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Spain wins restructuring of bank deal

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By Peter Spiegel and Joshua Chaffin in Brussels

Eurozone leaders agreed to radically restructure Spain's €100bn bank recapitalisation plan, allowing EU bailout funds to eventually be injected directly into teetering Spanish financial institutions, meaning Madrid can sweep the burden of the bailouts off its sovereign books.

The change, agreed as part of a deal struck in the early hours of Friday morning, will not happen immediately, however. Instead the leaders agreed it would come only after the eurozone set up a single banking supervisor to be run by the European Central Bank.

Ireland, which suffered a similar bank meltdown to Spain, would be considered for similar treatment. The euro gained as much as 1.5 per cent against the dollar in Tokyo trading after the agreement was reached.

The dramatic change in the bailout rules came after Italy and Spain forced leaders to remain at the summit overnight, blocking agreement on all other agenda items before getting a deal on short-term rescue measures.

The summit agreement also contained some concessions for Italy, though less than for Spain, setting the stage for Rome to become the sixth eurozone country to request EU assistance as part of the eurozone debt crisis.

Under revised rules demanded by Italy, countries that want the eurozone bailout fund to purchase their bonds – an essential way of lowering their borrowing costs – will no longer be subject to Greek-style monitoring programmes. Instead, they would simply have to maintain their EU debt and deficit commitments, though EU authorities could mandate tighter deadlines and timetables.

Italy is expected to make use of the new bond purchase plan. "It is a double satisfaction for Italy," said Mario Monti, the Italian prime minister. For Angela Merkel, the German chancellor who had for months insisted she would agree no new short-term rescue measures, the deal was a significant concession.

The change in the Spanish programme is likely to have the most immediate effect on the financial markets, particularly since leaders also agreed bailout loans to Spain would no longer be granted seniority status, a structure that had spooked the bond market because of the prospect of official lenders jumping the repayment queue.

However, the change in banking supervision could be the most far-reaching of all the decisions taken. Instead of the hodgepodge of 17 different bank supervisors, there will now only be one for all eurozone banks, a major step towards a so-called "banking union" that is arguably the most significant change to the single currency area since it was created.

Both the agreement to allow direct injections into weak eurozone banks and the creation of a single supervisor are major steps towards breaking what many considered the most insidious development in the eurozone crisis – weak banks dragging down otherwise healthy governments, and highly-indebted governments undermining otherwise solvent banks.

"It is imperative to break the vicious circle between banks and sovereigns," eurozone heads of state said in a post-summit statement.

Because countries will no longer be responsible for bailing out financial institutions on their own, bank crashes like those in Ireland and Spain will no longer be the burden of national treasuries. Instead, the €500bn European Stability Mechanism will pick up the tab.

Although creating an entirely new bank supervisory unit at the ECB was expected to be a long-term change, leaders tasked the European Commission to come up with plans for the shift "as a matter of urgency" and before the end of the year.

Thomas Wieser, head of the euro working group, said that while Spain's bank bailout would likely begin under current rules, the loans could quickly be moved off Madrid's sovereign books once the new bank supervisor was in place.

In exchange for the concessions, a German-led group of northern creditor countries will gain more control over all of the eurozone banks through the new single supervisor.

In addition to the ability to break the occasionally cosy relationship between national supervisors and their banks, eurozone authorities will now be able to force struggling institutions to recapitalise, something the US was able to do quickly and forcefully in 2008, stopping the Lehman Brothers crisis before it spread any further.

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