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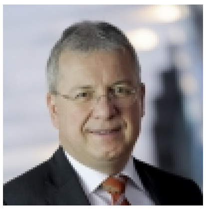
Resilience, efficiency and competitiveness of the Eu banking system

Speakers



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David Wright

Ladies and gentlemen, welcome to this half-hour discussion. On my left is a distinguished Member of the European Parliament, Markus Ferber, who is well known to you all. He is the Vice Chair of the Committee on Economic and Monetary Affairs and rapporteur on MiFID. I sense he hopes that that will finish soon. On my right, also very well known to you, is Jean Lemierre, the President of BNP Paribas.

We are going to discuss resilience, efficiency, competitiveness and challenges. I would like Markus to start us off by giving us his views on where we are in the European banking system. Are we more stable? Are we resilient? Will resolutions work? How do you see the stability aspects and the resilience aspects of the European banking system today? Then I am going to ask Jean the same questions. Thank you.

Markus Ferber

Thank you very much. It is a pleasure to have this chance to discuss such important issues because, whatever we do as legislators, we should of course ask ourselves whether we have fulfilled these criteria in terms of what the financial markets have to deliver. I hope that we always do so, and that applies not only to Parliament but also to the Commission and the Council.

The starting point should be that financial markets are a service for a real economy and we have to take care that the services can be delivered in a stable way. Secondly, the financial sector should be able to take its risk by itself. We have done a lot to achieve that and we are on the right path but we are not yet at the end of the road in terms of having that fully achieved.

On the other hand, I really appreciate that the Commission has started the call for evidence process because it allows us to think about whether we might have left some gaps – which I have not yet heard from anyone who I have met here in Amsterdam – or that maybe we have done some overruling or made contradictory rulings in various pieces of legislation. Identifying those things is very important.

We should take care to stick to the main principles when we speak about a resilient financial sector. The principle of liability is very important, i.e. that decision-making and risk taking is in the same hand. To be honest, I sometimes feel that this is forgotten and that those who desire it and those who take the risk are not the same. If you create something like that, you create the possibility for moral hazards and I think that should be avoided.

Proportionality is also very important. Everything has to be proportionate. Everyone agrees on the headline, but translating that into the details is always very complex. We should always have that in mind as a main principle.

The second principle is the principle of scrutiny and that is what I am mainly missing on the European level, although it takes years and although we have 28 Member States with all the wisdom of national ministries, the Members of the European Parliament and the Commission. There is a lot of wisdom in the legislative body, although it can happen or may happen that we fail in terms of wrong legislature or giving wrong incentives. We have not yet had a procedure on short track adjusting procedures to close this, and I think scrutiny is very important not only to identify but to deliver a solution to easily adjust it.

For the moment, we are trying, with the MiFID 'Quick Fix', to change something where legislation is not yet in place. We have already identified a few things and I am very happy that the Council today in its working group agreed on the principles – not in the wordings and the details that have yet to be done – that beyond the date other things have to be adjusted as there are missing issues in Level 1. Thanks to this delay, we have the possibility to deal with that. We do not have that in other pieces of legislation and so I think we have to invent a kind of short adjustment legislative procedure; otherwise this principle of scrutiny is a very theoretical one.

David Wright

Jean, in your eloquent contribution to the Eurofi Views Document, you list a lot of points where the European financial sector is considerably strengthened, but at the same time you mention a lot of concerns. Would you like to elucidate those?

Jean Lemierre

Sure. I will say a word about why I do believe that a good job has been delivered over the last few years. I think the European Parliament, the Commission, the ECB, SSM and all the central banks and supervisors in Europe, and to a certain extent the banks, have done reasonably well over time. I do believe that the system is more resilient today than it was, and this is good and positive.

Now, there are a few questions behind this. When I look at the banking sector in Europe today, when I read the press, I see tensions. There are questions and tensions. The first question is: is it a new crisis? We need to be aware that it is not a new crisis. It is the intended consequence of the decisions which have been made. When you want to make a system more resilient, there are consequences and nobody should say that they were not intended. Nobody should say this is a new crisis. That was wished for and expected.

And this is my key point about resilience: resilience has a cost in the adjustment. We see it today. What is the agenda today? From my point of view, it is probably not so much about adding regulation to regulations but rather implementing the existing regulations and the existing framework. I am sure you will agree with me that the proof of the pudding is in the eating. The quality of regulation is not in resolutions but in the implementation of regulations. I will not go any further. I think everybody in the room understands what I mean by this. This is crucial and this is not a question among us: it is a question which is watched by investors all across the world. They have carefully monitored what was done. They have welcomed it. Now they want this to be implemented in a fair, transparent and efficient way.

