Jörg Asmussen: Intervention in a panel on "The future of Europe"

Speech by Mr Jörg Asmussen, Member of the Executive Board of the European Central Bank, at the IIF (Institute of International Finance) 2013 Spring Membership Meeting, Paris, 26 June 2013.

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Mr Prot,

Ladies and gentlemen,

Thank you for inviting me to speak on this panel.

As the central bank of the euro area, Banking Union is of key concern to the ECB. It is essential to increase confidence in the euro area banking sector, to reintegrate financial markets, and to improve the transmission of our monetary policy. It is therefore among the most important issues for the euro area today.

While Banking Union comprises a number of regulatory and legislative initiatives, at the moment there are two key priorities.

First, the Single Supervisory Mechanism (SSM).

Second, the Single Resolution Mechanism (SRM), operating under the legal framework established by the Bank Recovery and Resolution Directive (BRRD).

A common deposit guarantee scheme, while important, is something more for the longer-term.

Let me say a few words on each of these elements, and how they fit together.

Starting with the SSM, we expect the Regulation to be approved by the European Parliament in September and for the ECB to take over supervisory responsibilities one year thereafter.

In the meantime, preparatory work is underway involving close cooperation between the ECB and the national authorities that are competent for supervision. The work includes mapping the euro area banking system, developing the supervisory model and, perhaps most topically, preparing the comprehensive assessment of all banks that will come under direct ECB supervision. This is required by the Regulation and will apply to around 130 to 140 banking groups operating in the euro area.

The assessment will involve an Asset Quality Review and Balance Sheet Assessment to be conducted by the ECB in the first quarter of 2014. This will then feed into the overall stress test to be conducted by EBA, in cooperation with the ECB, in the second quarter of 2014. Our objective is for the SSM to start with a clean slate and to restore credibility in the European banking sector after two previous stress tests failed to do so. We are therefore aiming for the assessment to be as rigorous as possible.

It is clear that the results of the Asset Quality Review and stress test may require recapitalisation or other means of support for weak banks. If banks cannot raise new capital themselves, the fiscal backstops which can be tapped if needed will be national budgets and the existing ESM facilities. Direct bank recapitalisation via the ESM will – with the exception of very rare and unlikely cases – only be available once the SSM is fully operational.

However, building the SSM's credibility requires more than just transparency on banks' asset quality. Markets also need to be confident that, in the future, the supervisor can "pull the trigger" on banks that are failing or likely to fail. This means that there must be a mechanism that can wind down banks without causing financial instability. And this is why the SRM is also an essential element of Banking Union.

In our view, the SRM should comprise of a European resolution authority backed by a single resolution fund. The rationale for this mainly concerns dealing with large, cross-border banks. For resolving these institutions, a central authority that can make swift, impartial decisions is key. Moreover, we need shared resources at the European level to avoid protracted wrangling between national governments on how to share the costs of resolution.

These resources, however, would not come from the taxpayer. The resolution fund would be financed provided by *ex ante* risk-based levies on the banking sector. In the build-up phase, any public support would be recouped by additional *ex post* levies on banks. This is consistent with the emerging consensus in Europe, also reflected in the BRRD, that the financial sector itself should pay for the cost of crises.

Indeed, when the relevant provisions of the BRRD enter into force, bail-in will be used as the primary tool to recapitalise banks falling below minimum supervisory levels. It is therefore important that we agree on an approach to bail-in that allows some but limited flexibility to ensure financial stability, while still providing an *ex ante* pecking order and clear rules. Global investors need certainty about the rules of the game in Europe.

As regards the date when the BRRD will enter into force, I believe that starting as early as 2015 will provide more clarity and legal certainty for investors than delaying the new regime until 2018. And since market participants will most likely anticipate the new rules *even if* the later date is chosen, we may as well aim at 2015 for the BRRD to enter into force.

Why is a common deposit guarantee scheme not also on the agenda? The reason is that a strong resolution framework lessens the need for it, at least for the medium-term.

Under BRRD, banks will have to maintain a minimum level of liabilities that are eligible to be bailed-in, meaning shareholders and creditors will absorb the majority of losses. Moreover, it seems very likely that BRRD will contain a depositor preference rule, with insured deposits given the highest priority. This means that only in extreme cases will deposit guarantee schemes have to pay out. National arrangements, harmonised under the Deposit Guarantee Scheme Directive, should therefore be sufficient.

Taken together, these two elements – the SSM and the SRM – form a robust foundation for Banking Union. It is essential that we make progress on each in parallel.

Thank you.