EUROPEAN CENTRAL BANK

EUROSYSTEM

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INTERVIEW WITH PHILELEFTHEROS

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1. How is preparatory work for the Single Supervisory Mechanism (SSM) progressing? Will everything be ready by 4 November?

As we are totally focused on our deadlines, the SSM is well on track and we are working within our timetable. We will be ready by 4 November when the ECB assumes its supervisory duties. The comprehensive assessment is also well on track; by the end of this month we will have concluded the asset quality review (AQR), the outcome of which will be joined up with the stress test under a hybrid approach. At the same time, recruitment is well under way. So far we have hired about 600 people for the SSM. Allow me to say that this has been a challenging and difficult task, as we have had to choose among highly qualified and talented people.

2. What conditions would trigger an alarm in the context of the SSM? How much time will banks have to address any identified weaknesses?

Once the results of the comprehensive assessment are published, banks with a capital shortfall will have two weeks to come up with their capital plans. Banks will then have six months to cover any capital shortfall identified in the AQR or under the baseline scenario of the stress test and nine months for those identified under the adverse scenario. I believe that this timeframe is sufficient.

3. How thorough will the supervision be? Will uniform rules apply to all banks in the euro area, for instance for non-performing loans, liquidity and equity?

Extremely thorough and the rules will be the same for all. This is the first time ever that there will be a truly pan-European supervisor. The way the SSM has been designed ensures the effective application of the single rulebook that has been developed by the European Banking Authority, thereby ensuring the harmonisation and homogeneity of supervisory standards in Europe. By eliminating regulatory arbitrage and removing national bias, the SSM will significantly enhance confidence in banking supervision.

4. What do you expect the capital shortfall for Cypriot systemic banks to be? Will their needs be covered by equity issuance? (The Bank of Cyprus has already initiated such issuance and Elliniki Bank is also planning to do so.) What about Greek and other European banks?

Even if I wanted to speculate on the outcome of the comprehensive assessment, I wouldn't be able to do so as the results will only be available in the second half of October. In this regard, let me also say that people should ignore any rumours. Regarding Cyprus, as many steps have been taken to stabilise the banking sector and the economy, I believe that the best way Cypriot banks can cover any possible capital shortfall is through the market.

5. Do you believe that some banks might not have a future and that they might have to be resolved if they fail the tests? What about banking in the new landscape?

If a bank has a viable business model, it can proceed with a capital increase in order to cover any possible shortfall. If not, there are sufficient rules on how to deal with it, since we have new regulation coming in, such as Basel III and the Capital Requirements Regulation and Directive, meaning that banks must hold more capital of better quality, and the Bank Directive on Recovery and Resolution, under which the price for using public support will be pretty high. State aid rules implemented since last summer state very clearly that the use of public money will require burden sharing, with the bail-in of junior debt and hybrid capital instruments. This will change the landscape. Another powerful new element is the bail-in of senior debt from 2016 on. Banks and supervisors will have to draw conclusions from this new environment. Profitability, the sustainability of profitability and the sustainability of the business models will all be very important. It is very good that we can address these questions for banks after a transparency exercise has been completed, provisions have been made and it has been established that there is no unidentified forbearance. These rules ensure that investors must be the first to pay for errors committed by banks, and taxpayers only as a last resort. Let me also add that, since July 2013, banks have started strengthening their balance sheets through various measures. According to the information we have so far, these are in excess of €100 billion.

6. What has the AQR revealed about non-performing loans and the valuation of collateral?

As I said, I cannot make any comments about an ongoing exercise. Let us wait until the second half of October to find out.

7. Do you believe that the stress tests will reveal whether the sector is in difficulty and whether austerity policies have significantly affected the quality of loan portfolios?

An economic slowdown usually affects the number of non-performing loans. But we must make a distinction here: reforms and fiscal consolidation are a prerequisite for ensuring the sustainability of an economy that was following an unsustainable path. They should help improve financing conditions and the growth potential, thereby enhancing investor confidence, which is essential for restarting the economy. And this can only happen if investors perceive that reforms will be pursued in the future as well.

8. How will supervision be transferred from national supervisory authorities to the SSM?

The SSM is composed of the ECB and the national competent authorities (NCAs) of participating Member States and therefore combines the strengths, experience and expertise of all of these institutions. The ECB is responsible for the effective and consistent functioning of the SSM and exercises oversight over the functioning of the system, based on the distribution of responsibilities between the ECB and NCAs, as set out in the SSM Regulation. To ensure efficient supervision, credit institutions are categorised into “significant” and “less significant” institutions, with the ECB directly supervising the significant banks while the NCAs are in charge of the supervision of less significant banks. The day-to-day supervision of the significant institutions will be conducted by Joint Supervisory Teams (JSTs), which comprise staff from both the ECB and the NCAs of the countries in which the credit institutions, their banking subsidiaries or their significant cross-border branches are established. A JST is established for each significant institution. The teams will be led by coordinators at the ECB – working with nine to ten people in the case of the largest banks – and they will rely on the national supervisors of the significant institutions. Local NCA sub-coordinators will be appointed in each country where these significant banks operate. It will be a bottom-up process, as it is now. The information will pass from the local coordinators to the head of the JST. Let me stress that distance in decision-making is very helpful, because we will have the best of both worlds: the proximity of supervisors to the banks and some distance for the decision-making.

9. The 2010 and 2011 stress tests came under criticism as they did not manage to reveal weaknesses in banks that later failed. Will the exercise be more reliable this time?

The comprehensive assessment aims to substantially increase transparency about the underlying quality of the banks' assets in a consistent manner across countries and has been designed to be rigorous and thorough. The baseline and adverse scenarios are extremely realistic and, together with the other procedures envisaged, ensure the reliability of the exercise.

10. Will the transfer of supervisory responsibility to the SSM make it more difficult for businesses and households to obtain credit?

On the contrary! By creating a level playing field and making sure that the control of banks is at arm's length from local politics, the banking union should lead to a more resilient and efficient banking system. This in turn should bring about less fragmentation of the banking sector, which will benefit the economy and improve the transmission of the ECB's low rates to companies and households. May I also add that, as of next month, the targeted longer-term refinancing operations should start finding their way into the economy to the benefit of credit growth.

11. What will the banking union mean for the ordinary people here in Cyprus then?

It will mean a lot. First, it will help to restore trust in the Cypriot banking sector. Second, following the conclusion of the Comprehensive Assessment it will be possible to address the gradual easing of the external restrictive measures. Third, banks will be able to have better access to markets and this will support economic activity by allowing the resumption of the flow of credit.

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