STATEMENT

Gerhard Hofmann, Member of the Board of Managing Directors of the National Association of German Cooperative Banks (BVR)

Statement

Press conference on the 2019 consolidated financial statements of the Volksbanken Raiffeisenbanken cooperative financial network

July 15, 2020

National Association
of German Cooperative
Banks • BVR

Melanie Schmergal
Head of the Communications and Public Relations Department / press spokesperson

Cornelia Schulz
Press spokesperson

Steffen Steudel
Press spokesperson

Schellingstrasse 4
10785 Berlin
Germany

Tel: +49 (0)30 2021 1300

presse@bvr.de
www.bvr.de
twitter.com/BVRPresse

Ladies and gentlemen: The Cooperative Financial Network further increased its capital base again in the reporting period. **Equity** rose by a healthy 7.7 percent, or €8.3 billion, to €116 billion. The increase in capital was again mainly due to the retention of profits by the local cooperative banks, which hold around 85 percent of the equity of the Cooperative Financial Network. This also includes newly issued cooperative bank shares to members, which created net capital of €549 million. These consolidated financial statements include accruals for planned dividend payments of €403 million, which are thus not included in the capital. From autumn 2020, the profit for the period and the financial strength of the institutions in the Cooperative Financial Network will allow them to make a distribution to their members from the healthy level of earnings for 2019. We have informed the regulators of our expectation that we will be able to pay the dividend for 2019 from October 2020. As you know, the European Systemic Risk Board (ESRB) has advised regulators that no dividends should be paid out before the end of 2020. We believe the regulators should take a more differentiated approach based on the financial health of each individual bank, rather than effectively prohibiting all banks from paying dividends or buying back their own shares.

The level of capital resources referred to above creates the resilience required to cope with the challenges presented by the consequences of the coronavirus pandemic, which are still hard to predict. The Cooperative Financial Network has doubled its capital since the last financial crisis, while the overall size of the balance sheet has only increased by just over a third. The cooperative banks have thus created the financial conditions needed to cope with the increasing demand for credit from their customers in these uncertain times. Despite the coronavirus pandemic, we still have the financial resources and the will to invest in key projects for the future.

The regulatory Tier 1 capital ratio including the reserves in accordance with section 340f of the German Commercial Code (HGB) fell slightly, by 0.1 percent, over the course of the year to stand at 15.5 percent as at December 31, 2019. This was due in particular to the strong increase in lending (up by 6.2 percent). The leverage ratio, which is the ratio of Tier 1 capital to the total volume of business (again including the reserves in accordance with section 340f HGB), remained unchanged at 7.8 percent and thus continues to be higher than at many other banks. We are viewed positively by the rating agencies and, in contrast with many other banks, our rating has not been downgraded. Both Standard & Poor's and Fitch Ratings continue to give the Cooperative Financial Network an excellent AA- rating.

The economic impact of the coronavirus pandemic will continue to negatively affect the risk position and consequently the capital ratios of the Cooperative Financial Network for the next few years, although we believe that our banks are well placed to withstand this. By the middle of 2020, only a small number of our customers had been identified as posing a higher credit risk. However, we expect a sharp increase in **loss allowances** over the next few years, especially for loans in the service sector and in manufacturing. This increase will also be reflected in the consolidated financial statements through the recognition of loss allowances in accordance with IFRS 9 from 2020, and in subsequent years will probably be at a higher level than over the last ten years.

Ladies and gentlemen, the events of recent months have shown the considerable procyclical effect of bank regulation. The economic downturn is already putting borrowers under considerable strain. Risk-sensitive accounting requirements and regulatory standards result in higher loss allowances or increased capital requirements, which in turn lead to more restrictive lending policies by banks, reinforcing the negative trend. Regulators and the European Commission have addressed this problem with their 'quick fix package' amending the EU banking rules (Capital Requirements Regulation (CRR)) and creating temporary exemptions. However, current events should provide sufficient grounds for a fundamental discussion about the required level of sensitivity for regulations to be adapted in response to sudden and rapid economic downturns. Examples include the definition of loan defaults or payment deferrals, the reporting of losses under IFRS 9 and the recognition of loss allowances for defaulted loans. In times of stable economic growth and low volatility, these rules may well fulfill their purpose. But when there are sudden economic shocks there is too great a risk of bank lending having to be excessively restricted, making the recession deeper and potentially preventing a rebound. For the avoidance of doubt: We are not calling for capital requirements to be lowered. What we want is to avoid unintended procyclical effects of banking regulation on the economy. This would obviate the need for hastily put-together emergency packages which always run the risk of being implemented too late and not being precisely what is needed.

Ladies and gentlemen: With the presidency of the Council of the EU, Germany is shouldering even more European responsibility in these uncertain times. The objective must be to overcome the effects of the coronavirus pandemic in the best way possible while at the same time making the European Union more competitive. However, the German presidency is also seeking to strengthen the **European banking union**. We continue to reject this aim. Our opposition applies in particular to the creation of a **mutualized deposit insurance scheme,** but also to the discussions about integrating small and medium-sized banks into the European resolution mechanism of the Single Resolution Board (SRB). At present, responsibility for the resolution of Less Significant Institutions (LSIs) rests with the national authorities. What is the reason for our skepticism? The risks in some countries that are particularly strongly in favor of mutualized deposit insurance are likely to remain at a heightened level for years to come. Banks in Europe are less profitable and stable than they were before the coronavirus crisis; non-performing loans (NPL) and insolvency risks are increasing. The European Commission recently adjusted its economic forecast downward, predicting a contraction in economic output of more than 10 percent for some EU countries. The resilience of the current stable deposit guarantee schemes must not be weakened by creating risks of economic contagion through European legislation. As in medicine, contagion risks can be minimized by maintaining safe distances. That also applies to any reinsurance system between the deposit protection schemes of the individual member states. This would place a substantial strain on the liquidity of the national deposit guarantee funds and it would be safe to assume that loans granted would not be repaid for a long time – if at all. If EU legislation were to force banks to assume liability for risks over which they have no influence, this would also damage confidence in the stability of the financial system in Germany.

Preconditions such as low NPL rates, harmonization of insolvency law, and risk-appropriate handling of government bonds must be met before the introduction of a European deposit insurance scheme can be seriously considered. These preconditions have, incidentally, also always been demanded by the German government, and it would be irresponsible if it were now to dissociate itself from the conditions it has itself been instrumental in formulating. A banking union must be a stability union from its very inception and must not be a rescue vehicle for already unstable structures. We are opposed to the idea of strengthening the SRB in accordance with the American model by giving it preventive and resolution powers over small and medium-sized banks. Powers which would, moreover, be financed with funds from the deposit guarantee scheme. The recovery and resolution of LSIs is better handled at local level – as at present – and should not be decided centrally in Brussels by the SRB. Our cooperative bank protection system, which has functioned well for 85 years, is proof of this, and many other countries have equally effective systems. In accordance with the principle of subsidiarity, national solutions for the resolution of LSIs must be retained.