Rolf Strauch in panel discussion - Safe and sound banks: differing philosophies, varying implementation

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14/12/2018
Speeches
ESM
Frankfurt am Main, Germany

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Impulse statement in panel discussion on “Safe and sound banks: differing philosophies, varying implementation”

6th Frankfurt Conference on Financial Market Policy

Frankfurt am Main, 14 December 2018

Ladies and Gentlemen,

Today is a special day for euro area reforms. The Euro Summit in Brussels is about to wrap up. And the fundamental question how to make the euro area “safer and sounder” is part of the agenda. Therefore this panel addresses a very topical question.

Europe’s political leaders will decide important steps today. Steps that the Eurogroup has prepared and that the Heads of State or Government have discussed since more than a year.

What are the next steps?

Let me run you through these steps.

The first step is **completing Banking Union**. In my view, most of the points decided can be dealt with shortly. This includes for example the **backstop to the**

Single Resolution Fund (SRF).

The SRF is a fund established by the EU as part of the Banking Union to allow failing banks to go through an orderly resolution. It is financed by contributions from the banking sector, not by taxpayers' money.

In the event that the SRF resources are not sufficient, the ESM can act as a backstop and lend more money to the SRF. If non-euro area Member States join the Banking Union, the ESM and non-euro area Member States will together provide the common backstop to the SRF, through parallel credit lines.

The common backstop will be in place at the latest in 2024. It can be introduced earlier, if banks make sufficient progress in reducing their exposure to risks, notably non-performing loans. This assessment will be made in 2020.

The size of the credit line will be roughly the same size as the SRF, around €60 billion, or 1% of covered deposits in the Banking Union. The backstop allows for a temporary financing of the SRF through the ESM.

Another important component of completing Banking Union is a **common deposit insurance**. But also here sufficient risk-reduction remains a prerequisite for this to be introduced and this cannot happen in a rush. Banks first need to deal with legacy assets such as non-performing loans (NPLs). But in principle, a common deposit insurance makes sense. Had it existed during the financial crisis, and the euro debt crisis, the volume of ESM loans could have been reduced by about one third.

In the beginning of December, the European Parliament and the Council of the European Union reached a provisional political agreement on the so-called banking package. This comprehensive set of reforms of existing legislation, proposed by the Commission, further strengthens the resilience and the resolvability of EU banks.

The package contributes significantly to further reducing risks in EU banks and it is an essential element for the completion of Banking Union. It builds on existing banking rules, implements international standards, and aims to complete the post-crisis regulatory agenda, making sure that outstanding challenges to financial stability are addressed. At the same time, it increases the ability of banks to finance the real economy.

The second step is **enhancing the role of the ESM**.

Like I already said, the ESM will provide the **backstop** to the SRF.

The ESM will also take on a stronger role in the **cooperation with the European Commission**. We will have a stronger say in the preparation and monitoring of future economic adjustment programmes. A Memorandum of Understanding (MoU) agreed with the Commission lays out the conditions and details of the agreed cooperation.

Moreover, an agreement has been reached on the **ESM's financial instruments**. The precautionary tools should become more transparent and predictable. We have the Precautionary Conditioned Credit Line (PCCL) and the Enhanced Conditions Credit Line (ECCL). The PCCL is only for countries with a sound economic situation, the ECCL for countries with some structural weaknesses. They have never been used so far. So it is good to understand why not and what to change to make them more accessible. Countries in need, but also market observers, should understand the objective and the impact of our tools.

And we will receive a stronger role in the area of **debt restructuring**. In my view, we managed to improve the existing framework for promoting debt sustainability. There will be "single-limb" Collective Action Clauses (CACs) introduced by 2022 to reduce the creditor holdout problem. This commitment should be included in the ESM Treaty. The debt sustainability analysis (DSA) will be done in a transparent and predictable way, while allowing for some judgement, and that's what we agreed. The ESM may facilitate the dialogue among members and investors – when appropriate and if requested by the member state. The ESM's role would take place on a voluntary and informal basis.

For the more distant future, it is worth thinking about a **fiscal mechanism** for the euro area. France and Germany have proposed euro area budget for convergence and competitiveness purposes, as part of the EU budget. Many other ideas are also floating around for a fiscal capacity, such as supporting investment, a rainy day fund, complementary unemployment insurance and short-term ESM loans. The underlying principle is always the same: to enhance risk-sharing between euro area countries. It could help prevent small problems turn into big problems, for which an

ESM-programme might be needed. What is important to note is that all proposals under discussion can be constructed without causing permanent transfers.

What remains to be done?

Let me finally take a look at what remains to be done.

A topic that has recently been debated is the issue of providing **liquidity to banks while they are being resolved.** With Banking Union in place, Europe has successfully tackled the issue of how to ensure that a bank that is winding down remains solvent. In other words, that the bank has sufficient capital to continue to operate during the resolution period.

But the issue of liquidity is trickier. For short periods of time, a bank may need amounts of cash that by far outstrip what was needed to replenish its capital during the resolution. This could for instance be the case to satisfy derivative contracts. Typically, the bank will only need the money for weeks or even just days. But without it, the bank could default. The amounts potentially needed go well beyond what the SRF could provide, even when backed up by the ESM. The SRF can provide some liquidity in resolution, but in all likelihood not all of it.

The ECB could be a natural provider of any liquidity shortfall for a bank in resolution, given the large size of its balance sheet. However, the bank may be constrained in the collateral it can provide to the ECB for drawing liquidity and markets may not have enough confidence that the bank is “safe and sound” to provide this liquidity. Some form of guarantee for bank funding or some residual collateral provided to the bank may therefore be needed. This is an important issue to make the resolution framework fully operational, and requires more discussion at technical level.

Let me sum up: many steps have been taken. I am excited to see the outcome of the Euro Summit later today on euro area reforms. Banking Union can be completed in a foreseeable time. But some aspects – such as liquidity in resolution and other details – need to be clarified and agreed on.

I am sure we will have more time to talk about the points I raised in my impulse statement later in the panel discussion.

Thank you.

Author

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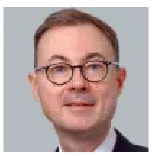

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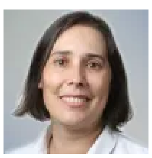

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