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The new bank recapitalisation scheme

proposed in the Euro area summit of 28/29 June 2012: its prerequisites and importance for the growth dimension and the level playing field in the Eurozone

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- **Is bank recapitalisation really needed?**
  - Credit institutions' capital erosion due to the financial crisis
  - The crisis has unveiled important risks stemming from distressed assets (housing, government bonds) which spilled over to core banking
  - The new capital and liquidity requirements will increase financial pressures and make it more difficult for banks to achieve targets on equity returns
- **Changes in banks' funding structures following the financial crisis**
  - Short-term wholesale funding seized up
  - Need for new, sound funding sources: customer deposits and equity
  - Investors reluctance to invest in banking stocks
  - Deposit flight from periphery to core banks
  - Practicable funding inability through the market in economies under crisis
  - No access to capital markets for several member states! What then?

Recapitalisation, but at what price and at what cost?

- **Subsidize or let banks go insolvent?**
  - The role of banks in financing the real economy
  - Adequate bank lending capacity as an indispensable precondition for sustainable economic growth
  - Recapitalisation vs. license removal and insolvency
- **Why not letting the banks go bankrupt?**
  - The “too big to fail” discussion
  - The “to systemic to fail issue”
  - The “too many to fail” issue (in the Eurozone) / ("systemic as a herd")
  - The impact of a massive banks’ insolvency to the real economy and the social peace and cohesion

- **A general bank crash as a major problem in the society as well as the domestic and European economy**
  - Impact on other market participants
  - Deposit guarantee schemes - Depositors' losses
  - Contagion of systemic risk / domino effect
- ***State aid to the benefit of banks*** **in the context of the financial and economic crisis**

  From October 2008 and until the end 2010, European governments used €1.6 trillion of state aid to support the banking sector, in the form of guarantees and liquidity support, recapitalisation and asset relief measures. It was perceived that, without government intervention, a systemic crisis with serious consequences for the economy would have been realized
- Between 2008 and October 2011 the national parliaments of the Member States committed for €4.5trillion (36.7% of EU GDP) of state aid measures, the majority of which in the form of guarantees on bank liabilities with maturities up to 5 years.

New Restructuring and Recovery Plans:

- Transformations and recovery or
- Orderly banks' wound down
- Reduction of systemic risks
- By bank restructuring / recovery, continuity of key bank functions
  - Bail in
  - Bail out / bank resolution funds
    - Recapitalisation is necessary for the recovery of each bank
    - The funding gap issue immanent for each bank resolution

Bank recapitalisation necessity and sovereign debt crisis

- Market confidence in the European banking system has been eroded in light of high sovereign debt exposure
- Banks have been encouraged to invest in domestic sovereign debt
- Financial institutions, slowly, but steadily, lost access to capital markets
- Worsening economic prospects and low PSI participation since the summer 2011
- Banks' response: Deleverage of the balance sheet and credit restraint

- **The financial crisis has caused recession and poverty in many Member States**
  - Job losses and sharp increase of the unemployment rate
  - Significant increase in public debt levels [banks' rescue]
  - Falling wages

- **The financial crisis enhanced European market fragmentation enlarging bank recapitalisation needs and sovereign recovery plans**
  - Banks’ capital and liquidity is partly embedded in national debt
  - National banking supervisors have built up firewalls
  - No meaningful ability to resolve cross-border institutions
  - Depositors’ bank run to credit institutions seated in strong economies
  - Currency risk
  - Privatisation failure
  - No real growth conditions
  - No level playing field
  - The sovereign debt crisis as additional reason for disequilibrium and segmentation of the European Market

- How to tackle the institutional disequilibria leading to the fragmentation in the European Market in the aftermath of the financial crisis as well as to the Eurozone crisis?
- Urgent need for a new post financial [bank and sovereign debt] crisis New European Financial Services Action Plan [FSAP] addressing and restoring the disequilibria created due to the imbalances inherent to the Eurozone's framework
- High-level Expert Group Report on reforming the structure of the EU banking sector, chaired by Erkki Liikanen, of 2 October 2012
- Euro area summit statement, 29 June 2012

  "*We affirm that it is imperative to break the vicious circle between banks and sovereigns*"

- Euro area's heads of state or government decision to:
  - establish a single banking supervisory mechanism which will be run the by the European Central Bank; and once this mechanism has been created;
  - to provide the ESM with the possibility to inject funds into banks in a direct manner
- Spain's bank recapitalisation would begin under present rules, i.e. funds will be provided by the EFSF until the ESM becomes available, provided it applies and conforms to conditions imposed by the EU
- Subsequently, it will be transferred to the ESM without acquiring seniority status

- The Lernaean Hydra is impeding any growth prospects:
  - The vicious circle of sovereign debt / banking crisis
  - The recession spiral due to structural inefficiencies and low competitiveness, deepened as a result of the austerity measures
- Banking recapitalisation in the form of European direct investments and not through granting of loans, which increase public debt
- A banking union and a pan-European Deposit Guarantee Scheme as core requirements for the restoration of level playing field in the European financial services market and, consequently, for a sound development of the banking sector, which would be capable of financing the real economy.

