

# Thoughts in 2020 on the Commemorative Book “Ten Years of the Vienna Initiative”\*

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*Ten Years of the Vienna Initiative*

*European Investment Bank, Luxembourg, 2019, p. 387.*

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## Introduction

At the Forum of the Vienna Initiative in June 2020, the Chairman of the Supervisory Board of European Central Bank (ECB) highlighted the much stronger position of banks in the Central and Eastern-South-Eastern European countries (CESEE), both in terms of capital and liquidity, relative to the previous global financial crisis. The commemorative book “Ten years of the Vienna Initiative” gives a detailed answer from the authors’ point of view to readers regarding what happened to the banks in the region and how they became resilient between 2009 and 2019.

After the countries in Central and Eastern Europe opened their economy in 1989, they provided a profitable market for West European banking groups. This resulted in the share of the foreign-owned bank became 70 per cent of total banks in 2008. Thanks to cross-border banking, a channel into the region was established to facilitate the flow of capital, the technological development, the stream of know-how, financial literacy as well as market and liquidity risk. Due to the U.S. sub-prime crisis, European banks were affected by the sharp reduction in interbank liquidity in 2007. Every country in the CESEE region was worried about whether multinational banks would keep funding customers in the region through their local subsidiaries.

In 2009, the European Banking Coordination Initiative, a popular name is Vienna Initiative (VI) was launched to help the CESEE countries<sup>1</sup> to preserve liquidity in the banking system and to overcome the effects of the global financial crisis. The VI’s participants are EU-based banking groups with subsidiaries in the region,

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\* The papers in this issue contain the views of the authors which are not necessarily the same as the official views of the Magyar Nemzeti Bank.

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<sup>1</sup> Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Kosovo, Latvia, Lithuania, Montenegro, North Macedonia, Poland, Romania, Serbia, Slovak Republic and Slovenia

international financial institutions (hereunder IFIs), the European Commission (EC), the ECB, as well as the financial authorities of the countries concerned. The VI, operating successfully between 2009 and 2019, was an informal co-ordinational forum, a unique platform that gave a possibility to the participants to meet regularly to exchange views on financial trends in the CESEE region. On the 10th anniversary of VI, its Steering Committee prepared a commemorative book with essays from the key actors. The authors of the book are chief economists, scholars, experts of IFIs, senior managers of national and international authorities and top executives of EU-based banking groups with subsidiaries in the region who worked for participating organizations at that time. The special feature of the book is, that the reader can see the operation of the VI through the eyes of the members.

The book, containing 19 essays, is organized into 5 main parts: Historical perspectives; The effectiveness of the Vienna Initiative during the 2009–2011 crisis; the Vienna Initiative 2.0: Post-Crisis stresses on cross-border banking; The future of cross-border banking; Conclusions on the achievement of the Vienna Initiative. Reading these essays, written in different styles, we can get a picture of the role of the main participants finally. The Annex of the volume contains a summary of the Conference held in Vienna on 27 March 2019.

## **Overview of the Vienna Initiative**

The book starts with a detailed, factual historical overview of the Vienna Initiative, written by Mark Allen (pp. 13–52). The first phase of VI (Vienna Initiative 1.0) focused on financial support, giving a signal to the international financial market and restoring market confidence. The first phase of the VI was very well received by scholars. Pistor, who was cited several times in this volume, highlighted the impressive, immediate results. “Not a single subsidiary of a transnational bank group in the CEE market has collapsed as transnational groups agreed not to withdraw from Central and Eastern Europe in an uncoordinated fashion and some instead recapitalized subsidiaries located in these countries.”<sup>2</sup> De Haas *et al.* (2012)<sup>3</sup> highlighted that VI became a public-private partnership that combined macro-financial support by the IMF and the EU (a ‘bail-out’) with funding by IFIs and a coordinated ‘bail in’ of private lenders. Based on their previous researches De Haas and Tabak summarized some empirical evidence on VI effectiveness in the second part of the volume (pp. 145–159). They answered 3 questions here: whether there were observable differences in the lending behaviour of banks that were part of the VI versus those that were not, keeping all else equal; whether

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<sup>2</sup> Pistor, K. (2012): *Governing Interdependent Financial Systems: Lessons from the Vienna Initiative*. Colombia Law and Economics Working Paper No. 396, 21 March. <http://dx.doi.org/10.2139/ssrn.1792071>, p. 8.

