

Klaus Regling

**Interview with "21st Century Business Herald" (Chinese Business daily)
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Question: You had visited Beijing and discussed China's investments in EFSF in Oct. 2011. Now you are going to China again. How much has China invested in EFSF/ESM until now?

Klaus Regling: We refrain from announcing a country-by-country breakdown. But I can tell you that around 22% of our bonds are bought by Asian investors. They are committed long-term investors and we are very happy about that. Asian investors are our most important regional investor group outside Europe. That's why I frequently go to Asia, as it's extremely important to keep contact, particularly with China.

In this context I would like to quote what your Prime Minister said in Berlin recently: stability in the euro area is good for Europe, China and the whole world.

Question: So how do you assess the situation of the euro area to make sure that those investments are safe and profitable?

Regling: The situation in the euro area has become much more stable in the last six or nine months. Market participants no longer expect a break-up of the euro area. The market's perception of the euro area has dramatically improved. The interest rates of long-term government bonds for problem countries are two thirds lower than they were eighteen months ago.

Another indication of the improvement is that countries like Portugal or Ireland are able again to borrow long-term from markets, both recently issued ten-year government bonds. And Spain, despite some doubts last year, never lost market access.

Question: What has improved precisely?

Regling: First, the countries in difficulties are really making their adjustment and they continue to do so. Second, we have fundamentally strengthened our economic policy coordination in the euro area. As you know, in the euro area we have a centralised monetary policy, one interest rate and one exchange rate for all 17 euro area countries. At the same time we have decentralised national fiscal and structural policies. This can be a problem. But it works if the economic and fiscal policies are very well coordinated. Third, we have important institutional changes. The EFSF and ESM fill an institutional gap that existed when the euro currency union was originally designed. Fourth, we are currently establishing a banking union in Europe. It will comprise a Single Supervisory Mechanism, the SSM, under the responsibility of the ECB. Also the ESM may in the future recapitalise banks directly. And there will be a

European bank resolution mechanism and a deposit guarantee scheme.

So the euro area is moving in the right direction. But we know that the crisis is not over, as unemployment is very high in some euro area countries and some countries still have important reform efforts ahead.

Question: It's reported that German Finance Minister Wolfgang Schäuble said on Monday, that European countries should be under no illusion that they can shift responsibility for problems in their national banking sectors to the bloc's rescue mechanism, the ESM. In your interpretation, what did he want to point out when he talked about an illusion?

Regling: I do not know the details of what he said. I just want to point out that we are already helping the banking sector - for example in Spain. But we do that with a loan to the Spanish government, which uses the money to recapitalise and restructure the Spanish banking system. We are currently in the final stages of talks on direct recapitalisation of banks by the ESM. The precondition is that the SSM is up and running. This may be the case by summer 2014 and it would be a very important step.

I presume the German finance minister wanted to point out that direct bank recapitalisation by the ESM may not be able to solve all the old problems that emerged when national supervisors were in charge of the national banking systems – the so-called legacy asset problem.

Question: About a week ago, a draft European Union law was voted in the EP's economic committee that would shield depositors with less than €100,000 from losing their savings in bank rescues, but depositors with more savings could suffer losses from 2016. Does that mean that Cyprus has become a template?

Regling: Cyprus is a very special situation. Cyprus is unique in the sense that the amount of money needed to recapitalise the bank was so big, that it could not be provided by loans from the ESM or the IMF alone. Otherwise the country's public debt would have become so huge that it would have been unsustainable. Even the programme for Cyprus as it is now is much bigger than other individual programmes - it is almost 100% of the country's GDP. That is the reason why the contribution from Cyprus had to be exceptionally large.

And another element of this uniqueness of the Cypriot situation was that the amount of junior debt and even senior bonds were only a very small share of the bank liabilities. They were wiped out in the case of the two largest banks in Cyprus. But that still would not have been enough. Therefore there was no alternative to including uninsured depositors above €100,000. No other euro area country is in a situation comparable to Cyprus.

In order to provide clarity and legal certainty for depositors, creditors and investors we are at the moment establishing a hierarchy for future bank bail-ins in Europe. It

seems clear that shareholders will have to give up first their equity and that junior debt holders will have to accept haircuts. Also it is very clear that insured depositors under €100,000 will not be touched. The discussion on some issues is not yet concluded, perhaps there will be clarity at the next meeting of the EU finance ministers on 21 June. Also there is a discussion of whether this would come to effect already in 2015 or not until 2018.

Interview: Lu Zhenhua