EUROPEAN CENTRAL BANK

OPINION OF THE EUROPEAN CENTRAL BANK

of 1 December 2005

at the request of Národná banka Slovenska

on a draft law amending the Act No 118/1996 Coll. on the protection of bank deposits and on amendments to certain laws, as last amended

(CON/2005/50)

1. On 19 September 2005 the European Central Bank (ECB) received a request from Národná banka Slovenska (NBS) for an opinion on a draft law (hereinafter the 'draft law') amending the Act No 118/1996 Coll. on the protection of bank deposits and on amendments to certain laws, as last amended (hereinafter the 'Act' or the 'Deposit Protection Act').

2. The ECB's competence to deliver an opinion is based on the second indent of Article 105(4) of the Treaty establishing the European Community, and in particular on the third and sixth indents of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions[1], as the draft law contains provisions concerning a national central bank (NCB) and rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets. In addition, the ECB notes that its role under Article 237(d) of the Treaty of ensuring that NCBs fulfil their obligations thereunder[2], which includes ensuring that they comply with the prohibition on monetary financing laid down in Article 101 of the Treaty, makes it necessary to ascertain whether the draft law and operations conducted by NBS thereunder are compatible with this prohibition. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

<u>The draft law</u>

3. According to the explanatory memorandum to the draft law, the draft law establishes a framework for a potential decrease in the level of commercial banks' annual contributions to the Slovak Deposit Protection Fund (hereinafter the 'Fund'). Under the current Slovak deposit-guarantee

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1 OJ L 189, 3.7.1998, p. 42.

2 See also Recital 9 to Council Regulation (EC) 3603/93 of 13 December 1993 specifying definitions for the application of the prohibitions referred to in Articles 104 and 104b(1) of the Treaty (OJ L 332, 31.12.1993, p. 1), which provides that notwithstanding the role assigned to the Commission pursuant to Article 169 (now Article 226) of the Treaty, it is for the ECB, pursuant to Articles 109f(9) (now Article 117(9)) and 180 (now Article 237) of the Treaty, to ensure that NCBs honour the obligations laid down by the Treaty.

scheme, the amount of the annual contribution, which is the same for all banks, is determined by the Fund specifying a level between 0.1% and 0.75% of the amount of protected deposits. The annual contribution during a period when the Fund is repaying a loan made to finance compensation payments for unavailable deposits under the scheme is set at the upper limit of the annual contribution range, i.e., at 0.75%. In addition, currently the Fund must fix the amount of the annual contribution in the upper half of the contribution range, i.e., between 0.425% and 0.75%, during a period when it does not have sufficient funds to meet compensation payments at the minimum level of 1.5% of the total value of protected deposits.

4. By contrast, under the draft law the Fund would henceforth have to determine the amount of the annual contribution during a period when it is repaying a loan made to finance compensation for unavailable deposits within a potentially lower range of between 0.35% and 0.75% or, with the prior written consent of NBS, within a range of between 0.2% and 0.75% of the amount of protected deposits. Further, during a period when it is not repaying such a loan and does not possess sufficient funds to make compensation payments at the minimum rate of 1.5% of the total value of protected deposits, the Fund would henceforth have to determine the amount of the annual contribution at a lower minimum rate of 0.2% of the amount of protected deposits. In this second case, the draft law would allow the lower minimum rate to be set without the prior written consent of NBS.

5. Regarding the draft law's reference to loans made to the Fund to finance compensation for unavailable deposits, the ECB takes note that pursuant to Article 24(3) of the Act No 566/1992 Coll. on Národná banka Slovenska, as last amended (hereinafter the 'NBS Act'), NBS itself may provide a loan to the Fund. The Fund may request such a loan from NBS pursuant to the Deposit Protection Act[3]. Furthermore, under the Deposit Protection Act the Fund may apply to other banks for such a loan, and a State guarantee may be granted for loans extended to the Fund[4]. In addition to any such loan from NBS or other banks, the ECB notes that the Fund's resources under the Deposit Protection Act potentially include, *inter alia*, repayable assistance funds and government subsidies to support the fulfilment of the Fund's tasks and the deposit-guarantee scheme, within the scope and under conditions set by the State budget for the relevant year[5].

