

Where are the new private sector central banks?

For the past 8 years banks have had it rough. Partly they had themselves to blame, partly this is the result of lax (or light touch, or 'growth oriented' stimulative) government legislation and action. Anti-banking public opinion and the subsequent more stringent state aid rules and bail in requirements are currently preventing public sector measures that are needed to create short-term financial stability. Now in the news are Monte dei Paschi di Siena and Deutsche Bank, but similar stories have been available in the past across the EU, and at certain times in e.g. the USA and China. For troubled banks there do not appear to be voluntary private sector interventions, and forcefully 'inviting' stronger banks to buy their weaker brethren does not work because either the stronger banks are too strong relative to their supervisor, or too weak to bear the cross alone, or are themselves part of the weaker side of the system. Normally the state balance sheet would now be used to prop up the relevant bits of the financial infrastructure. Examples of such traditional public sector solutions for banks overwhelmed by non performing loans, sovereign/bank cross infection (now more often in the modus that new or old bad fiscal decisions and doubts about sovereign debts are infecting their banks in e.g. the UK, Italy and in Greece) would be e.g. nationalisation or a state aid loan at non-market rates or conditions. Even though such measures are often financially beneficial to the investing state in the long term, the potential for high-risk and especially the sheer amount of money needed for the initial public investment has influenced the introduction of barriers to public sector intervention. More specifically, any use of public funds now needs to be preceded by the bail-in of shareholders, junior bondholders and then senior creditors, such as current account holders above 100.000 euro. Creatively, Italy has introduced its Atlante/Atlas fund as a private sector alternative to state aid, but there are continuing doubts whether the Italian financial sector, based in an over-indebted country, is sturdy enough as a whole for the least weak institutions to help out their weakest colleagues.

Even though at least three of the legs of a banking union (EBA in the whole of the EU, and SRM and SSM in the Eurozone) are now in their operational phase, the responsibility for coming up with the funding for solutions appears to continue to be territorial. The SRM is still building up its funding, and it is no doubt difficult

to determine when it should grasp the reins from the SSM and take control and responsibility for a concrete solution. In the mean time, local funds and savings account holders tend to be the biggest category of bail-inable creditors, once the more sophisticated financial sector investors have decided not to invest in shares or coco's of a troubled bank, or are dumping such shares or bail-inable bonds at the first hint of trouble. In the case of amongst others Italy, this is a political issue as a recent bail-in showed that many of the bail-inable creditors are consumers and small and medium sized enterprises. Agreeing that the Single Resolution Board of the SRM takes charge, means accepting that these voters will suffer. These are the same taxpayers who were supposed to benefit from the fact that 'taxpayer money' should only be in play after bail-in had taken place (but instead suffer most). The least sophisticated players are the most likely investors in the bail-inable unsecured bank bonds that at the moment do not pay a credible risk premium in the central bank stimulated low interest environment. A territorial approach does not work in a rich but stretched country such as Italy, however, nor is the health of Italian banks of interest only to other Italian banks, the health of Deutsche or the smaller community banks only of interest to Germany, or the health of the UK financial system upon Brexit only of interest to other UK banks. The reputation and financial health of all banks in the Eurozone, in the EU, and perhaps even in the world are now soundly linked in our open financial system, with information, distrust and fear propagating quickly on the internet. This should make it in the joint interest of the member states and governments of other financial centres to stand together, but the aforementioned public opinion and a sovereign tradition of not helping each other across borders when there are solvency issues at banking groups of which the top holding is licensed elsewhere, are preventing this.

Nothing is, however, preventing banks and other key bits of the international financial infrastructure such as CCP's to step up themselves. Regardless of whether Atlante/Atlas was voluntary or set up under political pressure, it would appear in the calculated self-interest of such institutions to create - as they did some decades or in some cases such as the UK centuries ago - a new central bank from their midst, to deal with this issue that no bank or member state can deal with unilaterally. Strong appearing financial groups can become weak almost overnight if the banking system is distrusted or an incident in one of their subsidiaries occurs (AIG, Citi, Deutsche, Unicredit, RBS, Fortis are examples that come to mind), so it would be in wise for both currently high ranking and for currently low ranking banks to participate in a new private sector bail-out

structure that would be able, allowed and willing to act. And no doubt such a EU or worldwide private sector bail-out fund could count on a high rating, and a low tax environment, especially if it is set up as a charity instead of as a profit centre (perhaps with any profits allocated to help out bail-in victims, or to sponsor financial education of consumers and small enterprises). Taking action themselves, jointly, in the common interest but by voluntarily putting up their own money would not least also give a valid emotional argument for allowing them to set their own course again, instead of being regulated to the max as is the current regulatory trajectory for the still nominally 'private' sector activity of banking, and thus take control of their own destiny again by also picking up the tab if things go wrong.

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