



## OPINION OF THE EUROPEAN CENTRAL BANK

of 7 January 2009

at the request of the Latvian Ministry of Finance

on a draft regulation establishing procedures for issue and supervision of bank loan guarantees

(CON/2009/2)

### Introduction and legal basis

On 29 December 2008 the European Central Bank (ECB) received a request from the Latvian Ministry of Finance for an opinion on a draft regulation establishing procedures for issue and supervision of bank loan guarantees (hereinafter the 'draft regulation').

The ECB's competence to deliver an opinion is based on Article 105(4) of the Treaty establishing the European Community and the sixth indent 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<sup>1</sup>, as the draft regulation relates to rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets. 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.

### **1. Purpose of the draft regulation**

The main objective of the draft regulation is to establish a procedure whereby the Latvian Minister for Finance may issue guarantees in the name of the State for loans of banks registered in Latvia in order to reduce general economic risks, avoid social and economic crisis, or minimise the impact thereof, and to ensure availability of financing in the event of extraordinary situations. The draft regulation also establishes a procedure for the servicing and supervision of the guarantees.

### **2. General observations**

2.1 The legal basis for the adoption of the draft regulation is Article 37(6) of the Law on budget and financial management. Article 37(6) was added to the Law on budget and financial management on 14 November 2008<sup>2</sup> as part of Latvian measures to stabilise the financial markets. Another part of

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<sup>1</sup> OJ L 189, 3.7.1998, p. 42.

<sup>2</sup> Published in *Latvijas Vēstnesis*, 183 (3967) on 25 November 2008.

the stabilisation measures was a Law on bank takeovers<sup>3</sup> which was adopted on 18 December 2008. It should be noted that the ECB was not consulted on the amendments to the Law on budget and financial management and that the ECB received the consultation request regarding the draft law on bank takeovers on 29 December 2008, after that law was adopted. Regarding these two stabilisation measures, therefore, the ECB reiterates its previous position<sup>4</sup> that even cases of particular urgency do not release national authorities from their duty under Article 105(4) of the Treaty to consult the ECB on draft legislative provisions falling within its fields of competence. The ECB has been flexible and has responded within short time limits to consultation requests received during the financial turmoil and reminds the Latvian authorities of the need to consult it on draft legislation at a stage in the legislative process that allows sufficient time to take into account its views. It follows from Article 3(4) of Decision 98/415/EC that once a consultation request has been submitted to the ECB, Member States are obliged to suspend the process of adoption of draft legislative provisions, pending receipt of the ECB's opinion or the expiry of a time limit set for the submission of the ECB's opinion, in accordance with Decision 98/415/EC<sup>5</sup>.

2.2 The ECB has issued a number of opinions on State measures taken by Member States to address the global financial crisis, which all emphasise the importance of a common approach aimed at restoring confidence in financial markets. Similarly, the ECB notes that the conclusions adopted at the Ecofin meeting on 7 October 2008 highlighted common principles to guide Member States' actions<sup>6</sup>. Moreover, the ECB notes that on 12 October 2008 the Heads of State of the euro area issued a 'Declaration on a concerted European action plan of the euro area countries'<sup>7</sup> (hereinafter the 'Declaration'), in which they confirmed their commitment to act together in a decisive and comprehensive way in order to restore confidence and the proper functioning of the financial system and to restore appropriate and efficient financing conditions for the economy. They agreed on common principles to be followed by the EU and euro area governments, central banks and supervisors, to avoid national measures adversely affecting the functioning of the single market and the other Member States. This coordinated approach includes initiatives aimed at ensuring appropriate liquidity, facilitating the funding of banks by various means, providing additional capital resources to financial institutions and recapitalising distressed banks. These principles were also endorsed for all Member States by the European Council on 16 October 2008. As pointed out

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<sup>3</sup> Published in *Latvijas Vēstnesis*, 202 (3986) on 30 December 2008.