Recent developments in relation to the Fund

6. The explanatory memorandum to the draft law states that the draft law is based on an initiative of the Slovak Banking Association to prepare the legal framework for a potential decrease in the level of banks' contributions to the Fund. According to the explanatory memorandum, the Banking

3 Article 13(2) of the Deposit Protection Act.

4 The Fund may approach a bank of foreign origin for a loan only with the prior approval of NBS (see Article 13(2) of the Act). State guarantees on loans made by NBS or other banks are granted pursuant to Articles 8 to 13 of the Act No 386/2002 Coll., on State debt and State guarantees and amending the Act No 291/2002 Coll. on the State Treasury and amending certain laws, as last amended.

5 See Article 13(1) of the Act.

Association argues that a decrease in annual contributions (which the explanatory memorandum states are some of the highest in the EU) would mean that the banks in Slovakia would not be forced to look for ways to avoid paying contributions to the Fund. The explanatory memorandum also states that a decrease in annual contributions may lead to an increase in interest rates payable on bank deposits.

7. The ECB understands that, in recent years, the Fund has had a negative share capital as a result of past problems in the Slovak banking sector. The ECB understands that the Fund is currently also indebted to NBS as a result of a loan that NBS provided to the Fund on 29 October 2001 to overcome problems in the Slovak banking system. The ECB understands that this loan was originally due to be repaid on 30 December 2005. However, the ECB understands that on 15 February 2005 it was agreed by way of an addendum to the loan agreement of 29 October 2001 that the original deadline for repayment would be extended to 31 January 2007. The ECB understands that the loan has declined from an original principal amount of SKK 15 653 641 000 (EUR 358 231 480) to SKK 7 358 390 000 (EUR 189 668 780) at year-end 2004[6].

<u>Funding of the deposit-guarantee scheme</u>

8. Deposit protection is an important element of the financial safety net and therefore contributes to safeguarding financial stability. The Financial Stability Forum (FSF) has noted that sound funding arrangements are critical to the effectiveness of a deposit-guarantee system and the maintenance of public confidence[7]. Funding can be assured in various ways, and in its recently published consultation paper on the review of Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes[8] (hereinafter, the 'Deposit-Guarantee Schemes Directive' or the 'Directive'), the European Commission noted that there exists a wide diversity of funding mechanisms between the different national deposit-guarantee schemes within the EU[9]. This diversity is a consequence of the fact that the Directive recognises that it is not indispensable to harmonise the methods of financing schemes guaranteeing deposits, given, on the one hand, that the cost of financing such schemes must be borne, in principle, by credit institutions themselves and, on the other hand, that the financing capacity of such schemes must be in proporition to their liabilities. The Directive emphasises that this must not, however, jeopardise the stability of the banking system of the Member State concerned[10].

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6 This information is based on the Fund's Annual Report 2004.

7 Financial Stability Forum, Guidance for Developing Effective Deposit Insurance Systems (Sept. 2001), p. 26.

8 Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes (OJ L 135, 31.5.1994, p. 5).

9 European Commission DG Internal Market and Services, Consultation paper entitled 'Review of the Deposit Guarantee Schemes Directive (94/19/EC)', 14 July 2005, published on the Commission's website at www.europa.eu.int/comm/internal_market/bank/docs/guarantee/consultationpaper_en.pdf.

