European Central Bank

ECB supervisor defends role in Italian banking crisis

Sabine Lautenschläger says watchdogs face 'question of balance' on when to intervene

Sabine Lautenschläger, vice-chair of the Single Supervisory Mechanism © Martin Leissl

Claire Jones and **Caroline Binham** in Frankfurt JULY 4 2017

One of the eurozone's senior banking supervisors has defended her institution's role in handling the failure of two Italian lenders but said her watchdog needed new tools to protect taxpayers better from bank failures.

The Single Supervisory Mechanism has come under fire for failing to declare that Veneto Banca and Banca Popolare di Vicenza were likely to fail until late June, despite longstanding concerns about their solvency.

In the first interview since the failure of the banks, Sabine Lautenschläger, vice-chair of the SSM, said the supervisor had to give both a chance to address shortfalls in their capital requirements.

"We were quite insistent on addressing risk in both these banks, which led to [us calling for] the need for capital increases," said Ms Lautenschläger. "[In the end] it was very clear-cut that there was no solution, and so then we had to act."

Critics of the two banks' bailout say Rome's decision to use up to €17bn of taxpayer money, and allow the banks' good assets to be taken over by Intesa Sanpaolo, made a mockery of a new post-crisis regulatory system that was meant to stop public funds being used for bank rescues.

Some believe earlier intervention by the SSM — the supervisory wing of the European Central Bank — would have led to smaller potential losses for the Italian taxpayer.

Ms Lautenschläger, who is also an ECB executive board member, said it was not within the SSM's remit to decide "whether the taxpayer is affected" and if so, by how much. She said supervisors faced "a question of balance" on deciding when to intervene.

"On the one hand, and I fully agree, a supervisor has to be forward looking . . . we are forward looking within the legal framework given to us," Ms Lautenschläger said. "The shareholders, the junior and senior debtors . . . have their rights too. They are expropriated. So you have to get the timing right, which is not always easy."

I cannot give you the idea that everything is fine because here and there, some homework still needs to be done

Sabine Lautenschläger, Single Supervisory Mechanism vice-chair

The SSM was set up in 2014 to address some of the gaps in supervising large international banks that appeared during the financial crisis. Along with its sister authority for winding up stricken lenders, the Single Resolution Mechanism, it is a pillar of the EU's "banking union" project to move power over lenders to the EU level and protect the currency union by reducing the impact that failing banks have on sovereign states.

The new supervisory structure has faced its biggest examination within the past month after Spain's Banco Popular nearly collapsed followed by the liquidation of the two Italian banks.

Danièle Nouy, who chairs the SSM, said last month that Popular's takeover by Banco Santander showed the system had passed its first test. But the Italian bailout using public funds has undermined that assessment, critics say.

Ms Lautenschläger, 53, said banking union — whose next steps would include a pan-EU deposit-guarantee scheme — had "made quite a lot of progress" but was a long-term project. "We need to acknowledge that we might not be there fully yet," she said.

Nicolas Véron, a senior fellow at Bruegel, a think-tank in Brussels, said the treatment of the Veneto banks "highlights one of the missing bits that was well known to experts but that many policy people were in denial of — namely, the lack of bank insolvency law harmonisation and the consequence that the single resolution mechanism is anything but single".

Ms Lautenschläger said it was indispensable that banks reach their target for issuing enough debt that is specifically designed to cover losses and protect taxpayers should a bank fail. Most banks have until 2022 to build up this debt, which is known as "minimum requirements for own funds and eligible liabilities".

While the SSM and national regulators will determine what levels are needed, some countries are behind others in making the legal amendments necessary.

"I cannot give you the idea that everything is fine because here and there, some homework still needs to be done," said Ms Lautenschläger during an interview in Frankfurt.

Ms Lautenschläger would still like more regulatory tools. One example she gives is to be able to impose a moratorium on banks to stop withdrawals — something that happened in the case of Banco Popular when deposits were pulled out in its final days, exacerbating its problems.

"When you have a bank with problems with liquidity it's quite helpful to have a moratorium; I'm used to it in Germany. I missed it in Spain," she said, referring to a German law that puts a payments freeze on lenders that face insolvency.

She would also like to be able to go beyond narrow accounting rules in pushing banks to make more provisions to cover their risk taking.

Aptly for a regulator who first trained in law rather than economics, Ms Lautenschläger emphasises legal certainty, with modern laws backed by a well-resourced legal system. She said this would help bank balance sheets by making investors more likely to want to buy the vast amount of non-performing loans that are weighing down many European lenders.

In a third of member states, banks' bad loans account for more than 10 per cent of their balance sheets. In Cyprus and Greece, NPLs stand at nearly 50 per cent.

“The solutions are not only with the banks, but with the national governments too. This is because it is also a question of the legal environment: the judicial situation is of utmost importance . . . for the value of a non-performing loan, and how fast a workout can be done.”

Warning to banks to speed up Brexit planning

Sabine Lautenschläger says the clock is ticking for lenders thinking about their post-Brexit future.

“My message [to middle-sized banks] would be very clear: speed up. Make up your mind and contact us early so that we can have a discussion about your plans, about the expectations on both sides,” she says.

Ms Lautenschläger’s team will approve the applications of banks that need to set up European hubs because of the UK’s decision to leave the EU. Those lenders include British high-street stalwarts but also US and other overseas investment banks, which have used London as a base to “passport” their products and services across the EU.

“I believe the very big ones are quite well progressed in their planning,” she said. “Many of them still need to make a clear decision over what kind of structure they want to adopt and what kind of location they want to have for their operations. It’s not yet too late, but I think these kind of decisions should be done pretty quickly because time is running out.”

But uncertainty is weighing on UK banks’ planning: will a deal be struck with the rest of the EU before the UK is expected to leave the bloc in 2019? And what terms will apply for financial services? Will the UK’s regulatory regime be deemed “equivalent” and thus grant at least partial access to the EU? Will the European Commission press ahead with a contentious plan to force overseas banks operating in the EU to set up holding companies to ring fence capital?

Puzzles also need to be solved by European banks that are already under the SSM's purview. Some of the larger ones are well advanced in thinking about how they will get access to the City of London post-Brexit but others "still have to make up their minds, and that's where I say very clearly that they should speed up", adds Ms Lautenschläger.