- Four building blocks contained in the "vision for a genuine economic and monetary union“
  - a banking union

    "*in no way a union for banks, but one which would allow to better manage the risks associated with a fragile, yet powerful sector prone to moral hazard*". In addition to a banking supervision system covering all banks, this union would entail the creation of a pan European Deposits Guarantee Scheme and "*a supranational framework to restructure and resolve failing financial institutions*". Banking union is not just technical solution “*a work of political conviction*”.
  - a fiscal union
  - an economic union
  - a deep-routed political union

- **Recapitalisation tools**
  - Preventing a bank from failing by increasing its capital (along with capital support)
  - Recapitalisation as a preventive / corrective measure
  - Guarantees by a financial stability fund for debt issued by the bank
  - Funding sources: Private Sector, Financial Stability / Bank Resolution Fund (how to finance it?)
  - Regulatory capital injections by financial stability funds on a national and EU level (EFSF)
  - Recapitalisation requirements: Viability assessment, viability criteria
  - The Restructuring/Resolution Fund shall ensure that credit institutions receiving capital support are taking steps to achieve restructuring, merger or acquisition or transfer of their business to another financial institution
  - An Institutional Stability Investment Fund shall render the bank profitable and marketable

- **Recapitalisation forms**
  - Capital injections to credit institutions through a Stability Fund: Possible methods:
    - Capital increase
    - Contingent convertible bonds (CoCos) or other convertible financial instruments.
    - How to determine the issue of pricing shares CoCos / fair value of the credit institution?
    - The role of the private sector / previous shareholders
- **Role of the Fund / Private Sector in the bank's governance**
  - Who will take on the management of the bank?
  - Shall the Fund exercise all its voting rights in the Shareholders Meeting?
  - Restrictions by the exercise of some voting rights?

- **Recapitalisation tools (cont.)**
  - **Way out / Disinvestment**
  - Issuance of warrants? (certificates representing rights to buy shares from the Fund, to be acquired by the private sector in proportion to the latter's participation in the capital increase)
  - Who will have the right to acquire such warrants? [Private sector investors who participate in the capital increase may acquire these certificates in proportion to their participation in the increase]
  - Motivation to private sector for efficient corporate governance
  - Way and procedure for disposing the shares and/or CoCos the Fund will acquire
  - Time limit?
  - Gradually or one-off disposal?
  - Criteria (Price - financial stability - level-playing field)

- **Other issues related to the recapitalisation**
  - Number of shares for which each warrant gives a right to acquisition
  - Time of issuance of the warrants
  - Time and modalities of exercising the rights attached to the warrants / CoCos
  - Conditions under which the warrants may be transferred

- The newly announced Bank Recapitalisation reform, aiming also at achieving growth and level playing field, intends to create a safer, sounder, more balanced, transparent , accountable and responsible financial system, operating for the cohesion of the economy and society as a whole; it aims at being able to finance the real economy, as an indispensable precondition for sustainable growth. In order to achieve that objective, the EU is taking measures to increase the resilience of banks and to reduce the impact of a potential bank breakdown.

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- He studied in Athens (1980 LLB) and in Frankfurt am Main (1986 PhD, summa cum laude). His main practice areas are banking, capital markets and corporate law.
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- Among other, he is a member of the Board of Directors of the Hellenic European Law Association (FIDE-Greece, since 2002), of the European Society for Banking and Financial Law (AEDBF, since 2003, and from 1.1.2012 Chairman of the BoD) and of the Hellenic Deposit & Investment Guarantee Fund (since 2009).
- He is an active member of many European financial law associations and working groups such as the European Financial Markets Lawyers Group ECB (1999-currently) and the Insolvency Law Experts Group (European Commission, 2010- currently); he also participated in several legal groups in the ECB and the European Commission advising on matters pertaining to the regulation of Banking and Financial Markets.
- Author of three books and many articles published in Greek and foreign legal magazines and collective works on company, banking and finance law.