My second remark about this is that we are living in a different environment. The decisions about the resilience of the banking industry have been made at a time when interest rates were high and growth was probably better. I think growth is roughly okay these days – though it could be better – but the monetary policy is different. We have to take this into account. We cannot consider that the situation is the same as it was. It has an impact. I do not make any judgements: it is a fact. It is a given element for me and this has to be taken into account in a careful way.

My third remark is that there is a small paradox that we need to accept. The European banking sector has never been so resilient but the valuation of the banks in the market have decreased, which is a paradox. It should have increased. Why is this? We have to make this compatible and understand what it means. The 'why' is maybe about the macro-economic policy or the monetary policy or because the capital cushion has been reduced by higher capital requirements, and because there are still a lot of discussions about regulations which are hanging over our heads with investors trying to understand what it all means. So resilience is good but we must be also resilient from that point of view, and we still have a lot to do.

This all leads to a very simple remark which I think you will agree on. It requires a lot of skill to fine-tune the wordings and statements of regulations in an environment which is very difficult from a macro-economic and monetary policy point of view with higher requirements. This very unfortunate debate about the MDA in February is a good example of this. It requires fine-tuning skills from everybody and the input of banks, supervisors, regulators and resolution agencies is going to be absolutely crucial in the next month. Yes, it must be more resilient but it must also be very well implemented. We are in the time of credibility.

David Wright

One of the last meetings I had when I was at IOSCO was with some of the titans of the world describing and trying to understand volatility in markets. One of the comments that came out of that was that one of the weaknesses being caused to the valuation of banks was uncertainty about the capital levels from Basel. You mention in your piece the trading book, operational risk, TLAC and the calibration of the leverage ratio. Do you think that is weighing heavily on bank valuation?

Jean Lemierre

I can confirm what I have just said: of course it is part of it. It is not the only piece but it is part of it. We have to give visibility and guidance to investors in a fair way and in a way which is compatible with what can be absorbed and done. I think we are no longer in a situation in which there would be some kind of artificial fight about being more resilient or not. Everyone agrees, I hope. But, once more, it is a question of implementation, delivery, showing it works well, and that a few pieces of agenda are driven to a reasonable conclusion.

David Wright

Both of you in your contributions talk in a way about the level playing field. Markus, you talked about it when you mentioned proportionality. You talk about the risks or the unlevel playing field of shadow banks. You talk about competitiveness across the Union, cleaning out the NPLs.

Jean, you talk more about how you want a level playing field of supervision and you do not want, as I understand it, proportionality of supervision or you are less keen on that concept. You certainly talk about the US capital markets and digitisation. How serious are these threats to the European banking model?

Markus?

Markus Ferber

That is a nice question because I would ask you what the European banking model is. Looking at the European market, it seems we have 28, or more, banking models with some deciding to take a more centralistic direction. I come from a member state where we think our system is the one and only and you know the ‘three pillar’ system in Germany. So, firstly, what is the European system? Then we have to answer the question of how to deal with that. Do we really want to come to a banking market in the European Union like we have in the United States? I will not answer that question but I will put it on the table for now. But looking, for example, at what the ECB does as a surveillance authority, and at what DG Competition is trying to organise in terms of competition in the European Union, it is clear we will never get a financial market like the United States. Whether you like it or not, whether you want to have it or not, according to our competition law, according to how the 124 banks are surveilled by a European Central Bank, that will never happen.

Then you have to ask: if that is not what we want to achieve because the rules are there and it is dealt with as it is, what else can we achieve? On the other hand we identified that we do not have a single market. That brings me back to the ECB problems. If a bank in the Netherlands has a lot of government bonds from Spain on its balance sheet, they will have problems. If a bank in Spain has a lot of government bonds from Austria, they have fewer problems. So is it really a developed market? I speak only about government bonds; I do not speak about other products. And it cannot be developed as long as we are doing surveillance as we do. That is one of the things that we have to take into account.

Also, as long as we have nationalised consumer protection rulings – which is what we have and will continue to have in the future – we will not create a European environment on the retail banking side either.

This brings me at the end to only one solution: proportionality can be the only way out to identify or to deal with these circumstances. I fully agree with what has been said in terms of implementing what is already there and implementing it in a way such that the financial sector can still deliver its service. You can create the most wonderful rulings and make the financial sector wonderful and safe but then nothing will happen in the financial sector. The safest financial sector is the financial sector that is not lending a single cent. That will be really stable. I sometimes get the impression – and I am not blaming anyone – that they really want to stabilise and make it safe but with that they kill the whole issue, and that is not the aim. The aim is to create the possibility to take risks and to deliver out of that risk-taking service. That means proper implementation in all 28 Member States of what has been decided and creating a level playing field as well as adjusting some other systems. That is why I really spoke about our competition law. Our competition law will never create European leaders; it creates national leaders. But in the world we need European leaders, and that is something we have to think on as well in the financial market as in other sectors.