<sup>3</sup> De Haas, R. – Korniyenko, J. – Loukoianova, E. – Pivovarsky, A. (2012): *Foreign Banks and the Vienna Initiative: Turning Sinners into Saints?* IMF Working Paper, WP/12/117, International Monetary Fund. <https://www.imf.org/external/pubs/ft/wp/2012/wp12117.pdf>

for those multinational banks that were part of the VI, their lending differed in countries where they signed commitment letters; whether signing commitment letters led to negative spill-overs to other countries. They found that on average, subsidiaries of VI parent banks were growing faster than the subsidiaries of non-participant banks. Subsidiaries of parent banks that signed commitment letters were significantly more stable sources of credit than subsidiaries of banks that did not sign such letters in the same country. Moreover, they did not find evidence that VI banks withdrew from non-VI countries in order to maintain exposures to countries where they signed commitment letters.

In 2012, due to the euro crisis and the new regulatory requirements, the VI was relaunched as Vienna Initiative 2.0. The second phase of VI focused on avoiding disorderly deleveraging, stimulating credit growth, ensuring a framework to safeguard the financial stability of the region and providing advisory support to develop the financial system. The VI recognized the need to remove obstacles to the extension of bank credit. This led to two lines of activities: tackling non-performing loans (NPL) and the use of guarantee schemes to support SME's access to finance. The VI also offered the participants the possibility of discussing various regulatory issues and setting up several working groups related to the EU's new measures to assist the region. The most important working groups were: The Basel III Implementation in Emerging Market, Non-Performing Loan in CESEE, the European Banking Union and Emerging Europe, SME Guarantee Schemes, Capital Market Union, as well as Financing Innovation and IFI financial products supporting investments in CESEE. The VI issued some publications semi-annually to monitor the lending activities of the banking sector in the region, such as NPL Monitor for the CESEE region produced by the European Bank for Reconstruction and Development (EBRD), CESEE Bank Lending Survey taken by European Investment Bank (EIB) as well as Deleveraging and Credit Monitor. In 2012, the VI structure became more formal. Now, the main informal decision-making body is the Full Forum; however, between the meetings of the Full Forum, a Steering Committee conducts the work of the Initiative and the Chairman of the Steering Committee coordinates all public statements. Operational support for the VI's work is provided principally by the EBRD.

“The overall risk level in the part of the European financial system addressed by the VI has undoubtedly decreased... More local savings have been mobilized and cross-border flows have been cut back to safer levels, but the net effect is most likely that financial access and opportunities for risk diversification have both become more limited in most countries in Central and Eastern Europe.” (p. 65)

## **The role of the “honest brokers”**

The main part of the volume reflects the opinion of the IFIs. The representatives of IFIs emphasized that their role was very important in the Vienna Initiative because they were seen as “honest brokers”, able to use their reputation, convening power and to bring all relevant parties around the table. Being “non-interested parties” they were able to play a neutral and constructive role as well as collectively provide sizeable countercyclical funding. “It was the technical convening power of the IFIs that gave impetus to the process. This was the first time the IFIs worked together as a system, as indeed they should.” (p. 371).

The volume did not highlight that VI was a good possibility for IFIs to come back to the Central-Eastern Europe region. They were planning to leave the region before the crisis, since these countries reached the “category of the advanced country” from their point of view and banks in the region were able to get funds at favorable market prices. They launched two Joint IFI Action Plans (JIFIAPs) in 2009 and in 2013 respectively. They invested EUR 75.7 billion in the region. JIFIAPs was beneficial for both parties as IFIs had the chance to invest into this region with relatively small risk and they also were able to sell their advisory services.

