Sabine Lautenschläger: Interview with Mannheimer Morgen

IKB, a German Mittelstandsbank*, was facing a serious crisis at the end of July ten years ago. Do you remember that?

The problems with subprime securities, i.e. risky home loans packaged together in bonds, started to appear in April 2007 in a US company. We already had an uneasy feeling in the spring, but we didn't think that it would send the banking systems into a tailspin.

Many people thought that it was a one-off event. Did you have a premonition of what September 2008 might bring and of what might follow?

Nobody foresaw the extent of what would happen between summer 2007 and summer 2009, even though in late summer 2007 it was becoming clearer that the turbulence could intensify.

Could such a financial and banking crisis happen again?

I would never say that there could be no recurrence of a financial and banking crisis. 100% protection does not exist. However, supervision is today in a much better position. We can intervene much more decisively and also in a more preventive way. Before 2009 supervisors in Germany could only take action if they could clearly demonstrate that banks were at risk and that damage would soon be inflicted. Supervisors can now demand much higher capital requirements for risks at a much earlier stage. A comprehensive new regulatory framework has greatly strengthened supervision.

So, banks and savings banks are now safer than ten years ago.

All credit institutions have significantly more capital and significantly higher liquidity today. The requirements have been increased, including in respect of a bank's risk management. The management board of a large bank must, for example, include a chief risk officer with wide-ranging powers who has equal status with the other board members.

Banks only need to hold 3% of their balance sheet total as capital. In Germany, measured against the risks on the balance sheets, the figure is now on average around 12%. That seems small when you look at the capital ratios of small and medium-sized enterprises, for instance.

The 3% relates to each and every bank transaction, whether it is risky or not. It is a sort of basic provision. Besides, the quality of capital is very carefully monitored. Is it immediately available to cover risks? Or is there only a commitment that the capital would be available in the event of a crisis? Supervisors closely scrutinise the risks posed by assets, loans and trading activities. The greater the risks of such deals, the more capital the bank must hold. A German government bond, for example, does not represent a risk when calculating the capital ratio, unlike securitised loans. So the average figure of 12% is only indicative.

So you take a close look at banks' books?

Yes. And in the end the capital ratio for one business segment may be much higher than the average. On average three times as much capital has been put aside for the trading activities of banks as in 2008. But we also need to strike the right balance between capital requirements and risk. After all, banks should always be able to issue loans to businesses and consumers and to support the real economy, to assist with mergers and acquisitions, and to organise initial public offerings on the stock market.

Savings banks and credit unions are complaining about the costs of regulation and about supervisors going too far.

Generally speaking, the same risks must be subject to the same rules. Nevertheless, a systemically important bank must today meet considerably more stringent requirements and is monitored much more closely than a savings bank or a credit union. The key point is that a major bank in difficulty is more likely to pose a threat to financial stability than a small bank, and if that is the case, distinctions are called for in some, but not all, rules. And after ten years, we should check whether the new rules are also having the intended effect.

In the United States there are plans to relax the rules for banks.

I don't believe in returning now to deregulation or to purely national rules. That would be a big mistake. We need globally consistent rules for the activities of large banks, of banks which are important for the financial system. The crisis should have taught us that. Banks are not only highly interconnected with each other but also with financial markets, and only global rules can protect us from chain reactions and regulatory arbitrage, i.e. exploiting differences in regulatory standards.

There is now a European resolution authority for ailing banks, but recently it didn't intervene in several credit institutions in Italy. Again, the taxpayer is being asked to cough up. You can't have liked that.

We have taken some enormous steps forward with the European resolution authority and our banking supervision. But we haven't yet reached our goal. For instance, European banking supervision is still lacking some tried and tested tools to be able to act more quickly and effectively. Take the moratorium tool, for example: if a bank gets into trouble, all cash outflows can initially be stopped. That tool exists in Germany but not in Spain.

But banking supervision is in any case in a state of flux because there are constant innovations. Just think of the fintechs.

Yes, there are always new developments in the banking business – but there's no need to react to every innovation with a new tool. After all, you don't buy a new screwdriver every time you buy a new shelf, regardless of whether you bought it from a Swedish furniture store or from an exclusive manufacturer.

Are credit institutions earning enough money? Banks are complaining about low interest rates and the resulting lower interest margin.

The low interest rate environment is certainly a challenge in the long run. But the earnings performance of quite a few banks was already critical when interest rates were high. That’s because, among other things, we have a very large number of banks in Germany, around 1,600. There are, in fact, too many of them. They maintain a large and very costly network of branches. And because competition is fierce, the banks’ margins are low. Loans are cheap, some of them too cheap, and some banking services are being provided free of charge. That eats away at earnings.

So we need more mergers.

Consolidation is necessary. Some banks have already been moving in that direction, such as in the cooperative sector. There are now fewer than 1,000 cooperative banks; 15 years ago there were several hundred more. But banks must continue to squeeze costs and open up new sources of revenue.

So prices are set to rise for customers?

Not all banking services can remain as favourable as they are now. We see aggressive rates in some areas. While the supervisor doesn’t determine prices, generally speaking good services should command fair prices. Such services can’t be free forever.

Do you understand why German savers are complaining about low interest rates?

Yes, I understand why, but every saver is an employee or a business person, and sometimes also a borrower. There are, for instance, many young families who can build their own home because interest rates are very low. An expansionary monetary policy helps in the medium and long term, also because, as a result of growth, jobs are created, which in turn generate income. Only that makes it possible for people to buy property or to save or invest.

You approach monetary policy as a member of the ECB’s Executive Board and Governing Council. When will the ECB start to unwind its monetary policy?

The expansionary monetary policy has both advantages and side effects. As time passes, the positive effects get weaker and the risks increase. So it’s important to prepare for the exit in good time. What’s crucial in that context is a stable trend in the rate of inflation towards our objective of just under 2%. It’s not quite there yet. Still, we need to address the issue: how should the return to normal monetary policy be arranged? What will be the time frame, what will be the tools and what will be the sequence? What steps are to be taken and when should we start to wind down the bond purchases?

That’s likely to be a long process.

That’s why we on the ECB’s Governing Council should now answer the questions I just asked.

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* A Mittelstandsbank serves small and medium-sized enterprises.