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I. ORIGINS: IMF Mandate

**Surveillance Economic Policies**
- Mandatory annual consultations with all member countries

**Financial Stability Assessment Program**

- **National**
  - Voluntary since 1999
  - Mandatory for 25 systemically important countries since 2010

- **Supranational**
  - EU 2012
  - Focus on supranational institutions & reform priorities not on financial institutions
**II. Contents**

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- **II. Contents**
  - Macro-prudential policy and the ESRB
  - Cross-border clearing and settlement
  - Mortgage markets
  - Resolving SIFIs
II. KEY FINDINGS

EU and euro area (EA) institutional features and the absence of an EU-wide crisis manager amplified the crisis

EU institutions lacked power/authorities

Contributed to negative sovereign-banking loops and financial fragmentation

Need for a regional approach to financial stability to safeguard the single currency area and achieve EU single market for financial services

Important steps are taken but gaps remain

EU institutions (ESRB, ESAs) face challenges
III. STABILITY ASSESSMENT

Progress made

- Bank recapitalization
- Liquidity backstops established
- Supranational sovereign support established (EFSF/ESM)
- Roadmap to BU announced, SSM under preparations, SRM negotiations

Significant challenges remain

- Low growth, limited fiscal space, funding risks
- Vulnerability to sovereign-fiscal feedback remains
- Incomplete policies and institutions
- Fragmented financial system
V. FRAGMENTED FINANCIAL SYSTEM

EU Bank Deleveraging

Retail Lending Conditions

Euro Area Corporate Lending Rates (percent)

Note: Unweighted average; MFI lending to corporations over €1 million, 1-5 years. Belgium and Portugal reflect rates on all maturities.
Core: Germany, France, Belgium, Netherlands.
3/ Core excludes Belgium from May 2011.
VI. SOVEREIGN-BANK LINKS REMAIN

**Average Monthly Bank and Sovereign Stress**
(Basis points, 01/2010 to 9/2013)

**Average Monthly Change in Bank Exposures to the Domestic Sovereign**
(billions euros)

*Source: IFS*
VII. BANK BALANCE SHEETS AND REAL ECONOMY

**Impaired Loans / Gross Loans**
(100 = 2008 Q4)

- Italy
- Spain
- Portugal
- Ireland (RHS)

**Source:** IMF FSI

**Euro Zone: Monthly Interest rates and Banking Stress, 2010-13**
(Germany, France, Italy and Spain)

- Interest rates on new loans to NFC (in percent)
- Average bank CDS spreads (bps.)

**Source:** IMF FSI
VIII. PRIORITIES TO MANAGE THE CRISIS

Complete the repair of banks’ balance sheets

Complete the Banking Union Swiftly

Coordinate better
Complete the Repair of Banks’ Balance Sheets

Supervisory assessment, asset quality review, stress test

Complete regulatory reforms

Enhance disclosure
Complete Fast the Banking Union Swiftly

**ASSIGN ADEQUATE AUTHORITY AND RESOURCES TO THE ECB**
- High quality supervision
- Information sharing and cooperation

**DEFINE A SINGLE RESOLUTION MECHANISM WITH COMMON BACKSTOPS**
- Needs requisite powers; e.g. Intervention and bail in
- Swift decisions and least cost resolution
- Burden sharing
- Single Resolution Fund

**ADDRESS TRANSITION RISKS**
- Seamless cooperation with national authorities is critical

**ESM**
- Governance arrangements for direct recapitalization of banks, to weaken bank/sovereign link
- Conditional on BRRD
Coordinate better

- Set up closer collaboration and coordination amongst the various agencies
- Set up an integrated crisis management system
- Refocus the role of ESAs and ESRB to accommodate the SSM requirements
IX. NEAR TERM CHALLENGES FOR BU

Reach agreement on SRM

• Should be in place by the time the SSM is declared effective
• EC proposal goes in right direction, but:
  • Mitigate legal risks
  • Need for common backstop and single resolution fund
  • Address conflicts of interest and clarify accountability
  • Ensure level playing field (ins/outs)

Complete credible comprehensive assessment

• Ambitious and appropriate timeline and methodology
• Communication essential given complexity and sequencing with EU stress test
• Clarity on backstops and recapitalization strategies (including bail-ins)
X. STRENGTHEN FINANCIAL STABILITY ARCHITECTURE

**ESAs**
- All agencies need strong independence, resources, access to data, and escape from national bias

**Macropurposential Supervision**
- ESRB has wider responsibilities: covers nonbanks and non-SSM
- ECB to take on role for banks in SSM countries

**Financial Market Infrastructure**
- Enhance risk management by centralizing key functions
- Eurosystem infrastructure to be overseen by ECB

**Structural Reforms**
- Proposals to improve resolvability welcome but the benefits of ring-fencing unclear, possibly at odds with single market

**Financial Stability as EU Objective**
- Provide robust legal protection and increase flexibility of architecture
XI. FROM BAIL-OUT TO BAIL-IN

Bail-in as an alternative to (i) bail-out and (ii) disorderly liquidation

Ensure PSI and break the negative sovereign-banking feedback loop

Should be seen as an additional resolution tool

- Crisis calls for expanding resolution powers and tools.
- General corporate insolvency proceedings inadequate in addressing TBTFs
- Should supplement, not replace, other resolution tools that allow institutions to fail orderly

Key design elements/implementation issues

- Ensure legal certainty and “order of priority” as in liquidation
- Avoid unintended systemic consequences
- Achieve cross-border effectiveness and address group issues
XII. CHALLENGES AHEAD

*Low growth* will complicate resolution of legacy problems and completion of architecture

*Withdrawal of public sector.* Emphasis on resolvability and bail-ins may modify funding structures and business models

*Variable geometry and single market.* Two-tier institutional framework between EA and others

*Playing field.* Move away from maximum harmonization, specializations will remain
Thank You