FINANCIAL TIMES

43

June 19, 2012 7:57 pm

EU bank reforms

Ten days after eurozone leaders trumpeted a €100bn rescue plan for Spain's banks, investors have made it abundantly clear what they think. On Tuesday, Madrid had to pay more than 5 per cent for one-year loans, prompting fears that it will soon have to seek international help to refinance its debt.

The market reaction exposed the gaps in the eurozone's toolkit to resolve its banking problems. Rescuing credit institutions by piling more debt on to the sovereign and by giving seniority status to the official loans may be politically tempting, but it also leads investors to dump government bonds.

To be fair to EU leaders, they have acknowledged that European banking rules need to be rewritten. But so far their reform efforts have concentrated on the long-run. In typical eurozone style, the bold but politically divisive moves needed to take Europe out of the current crisis have so far been ducked.

This is why the reports that several European countries, including France, Germany, Italy and Spain, are at last showing some urgency to create a common supervisor for the eurozone's largest banks are encouraging. Not only would this allow more efficient monitoring of complex transnational arrangements. It would also reduce the risk that domestic political pressures get in the way of effective oversight and crisis management.

But this idea falls short of what is required. First, it excludes smaller banks. As the case of Bankia showed, the failure to put out a fire in limited-sized institutions can still send powerful shockwaves throughout the eurozone.

Then there is the issue of what powers should be given to the new regulator. These should include the right to bail in bondholders and, if necessary, to deploy the rescue funds to inject capital directly into troubled institutions. Without them, it will be impossible to unwind the spiral between banks and sovereigns, which has entangled Ireland and now risks doing the same with Spain.

Finally, Europe should move towards a common deposit-guarantee scheme to eliminate fears of bank runs. This should be at least partly industry-funded, addressing the concerns – raised by Germany and other countries – that it will be taxpayers in creditor nations who will ultimately foot the bill.

- The political obstacles on the way to a banking union are significant, but a watered-down version will not do. As the reaction to the rescue of Spanish banks shows, investors are becoming ever quicker at calling Europe's bluffs.