The EIB invested EUR 43.8 billion into the region. Their lending fulfilled the dual function of supporting both final beneficiaries – small to medium-sized enterprises (SMEs) or small infrastructure projects – and the region’s banks. The World Bank Group (WBG) invested EUR 17 billion, the representatives of the World Bank emphasized that the unique way of cooperation within the WBG in the framework of the VI has been beneficial. Joint activities conducted by International Finance Cooperation and Multilateral Investment Guarantee Agency (MIGA) led to some jointly developed new products, including MIGA’s bestselling “Capital Optimization Product”, which creates synthetic capital for international banks having subsidiaries in sub-investment-grade emerging markets. The EBRD role in the VI is dominant; it manages the “co-ordinational organization”, it also invested EUR 15.1 billion. IMF participated in macro-financial support, it invested EUR 31.2 billion in five countries.

One of the main obstacles to the extension of bank credit is the high level of NPL; for example, in the case of Albania it exceeded 20 per cent in 2014. The representatives of EBRD highlighted that there is a robust relation between high NPLs, weaker credit and GDP growth, with two-way causality. High NPLs can depress credit growth and ultimately job creation, which has a strong negative influence on the private sector. This causes a further increase in NPLs, potentially leading to a downward spiral. IFIs made a lot of effort to assist the region in NPL management. In line with the objectives of enhancing the transparency of restructuring frameworks and

disseminating knowledge, the website<sup>4</sup> of VI has become an industry reference. They also provided capacity buildings, technical assistance in the region. They also offered policy recommendations across three areas: enhancing prudential oversight, reforming debt enforcement regimes and insolvency frameworks and developing distressed debt markets. The published monitoring reports helped credibly inform markets at critical times. The website of the VI managed by EBRD contains the most important information now, more detailed information can be found on the website of EBRD and EIB.

The representatives of EIB emphasized that in this environment, the role of the VI is no longer crisis management; rather, establishing the link between the financial sector and the areas that are crucial for the region's economic development, such as financing innovation, the transition towards a green economy, digitalization, etc., are of the essence (p. 97).

### **The Vienna Initiative from the Authorities' Point of View**

The representatives of the EC highlighted the challenges of the supervisory and regulatory changes since the crisis. The VI became a platform for formulating and sharing with key EU decision-makers the observations on supervision and resolution from the perspective of host countries while taking account of the specific situation of the banks operating in the region. These discussions led to the signature of a Memorandum of Understanding between the European Banking Authority and the Southeastern European countries. It was also a question, how banks in the region could fulfill their minimum requirement of own funds and eligible liabilities targets, given the small size of their capital markets.

As economies develop, the services provided by financial markets become comparatively more important than those provided by banks<sup>5</sup>. Consequently, the VI focused on supporting the development of the capital market in the CESEE region because they have a high catch-up potential given, especially after the Capital Market Union (CMU) Action Plan, adopted by the EC in 2015. CMU aims to mobilize capital in Europe and channel it to companies, including small and medium enterprises and infrastructure projects. The VI set up the Working Group on Capital Market Union, chaired by the EC, which reported that the Capital Markets in CESEE lag behind their EU peers in terms of liquidity and depth, as well as listed

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<sup>4</sup> <http://npl.vienna-initiative.com>

<sup>5</sup> Demirgüç-Kunt, A. – Feyen, E. – Levine, R. (2012): *The Evolving Importance of Banks and Securities Markets*. NBER Working Paper No. 18004. <http://doi.org/10.3386/w18004>

policy actions on national, regional and EU level that should be taken to support the development of CESEE markets<sup>6</sup>.

The Chairman of the VI is the Governor of the Croatian National Bank, who emphasized the important historical role of the VI and its current and future relevance. The representatives of Hungarian, Macedonian and Albanian National Authorities gave a detailed explanation of the situation of their financial system at that time and of the impact of the VI on the banking sector in their countries. It was highlighted that the liquidity crisis hit Hungary, Romania, Serbia, Ukraine and Latvia hard, so they turned to the IMF and the EU for standby credit in 2008.

The subsidiaries of banking groups constituted a large share of the Albanian banking sector, however, at the consolidated level, these subsidiaries had very small shares on the balance sheets of the banking groups. The Governor of the Bank of Albania highlighted that the gradual deleveraging, and the ongoing process of EU banks selling, merging and acquiring, had resulted in a continuous shrinking of their market share against other foreign-owned banks and domestic banks. The authors from the Narodowy Bank Polski analyzed the structure of the financial sector. They argued that the small financial system does not foster economic growth because it does not provide sufficient resources for the economy. On the other hand, if financial development is too large, the positive effects on economic growth decline, while economic and financial volatility rises. It leads to a decrease in efficiency of investment, as it does not allocate financial resources to the most productive activities.

