BENOIT COEURE

Member of the Executive Board, ECB

Jean-Claude Trichet, former President, ECB

We go now to the second main issue, the banking union, and we start in that regard with Benoît Coeuré.

Benoît Coeuré, Member of the Executive Board, ECB

Thank you, Mr Chairman. The relevant starting point is to note that 80% of the Eurozone economy is financed by banks. Why do we need a banking union and how should we make it work? We need a banking union because we need the banking sector to finance the economy and to transmit the impulses of monetary policy in a way that is useful for the economy. That did not happen during the crisis. It unravelled during the crisis for two reasons: because banking supervisors had a national mandate rather than a Eurozone mandate – their incentives framework was mostly national – and because banks were backstopped at a national level, meaning that any risk related to the banking sector was ultimately an off-balance liability of the local government. These two reasons were at the heart of the financial crisis in Europe and they both have to change. This is why we need a single supervisory mechanism and a single resolution mechanism. We need supervision to be under a European mandate, that is a single supervisory mechanism, and we need the backstop to be European, and that is a single resolution mechanism.

We have come a long way towards achieving the first objective, a single supervisory mechanism, but less so towards the second objective, which I will comment on later. It is still moving forward. On the single supervisory mechanism we have a European law that was published in October which hands over to the ECB, as of the 14th November, the task of being the single supervisor for all Eurozone banks. This single supervisory mechanism is for all banks, of which 130 or so will be under the direct supervision of the ECB, meaning that they will be supervised by joint supervisory teams with a mix of national supervisors led by the ECB and based in Frankfurt. The mix of nationalities on these multinational supervisory teams for large European institutions will be one of the first major cultural changes that we would like to bring as early as next year. In addition to the 130 banks under direct supervision, the ECB will also have a mandate on all other banks with the right to bring any bank under direct supervision if needed.

The new supervisory arm of the ECB will have four business areas, led by four director generals. One of them will be entirely devoted to non-directly supervised banks in order to ensure that everything is okay under indirect supervision and to bring supervision back to Frankfurt if necessary. The current head of the French supervisory authority, Madame Nouy, should be appointed as the chair of this new supervisory mechanism within the next couple of days by the European Council. She has been confirmed by the European Parliament. In 2014 the first priority of this new institution within the ECB will be to run a comprehensive assessment of banks in three parts. The first part is a risk assessment, which will in particular include funding risk, which is very important. So the comprehensive assessment it is not only an the asset quality review, since liabilities are also important and will be covered under the first pillar of the assessment. Second, there will be an asset quality review of all of the directly-supervised banks and, third, there will be a stress test that will be coordinated by the European Banking Authority. The stress test will therefore cover the entire EU with the ECB in charge of the Eurozone part of that.

The comprehensive assessment, in particular the asset quality review, is so important because it is the first opportunity we will have to show that this time is different. This is very practical. It is a practical exercise to create a common supervisory culture and to harmonise methods, and this harmonisation may be the most important achievement, to have common definitions, common methods, common rules for non-performing loans and forbearance on such loans and so forth. These are all different today and they will have to be the same as early as next year. That is the first outcome. The second outcome is that we need to create trust in the valuation of bank assets. This serves a macroeconomic purpose, which is to help banks reorganise their balance sheets and make room on their balance sheets to extend new loans to the economy.

It is often said that this asset quality review will be procyclical. There is a risk that at least initially it would accelerate deleveraging, that banks would have a tendency to clean up their balance sheets before our assessment, and this unquestionably has a procyclical dimension. However, it is ultimately a counter-cyclical exercise in my view because it will make it possible for banks to reorganise their balance sheets in a way that creates room to extend profitable loans to the economy. Moreover, there is a very ugly way to deleverage, which is to divest good assets because there are buyers for them at good prices and to keep the bad assets, meaning non-profitable assets rather than non-performing ones, on your balance sheets. We have seen that to some extent. To stop it we need to put a price on all assets and this is exactly what the asset quality review will achieve: it is a price-discovery exercise. The ECB will therefore play a role similar to an auctioneer to make prices for bank assets which currently do not exist. The lack of prices for these assets currently prevents the market from functioning. This is a very important macroeconomic factor.

Now, what are the challengs? Let me mention three of them. First, we need to make the single supervisory mechanism work in a way which is genuinely European, so we want the supervisory board not to be a committee of national supervisors but to become a European institution as part of the ECB. That is an enormous challenge, but we are confident that we will be successful. Secondly, we need to support the deleveraging process in the European banking system in a positive way that makes it possible for banks to extend new loans as the economy recovers, as it will do. A third challenge, which is even more daunting, is that we have to get the macroprudential dimension right. There is a lot of liquidity around and that will remain the case because the European economy needs ample liquidity and it needs, as the Governing Council of the ECB has said, rates remaining low or lower for an extended period of time. Liquidity will therefore remain ample, but we know that this can create risk. Liquidity cycles can turn into hunt for yield cycles that can create risk in many sectors of the market. This will need to be monitored. Looking further ahead, we learned from the crisis that there is a close interaction between macroprudential surveillance in the sense of looking at financial markets and macroeconomic surveillance in the sense of monitoring macroeconomic imbalances. Looking beyond 2014, one of the big challenges will therefore be to have a common approach between the ECB on the one hand, as the single supervisor, and on the other hand the European Commission and the Eurogroup, being in charge of macroeconomic imbalances, so that we can articulate macroprudential supervision by the ECB and the macroeconomic imbalances procedure as run by the Commission, which is a key element of the new European governance, in a useful way. I can elaborate on resolution later if you wish.