

**Joaquín Almunia**

Vice President of the European Commission responsible for  
Competition Policy

## **Overcoming the crisis: The role of finance**

Check Against Delivery  
Seul le texte prononcé fait foi  
Es gilt das gesprochene Wort

*Second European Financial Congress*

**Sopot, 23 May 2012**

Ministers,

Authorities,

Ladies and gentlemen:

It is an honour for me to address such a distinguished audience, and I am deeply grateful to Prime Minister Bielecki and Mr Pawłowicz for inviting me to this conference.

I find it particularly fitting that that this Congress here in Sopot is devoted to "Financial stability and safety in Europe". Of all the European countries I have visited as European Commissioner, Poland stands out for the stability and safety of its banking sector.

And of all the places in Poland, Sopot and nearby Gdansk remind us that freedom, democracy and prosperity – the ultimate goals of the European project – can only be built on the respect of human rights, responsibility and solidarity.

It is important to recall these basic values, because what we see today in some parts of Europe is a growing scepticism; some citizens wonder whether Europe still stands for a stable and prosperous future.

The recent rounds of elections saw the rise of parties which reject Europe and its fundamental tenets: the rule of law, openness, and integration based on mutual respect and support.

As national and European authorities, we need to do what is necessary for our Union to overcome its current crisis with firm determination.

Europe must become once again what it has always been; a catalyst for the economic, political and social development of our entire region.

And, of course, we need to convince our citizens to support the decisive actions required for this purpose.

Taking this into account, as we discuss today what finance can do to help us negotiate this difficult passage, we should not forget what is at stake.

To overcome the crisis – which spread from the financial sector to the real economy and to some sovereigns – we need to address the root causes of the troubles in the banking sector.

To succeed, we ought to do two things; changing the way banks are regulated and restructuring or liquidating the institutions that cannot survive in the medium term without state support.

I regard both these tasks as crucial responsibilities for national and European public authorities, because we need a healthy financial system to take the path to growth again.

We also need to make sure that banks never again are a threat to the sustainability of public finances.

Looking at the size of public support to the financial sector, it is easy to understand why the balance sheet of banks and government accounts have become dangerously linked to each other.

According to our figures, since the start of the crisis in 2008, EU governments have used more than one and a half trillion euros to support and rescue their banks.

Around three quarters of this amount were guarantees, and the rest was given as public capital injections and treatment of impaired assets.

This extraordinarily large package was necessary to maintain the stability of our banking and payment systems – and in this respect it has worked rather well.

On the other hand, it effectively moved risk from banks' books to governments' accounts, tightening the links between them.

We can draw two main lessons from the experience we have gained so far during this process:

- First, that an early recognition of the problems in banks' balance sheets, coupled with a sizeable state support and decisive restructuring, have produced tangible results.
- Second, that in some countries the financial sector was simply too large compared to their output or to the state of their public coffers.

In the Irish case, the bailout turned out to be too onerous and support from the European Financial Stability Facility was needed.

But things are much more complicated. In particular, Europe's sovereign-debt crisis is not only the product of troubles in the banking sector.

There are other factors as well, such as the lack of fiscal discipline in some countries – such as Greece – and internal imbalances in the euro area; especially, persistent current-account deficits with other countries of the EMU.

In addition, a number of structural problems have been let to simmer for too long; such as a continuing loss of competitiveness in some of the peripheral EMU countries and an inadequate system of governance for our common currency.

Eventually, these conditions have resulted in a very serious confidence crisis. Investors no longer perceive sovereign bonds as virtually free of risk; and this means that no measure addressing the banking sector alone will bring a lasting solution to the current crisis.

A lot has been done in recent times to address these issues, and we are witnessing a major overhaul of the governance framework in the euro area.

The Fiscal Compact is one notable example. The compact must be urgently ratified so that its instruments can be put to work while the European semester is in full operation. The same applies to the European Stability Mechanism.

Remaining vulnerabilities in the banking system also need to be addressed. The recent measures taken by the Spanish government to increase provisions against real-estate assets and for more transparency in the books of the Spanish banks are steps in the right direction.

And as we wait for the outcome of a second electoral round in Greece, I remain convinced that the future of the country lies within the euro.

Now we need to complement the necessary consolidation of public finances with fresh measures to spur growth; because, at the end of the day, only growth will take us out of the crisis.

Today, Europe's leaders are holding a special growth summit to discuss how to re-launch the economy while maintaining fiscal discipline.

This follows the package of initiatives that President Barroso sent to the Member States on May 9 – Europe's day.

In it, the Commission called for faster structural reforms at national and EU level and for the removal of the remaining barriers that fragment the Single Market.

In addition, to step up investment, the Commission called on the European Council to increase the lending capacity of the European Investment Bank by boosting its paid-in capital.

To pursue the same goal, the Commission put forward a proposal for the so-called project bonds for key infrastructure projects in transport, energy and the digital economy.

The new focus on growth is not limited to the EU. The leaders of the G8 agreed last weekend that austerity needs to be balanced with a fresh stimulus to reinvigorate the economy.

The common efforts to overcome the banking and sovereign crisis show that the European project is vital to the future of our Member States, which can only be a common future.

No EU country – no matter how large and rich – can overcome the crisis on its own. And no one can be saved at the expense of the others.

While some countries are making huge and painful adjustments to put their public finances in order and to correct other macroeconomic imbalances, all should take responsibility for Europe's most precious common goods – which are the euro, the internal market, and our progress towards integration.

Today, the passage is narrow, and nobody can expect a smooth ride through it. But beyond the lists of austerity measures, the new governance rules, and some political tensions, what one can see is a giant common effort of the Union to help its members in trouble.

