

# Renzi is right – there is a banking problem

## OPINION

Philipp  
Hildebrand

With Britain's vote to leave the EU, the bloc has been granted a golden opportunity to prove that what does not kill you makes you stronger. The EU however needs to be clear-sighted about what the lethal threat is. It is not the UK's vote, but what lies behind it: poor economic performance and inefficient decision-making. That is what the remaining 27 member states should focus their energy on fixing. And they should start where the pain is most acute: Europe's banks.

Matteo Renzi, the Italian prime minister, might have gone about tackling this issue the wrong way when he floated the idea of suspending bail-in rules in the wake of Brexit to facilitate a publicly funded bank recapitalisation. On the substance, though, he is absolutely right: Europe has a banking sector problem. Weak bank balance sheets make for weak growth. And the markets agree. Eurozone bank shares have fallen nearly 40 per cent since the start of the year and have been hit as much by the news of Brexit as UK banks.

At the same time, I agree with those who reacted to Mr Renzi's proposal by saying there is no case to suspend the bail-in rules that are encapsulated in the

Bank Recovery and Resolution Directive, which came into force at the start of the year, and that doing so would fatally damage the credibility of the brand-new bailout framework.

But as Angela Merkel, German chancellor, has pointed out, the rules as they stand provide for enough flexibility – for example, in the context of “precautionary recapitalisation”, which does not require bail-in and permits the temporary shoring-up of banks with public money to make up for a capital shortfall revealed by a regulatory stress test, if raising private capital is not feasible. It is a fortunate coincidence that the 2016

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European Banking Authority's stress test campaign is under way. And it is clear, with most European banks trading far below book value, that raising private capital at this juncture is not a practical option. At the same time, most European banks are perfectly viable, and so resolution is not the way to go.

The European Commission should therefore allow those governments that wish to do so to take temporary equity stakes in banks that need a capital boost. Importantly, state aid rules apply, so this should not be a free handout. Rather, it should be conditional on

banks committing to significant steps to address the structural difficulties they face and diversifying income sources. This would be similar to the US Tarp process in 2008 that ended up returning money to taxpayers. The scheme would ideally include provisions to encourage consolidation. Since they would be intended to be temporary, the equity participations taken by governments under this scheme should be excluded from calculations of government debt for purposes of the EU's fiscal rules.

Agreeing to this scheme would have a number of significant benefits: it would solve once and for all the deep structural weaknesses that have plagued eurozone banks since the crisis and which explain in large part why recovery has lagged behind those of other economies. And it would signal to markets and voters alike that European policymakers have grasped the need to finally get to grips with structural impediments to growth. It would also clear the way for further progress in completing the banking union, as core countries will no longer need to worry about being made to pay for the bad loans of southern European banks.

Equally important, this solution would have no meaningful downsides: no rules would be broken, no perverse precedent or incentive set and no complicated legal process set in train. It is, in short, a no-brainer.

*The writer is vice-chairman of BlackRock and a former chairman of the governing board of the Swiss National Bank*