David Wright

Jean, on the points about competitiveness and the level playing field, was I right in the way I described your views?

Jean Lemierre

Yes. Your question is such that in order to answer it I will quickly go through a few points.

What are the main concerns that we may have about this? The first is one that I hear from the G20 and from many governors: that, in terms of Basel 3, 3.5 and 4, there should be no significant increase of capital requirements. This is what I am being told. Then I listen to rumours. Then I read some statements from Basel and what do I discover? There will be increases. We should fix it. These new reviews are fair and I have no difficulty with them. There should be no significant increase. This is the clear commitment taken. It is big news to say that that will not be the case, so I hope it will be the case.

I also hear a lot about proportionality. Fine. I have no difficulty with proportionality, bearing in mind the reporting needs. But proportionality is not about cutting corners; it is about the level playing field. If proportionality means that they cut corners on regulations and the security of the banking system, bearing in mind what has happened in the past, then I do not understand. Words do matter. We have to be careful there. Yes, there is big progress which can be made but not to make the system riskier.

I hear a lot about a level playing field in Europe within the Eurozone. We like it. We support it. I have always been in favour of a banking union in the Eurozone. So we need to be clear about the free allocation of liquidity within the Eurozone. We need to be clear that there is no internal TLAC dedicated to some countries, because this is fragmentation; this is not the SSM. Then we need to make sure that, when we calculate the global SIFI surcharge, that the Eurozone is not an element of complexity. I would have thought that it was an element of security because of the quality of the SSM. So we need to put concrete comments and decisions behind the words. Words are nice. Proportionality is fine. No significant increase is fine. SSM and banking union is absolutely fine. But what does it mean? I hope the next few weeks will show that there is real content and a real discussion about this.

May I add one comment which I made six months ago in the same place? I see that it is about capital market. What does it mean? Everybody speaks to the world about the European capital market. What do I mean by this? It is simple. If we increase capital requirements, if we add TLAC on this, there is a moment where the system cannot finance the economy; and the only way to finance the economy is to share or shift assets from the balance sheet of the banks to other investors. This is securitisation. This is the way it works in the US. May I remind you that in the US the assets are not so much shifted to the private sector investors as they are shifted to the taxpayers? Mortgage portfolios are shifted to the taxpayer in the US. So we need to be consistent. If we want a more resilient, more efficient, competitive banking sector based on a different design – which is not my choice but the choice of policymakers – then we have to be consistent. My message is simple: we need to move forward on the capital market today – not in two years or 20 years, but quickly. It has a lot to do with Solvency II with these types of measures because otherwise one day we shall have a problem.

I shall stop here but what I am trying to say to your point, David, is that it is about the words we use and the content we put behind those words. Words are perfect. Words are great. But we are waiting for deliveries behind the words.

David Wright

Do you want to add a final word?

Jean Lemierre

I agree with that and that is what I really like in Europe: we use the same words but we speak about different things.

Markus Ferber

If you read the Council conclusions, you will understand what I mean on all the issues, not only on financial issues. But, seriously, proportionality is not only a question of size but also of risk. A large retail bank does not need fuller surveillance than a small investment bank, so proportionality is more than just about size. If we put some meat on the bone, then I think we can agree. I fully agree with what has been said. The headlines are always very easy to identify but bringing life to those headlines and speaking about the same things – we speak about ducks but some speak about birds and others about cats – is a real problem, and that is a classically European issue. So I fully agree with what you have said.

Jean Lemierre

That is why we are happy to be with you this afternoon.

Markus Ferber

David, you delivered the real interpretation here.

David Wright

Let me just conclude, and thank you both for a very interesting exchange. I think we all sense a certain degree of frustration and worry, and the need for political and legal certainty as well as the need for a level playing field. As you quite rightly said, Markus, the word 'proportionality' reminds me of the word 'equivalence' which does not mean the same thing in the United States as it means in Europe. I sense here that we do need proper implementation in the banking system in Europe while accepting that there are different parts of it and different models. The whole purpose of all the work that has been done over the last 15 years, especially since the de Larosière reforms, was to ensure that we had a level playing field, proper implementation and so on. I sense from both of you a frustration in that sense and a real need, as I said, for certainty – certainty because there has been a massive amount of regulation. Nobody is against more regulation if it is really needed but, at the same time, I get the strong sense that you need breathing space and we need to be able to restore credit and financing in the economy. I agree very much with what Jean said at the end about making securitisation and other instruments work.

Thank you very much to both of you and we look forward to your further contributions here in Eurofi.

Acronyms Used

DG Directorate-General

ECB European Central Bank

IOSCO International Organisation of Security Commissions

MiFID Markets in Financial Instruments Directive

MDA maximum distributable amount

NPL non-performing loan

SIFI systemically important financial institution

SSM Single Supervisory Mechanism

TLAC total loss-absorbing capacity