The passage is also difficult because it has to pass the double test of the markets and of the people's democratic support.

The general direction of what needs to be done is crystal clear: the EMU must be completed. Building a true fiscal Union will take time, but I am convinced that we have no option; we must take this path as soon as possible.

A more integrated banking space will also be necessary. We need more coordinated supervision and resolution capacities, coupled with an EU-wide deposit guarantee scheme system.

And of course, we must gradually advance towards the mutualisation of public debt at euro-area level.

I have no doubt that Europe will take this path. I am convinced that our leaders have the vision and the courage required. Besides, as President Barroso said earlier this month, "more has been achieved in the last two years than in the previous ten" in the construction of a true economic union.

Ladies and Gentlemen:

Let me go back in more detail to the complex process of restructuring and regulating the banking sector.

Since the beginning of the crisis, the Commission was given the task to make sure that the public bailout of banks would be carried out under the same conditions throughout the internal market with the objective to return the banks to long term viability – or, failing that, to oversee their orderly resolution.

Our rules would also address the moral-hazard issue and lay down the conditions for the competitive functioning of the sector in the medium term.

The Commission responded by introducing special rules for State aid to banks in 2008 and 2009. Under these rules, we have decided on the viability, restructuring or liquidation of 43 banks, and are still working on more than 20 other cases.

The emergency regime has given guidance on the pricing, duration and type of liabilities that national authorities across the EU can guarantee for a bank. It has also provided common criteria on how banks must remunerate the government for recapitalisation and impaired-asset measures.

Finally, it set out the terms for the restructuring or orderly liquidation of aided banks, depending on the size of the support received and on the soundness of a bank's business model.

On the basis of these rules, the Commission has been acting as a *de facto* crisis-management and resolution authority at EU level, also addressing the structural problems that had been affecting many banks well before the crisis.

The conditionalities we impose on banks which need to restructure fall under three main headings:

- First, aided banks need to restructure to return to long-term viability without any need for further aid. If this is not possible, we ask for an orderly liquidation of the institutions;
- Second, the capital holders – shareholders and hybrid-capital holders – should contribute adequately to the cost of the rescue and restructuring to limit the aid and the cost to the taxpayer; and
- Third, to limit competition distortions, we ask the aided banks not to expand on the back of State support to the detriment of unaided competitors.

In practice, to address the structural problems, we are asking some banks to move away from unsustainable business models.

Significant restructuring efforts will have to continue in the future in Ireland, Greece and Portugal – the so-called programme countries.

Parts of Spain's banking sector also need to undergo deep restructuring and decisively address the legacy of the real-estate boom and governance problems.

And we are also looking for adequate solutions for some banks that were rescued a long time ago in other EU countries, such as – among others – the UK, the Netherlands, Belgium and Germany.

As a side remark, let me tell you that, in our experience so far, when a bank which needs to restructure after receiving state support has a Polish subsidiary the problems are easily solved.

In these cases, we can be confident that – if needed – there will be valuable and sellable assets even in the present market conditions, since many investors in the world seem keen to establish a presence in the Polish banking market.

As I mentioned at the beginning, breaking the link between sovereigns and banks is the first step we must take to solve the current crisis.

The European Banking Authority and the European Central Bank have taken action: the EBA demanding that banks reach a 9% Core Tier 1 capital ratio by the end of June; and the ECB, with its Long Term Refinancing Operations, or LTROs.

The LTROs eased tensions in the sovereign debt markets in the early months of the year, but were not a silver bullet.

We should continue to explore the conditions to set up and use the appropriate firewalls which would ring-fence the European sovereign debt from speculative attacks.

The second step is asking banks to hold high enough capital buffers, in accordance to the Basel III agreements.

The EU is working on two pieces of legislation, the Capital Requirements Directive – or CRD 4 – and the Capital Requirements Regulation, and significant progress has been made in the Council last week.

Another piece in the new regulatory and supervisory architecture we will put in place soon is the new resolution framework.

Under normal conditions, banks need to be allowed to fail without endangering public finances.

The proposal the Commission is working on is a EU-wide framework to tackle bank failures at the earliest possible time to prevent major disruption to the system and minimise or eliminate the costs to the taxpayers.

A common European resolution framework which effectively protects the sovereigns and the taxpayers from paying for the mistakes of bank managers is also a political imperative.

And a high-level group chaired by former Commissioner Erkki Liikanen, now governor of the Bank of Finland, is looking into the structural reforms in EU banks that can strengthen financial stability and improve efficiency and consumer protection.

This is similar to the structural changes adopted outside the euro area, such as the Volcker rule in the US, and to the debate prompted in the UK by the recommendations of the Vickers commission.

Ladies and Gentlemen:

I would like to tell you in closing that the Commission is taking its responsibilities very seriously in this process – as I take mine as regards State aid control – because rescuing and restructuring Europe's banks has implied a transfer of taxpayers' money to private banks of unprecedented scale.

It has also implied a large inter-generational transfer. To safeguard financial stability and avert even larger costs, EU countries have taken decisions that will inevitably affect the availability and quality of public goods in the future.

It is our duty to create the regulatory conditions to prevent the recurrence of the irresponsible behaviour of the past.

It is also our duty to make sure that the benefits and efforts of restructuring are distributed equally; because we cannot accept that the profits remain private while the losses are nationalised.

Finally, it is our duty to protect and reward the institutions that did behave responsibly and have continued to provide vital functions to the economy. Banking will have to change, and we will accompany this change.

We are laying the foundations for the financial markets that will emerge from the crisis. In it, banks will be more resilient, business models will be more transparent to allow the market to assess their solidity, and the system will be more sustainable not to threaten public finances ever again.

Thank you.