### **The Vienna Initiative from the point of view of EU-based banking groups**

There were three EU-based banking groups with several subsidiaries in the region (Raiffeisen International, Société Générale and the UniCredit) that shared their experience on the VI in this volume. The representatives of these banking groups highlighted that the money market started to dry up in 2009. They realized that no official platform existed where regulators of Western and Eastern European countries could informally exchange their views, let alone talk about coordinating or jointly designing important measures. The representative of Société Générale analyzed the role of the FX denominated loans in CESEE. Swiss franc loans were very risky, as was illustrated in 2015 when the Swiss unpegged the franc from the euro. The representatives of Raiffeisen International summarized the doubts of some observers related to the success of the VI. The VI was “international institutional pressure on private sector banks that helped resolve the apparent collective action

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<sup>6</sup> EBCI WG (2018): *Report by the Working Group on Capital Markets Union*. <http://vienna-initiative.com/resources/themes/vienna/wp-content/uploads/2018/03/VI-CMU-Working-Group-Final-Report-March-2018.pdf>. Downloaded: 15 December 2020.

problem by compelling the largest banks to stay – with commitment letters by banks, IMF stabilization and open communication among stakeholders.” (p. 349)

Maintaining exposure in the CESEE market was a good decision of the banking group, because the net interest margin is still higher in these countries. In the case of the Erste Group, 70 per cent<sup>7</sup> of the net interest income of the Group was from this region in 2018. There is a continuous shrinking of EU based banking group’s market share against other foreign-owned banks and domestic banks, because the banking groups with a small market share were not economies of scale. The Volksbank sold their subsidiaries to the Russian Sberbank in 2012, and the Société Générale Group sold their subsidiaries to the Hungarian OTP group in 2019.

### **The Success of the Vienna Initiative Mechanism**

The representatives of the EC outlined the success of the VI mechanism, which was based on the mixture of the cooperative approach, bilateral and general commitment letters by EU parent banks, involvement of European institutions and the institutional/governance setting of a banking group creating a strong link between parent banks and their subsidiaries. They compared VI and Nordic Baltic cooperation, on which the Vienna Initiative was modeled. They highlighted that the financial integration in the Nordic-Baltic region had been more advanced. Six financial groups dominated the markets of Denmark, Sweden, Norway, Finland, Estonia, Latvia and Lithuania. These banking groups’ foreign exposure to the countries in the region played a major role in their balance sheets, but the EU based banking group’s market share was not relevant in the CESEE countries. The legal status of the Nordic-Baltic is semi-formal and the VI is informal. In the case of VI, the informal organisation is open, and everybody can be invited<sup>8</sup>.

This unique cooperative approach is one reason that the VI mechanism could not work properly in other circumstances. Nagy-Mohácsi emphasized at the anniversary conference that in the case of Ukraine, an attempt to use VI mechanisms foundered because, in the absence of a strong host country adjustment program, it was impossible to get bank commitment. In the case of Greece, the approach was not that of the VI – there was no collective treatment of the banks, nor was peer pressure applied<sup>9</sup>.

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<sup>7</sup> Erste Group Annual Report 2018

<sup>8</sup> pp. 313–328.

<sup>9</sup> p. 372.

## **Conclusion**

The commemorative volume brings together experiences from the key actors and institutions involved. The strength of this volume is giving an overview of VI’s activity, history and its impact on the economy of the countries in the region from expert’s point of view. At the same time, this is also one of the weakest points of it, because it contains a lot of redundancy. The essays were written by different authors without knowing each other’s work, so some events, e.g. the starting points in 2008, were described several times. This volume did not present the dissenting, opposite opinions on the VI. Some other researches, academic papers related to the development of the financial sector in the region could have completed the book.

The book is recommended to experts, scholars and students who are interested in the challenges, solutions and open questions in the financial sector of the CESEE region from 2009 to 2019 and would like to get first-hand information on the subject. This book is also useful for students who would like to know more about the activities of International Financial Institutions in the CESEE region as well as the operation of an informal cooperation directed by the IFIs.