10 See Recital 23 to the Deposit-Guarantee Schemes Directive.

9. In this context, the prudence of enabling a decrease in annual contributions (within a range of between 0.35% and 0.75%, or between 0.2% and 0.75%) during a period when the Fund is still repaying loans[11] taken out to finance compensation payments under the scheme, or where the Fund does not possess sufficient funds to make compensation payments itself, might be questioned. The current level of contributions is understandable in the light of recent developments in the Slovak banking sector. Indeed, some Member States which have not experienced problems of the kind experienced in Slovakia maintain a much higher level of funds in the scheme in relation to the total deposits protected by the scheme than that currently maintained under the Slovak deposit-guarantee scheme. There might therefore be a risk that the changes proposed under the draft law could delay the establishment of a financial buffer within the Slovak deposit-guarantee scheme at a time when its financial position may still be vulnerable.

10. Notwithstanding these remarks, the ECB acknowledges that it is difficult to evaluate fully the impact of the proposed changes under the draft law without undertaking a detailed and more comprehensive study of all relevant elements affecting the Slovak banking system. As noted in paragraph 8, the Deposit-Guarantee Schemes Directive has not harmonised the methods of financing deposit-guarantee schemes within the EU, which are left at the discretion of Member States to determine. In these circumstances the ECB would only emphasise the general framework provided by Community law in accordance with which the financing capacity of such schemes must not be allowed to jeopardise the stability of the banking system of the Member State concerned.

Prohibition on monetary financing

11. Under Article 237(d) of the Treaty the ECB is entrusted with the task of ensuring compliance by the NCBs with the prohibition on monetary financing laid down in Article 101 of the Treaty. Article 101(1) of the Treaty provides that '[o]verdraft facilities or any other type of credit facility with the ECB or with the central banks of the Member States … in favour of Community institutions or bodies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States, shall be prohibited'. As previously noted by the ECB, '[a]lready in 1993 the Committee of Governors of the central banks of the Member States of the European Economic Community noted that this prohibition is of 'essential importance' to ensure that 'monetary policy [is not] hindered in the pursuit of its primary objective of price stability. Furthermore, central bank financing of the public sector lessens the pressure for fiscal discipline'[12]. Therefore, this prohibition must be interpreted in a strict manner'[13].

11 Currently, the only loan that the Fund is repaying is to NBS.

12 Letter to Commission President Delors of 20 April 1993.

13 Paragraph 6 of ECB Opinion CON/2005/1 of 3 February 2005 at the request of the Italian Ministry of Economic Affairs and Finance on a draft law amending Law Decree No 7 of 25 January 1999, as converted by Law No 74 of 25 March 1999, concerning urgent provisions on Italian participation in the International Monetary Fund's interventions to confront severe financial crises of its member countries.

The Fund is established under the Deposit Protection Act as a legal entity registered in the Slovak Companies Registry, and qualifies as a 'body governed by public law' within the meaning of Article 101(1) of the Treaty. The provision of loans by NBS to the Fund as permitted under Article 24(3) of the NBS Act constitutes a credit facility within the meaning of Article 101(1) of the Treaty. Therefore, the ECB considers the provision of loans in the present case to be incompatible with Article 101(1) of the Treaty.

12. Regarding the outstanding loan made by NBS to the Fund in October 2001, the ECB notes that this loan was made prior to the Slovak Republic's accession to the EU, and that in strict legal terms the loan was not subject to the prohibition on monetary financing under Article 101 of the Treaty at the time it was granted. However, the ECB notes that any extension of the loan following the Slovak Republic's accession to the EU on 1 May 2004 would need to be assessed taking into account the monetary financing prohibition. The loan was originally scheduled to be repaid on 30 December 2005. The ECB considers that extending the loan's maturity would constitute a breach of the monetary financing prohibition under the Treaty. The necessary arrangements should therefore be made for the Fund to repay the loan to NBS on 30 December 2005, as originally agreed.

13. Finally, the ECB would like to emphasise that in its next Convergence Report in 2006 it will address the compliance of national legislation with the prohibition on monetary financing under Article 101 of the Treaty.

14. This opinion will be published on the ECB's website six months after its adoption.

Done at Frankfurt am Main, 1 December 2005.

[signed]

The President of the ECB

Jean-Claude TRICHET