Interviews
Italy

Interview with Rolf Strauch, Member of ESM Management Board

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Il Sole: The role of the EFSF/ESM has evolved: your activity started during the peak of the European sovereign debt crisis by giving financial aid directly to States and indirectly to their troubled banking sectors. Then a new tool has been added to your toolkit, the ESM can support banking systems by entering directly into bank recapitalisations. What is the difference between these two ways of giving aid?

Rolf Strauch: In the general assessment of a programme we determine the overall financing needs over a period of time. For example, in the case of the programmes for Cyprus and Greece, part of the money we provided was specifically dedicated to supporting the banking sector via recapitalisations.
Let me give you some examples. In the third programme for Greece, which foresees up to €86 billion in total financial assistance, there was originally up to €25 billion that could have been used for banks. Then after the banking recap exercise was conducted, according to State aid rules, it turned out that the amount needed of the Greek banks was much smaller, only €5.7 billion.
The Irish and Portuguese EFSF programmes also foresaw earmarked amounts to help the banking systems but their Facility Agreements and Memoranda of Understanding (MoUs) did not detail the exact way and the exact amount that would have been used to support the banks.
The Spanish programme was a totally different instrument: it was a loan specifically aimed at supporting financial institutions. The loan was directed at the banking system, but as in the other countries, the loan was given to the State.

The conditionality for Spain was targeted at the banking sector. For example, the MoU required the improvement of regulation and of supervision. New legislation also needed to be introduced on bankruptcies and insolvencies.

What is the difference with the direct bank recap?

As far as direct bank recapitalisations are concerned, there are very clear limits for its use and what we can do. It is a last-option tool, to be used only for very extreme circumstances, which are the following:
a) the sovereign State must be in real need of external aid, which means that the state has lost or is at risk of losing market access;
b) the bank must be in real need of external aid, in other words it cannot raise capital on the market, it must be viable and systemic;
c) all other tools have been exhausted, that is, the EU Bank Recovery and Resolution Directive (BRRD) and State Aid rules have been applied, and the other ESM instruments are not viable without overburdening the State. So only when all three circumstances occur together can direct bank recap be used. Another condition, as for the use of all other ESM instruments, is the unanimous decision of the euro area finance ministers in the ESM Board of Governors.

How could Italian banks benefit from the instruments you described?

Let me be very clear on this question about Italian banks: we are not working on any ESM solution. Any such speculation would be completely absurd and unfounded. Italy is the third biggest economy of the euro area and the third largest shareholder in the ESM. The ESM and its predecessor EFSF were key to keeping several countries in the euro area; the contribution and commitment of Italy and its people were central to these achievements. Embracing a reform agenda, Italy’s commitment to the euro and to sustainable policies is now stronger than before. From an ESM point of view, I can only encourage Italy to stay on this path so as to have even stronger growth and help make the ESM even more robust. This policy commitment of Italy is seen as credible in the markets, which is why Italy continues to have good market access. Given this context, we expect Italy to deal with its banking sector issues without any need for assistance.

Does the ESM give guarantees on top of loans and financial aid?

No, we do not grant guarantees on top of our loans. Our counterparty is the State and the State can use our money for many purposes, including support to the banking sector, as I explained. This money can be channeled to the banks through a vehicle, such as the FROB in Spain or the HSFS in Greece. Part of the money we gave to programme countries was used for resolution purposes or for small injections of equity in a holding company.

The ESM can step in to support a bank directly only as a "last resort" after the bail-in resolution regime has been activated, and if State aid is not enough. Wouldn't it be better for the ESM to intervene in the banks before the bail-in, to prevent panic selling or a run on the bank which might be triggered by the bail-in mechanism itself: a capital loss on senior bonds is a very destabilising solution.

I do not see this applying at all to Italy.
But let me explain how the instrument works in general terms, and based on the case of Greece. When there is a problem, as with Greek banks, the State first of all has to take all the steps in line with the BRRD, including bail-in, and respecting state aid rules.
After all that is done, the government can capitalise banks in line with the rules; only at this stage would the ESM provide a loan within the context of a State intervention. There would be an agreement, an MoU. In 2015, for the new Greek programme, the bail-in was applied in line with State Aid requirements and including senior debt. Since 1 January this year, all BRRD instruments including a more far-reaching bail-in now apply: the principle still remains, first the money comes from the private sector, then the State can intervene.
In the case of ESM's direct bank recap, the conditions are even more demanding, so that an ESM direct bank recap could only be used in very extreme situations. First, the conditions need to be met: the bank cannot get money from the private sector; the bank must be systemic and viable; and, the sovereign is unable to provide support. Then a bail-in of a minimum amount of 8% of all liabilities would need to be applied; after that, the resolution authority up to 5%, then if that is not enough the bail-in takes the money from the private sector over the 8% of liabilities from shareholders, subordinated debt, senior bonds and deposits over €100,000. Only after all this series of steps have been taken, could the ESM step in with a direct bank recap, provided the ESM Board of Governors decides so unanimously.

Do you have agreements with banks?

The ESM Treaty obliges us to establish agreements with States. This is the same for any instrument: loans to countries or direct bank recap require a financial agreement and an MoU. The only difference for direct bank recapitalisation is that we would have a direct financial engagement with the bank that would not be registered in the country's public finances. In this case we would have an additional contract with the bank as we would become shareholders. There is no limit pre-set to the shares or the percentage we can buy. We can even own a majority of shares of a bank but the government would also have to co-invest alongside the ESM – it would also need to put itself in the game.

Italy has not asked for external aid from the EFSF/ESM but it still has a banking problem. And the Eurozone banking sector in general does not seem to be out of the woods. The ECB extended the PSPP to give liquidity and help the banks finance the economy. Do you think that the ESM could do more in this stage?

The ESM has already done a lot. And its intervention in the euro area crisis has worked: its approach was tested and it was successful. Four countries we have helped are back in the market. And we have successfully run these programmes. Four years into the euro area crisis, in the second half of 2014, even Greece was able to issue bonds again and it was growing. Without the ESM, the euro area would not be the same; we helped to keep it together and contributed to the financial stability of the euro area. Some people tend to underestimate what we have achieved in Europe during the crisis.
Another major achievement is the Banking Union, which is built on a common supervision and resolution frameworks for banks. A fundamental principle here is the bail-in: one of the lessons of the crisis is that it will not be possible in the future to socialise the costs of bank failures, and for taxpayers to pay for the mistakes that banks make.
In this set-up, the ESM has a role of lender of last resort. If a country needs financial assistance, we can provide loans against conditionality. And under the extreme circumstances I've described, it can also do direct bank recap.

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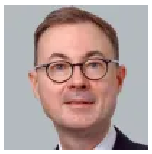

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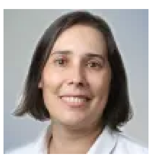

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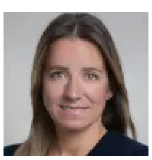

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