<sup>4</sup> See paragraph 2.4 of ECB Opinion CON/2008/76 of 25 November at the request of the Slovenian Ministry of Finance on a draft law amending the Law on public finance.

<sup>5</sup> See Title IV, Section 1 of the Guide to consultation of the European Central Bank by national authorities regarding draft legislative provisions, available on the ECB's website at [www.ecb.europa.eu](http://www.ecb.europa.eu).

<sup>6</sup> According to these principles: (i) interventions should be timely and the support should in principle be temporary; (ii) the interests of taxpayers should be protected; (iii) existing shareholders should bear the due consequences of the intervention; (iv) the Government should be in a position to bring about a change of management; (v) management should not retain undue benefits; (vi) governments may have, *inter alia*, the power to intervene in remuneration; (vii) legitimate interest of competitors must be protected, in particular through the State aid rules; and (viii) negative spill-over effects should be avoided.

<sup>7</sup> Available on the website of the French Presidency at [www.ue2008.fr](http://www.ue2008.fr).

in relevant ECB opinions<sup>8</sup>, it is of utmost importance that the operations conducted by national authorities do not interfere by any means with euro area monetary policy and/or with the Eurosystem's refinancing operations. In this context, as regards the Latvian support measures proposed under the draft regulation, the ECB considers that they should aim at: (a) addressing the funding problems of liquidity-constrained solvent banks by improving the functioning of the market for bank debt of longer term maturity; (b) preserving the level playing field among financial institutions and avoiding market distortions; and (c) ensuring consistency with the management of liquidity by Latvijas Banka<sup>9</sup>.

### **3. Specific observations**

#### *3.1 Implementation of the support measures*

As stated in its Article 17, the draft regulation is a temporary measure and will only apply until 31 December 2009. The ECB notes that this provision is in line with the principles stated in the Declaration which point to the temporary features of such support schemes.

#### *3.2 Selection of beneficiary credit institutions*

Pursuant to Article 3 of the draft regulation, only branches of banks registered outside Latvia are ineligible to benefit from the State guarantee arrangements. The ECB therefore understands that the draft regulation applies to all solvent Latvian banks, including Latvian subsidiaries of foreign banks. The ECB welcomes the non-discriminatory application of the above provisions, as it avoids distortion of the level playing field as regards the treatment of domestic financial institutions and subsidiaries of foreign institutions<sup>10</sup>. This also appears to be in line with the Commission's guidance on the eligibility criteria for beneficiary institutions<sup>11</sup>.

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<sup>8</sup> See, in particular, ECB Opinion CON/2008/52 of 17 October 2008 at the request of the Spanish State Secretary for Economic Affairs on a Royal Decree-Law creating a Fund for the acquisition of financial assets and on a Royal Decree-Law adopting urgent financial and economic measures in relation to the concerted European action plan of the euro area countries and ECB Opinion CON/2008/79 of 27 November 2008 at the request of the Greek Ministry of Economy and Finance on a draft law on enhancing liquidity of the economy to address the impact of the international financial crisis and on a draft decision on its implementation.

<sup>9</sup> See, e.g. paragraph 2.1.2 of ECB Opinion CON/2008/62 of 29 October 2008 at the request of the Swedish Ministry of Finance on a draft ordinance on State guarantees for banks etc.

<sup>10</sup> On this aspect see, in particular, ECB Opinion CON/2008/44 of 3 October 2008 at the request of the Irish Minister for Finance on a draft Credit Institutions (Financial Support) Bill 2008. See also ECB Opinion CON/2008/48 of 15 October 2008 at the request of the Irish Minister for Finance on a draft Credit Institutions (Financial Support) Scheme 2008. See also ECB Opinion CON/2008/52 and ECB Opinion CON/2008/55 of 20 October 2008 at the request of the Austrian Ministry of Finance on draft legal measures to ensure the stability of the Austrian financial market, as well as ECB Opinion CON/2008/67 of 13 November 2008 at the request of the Spanish Ministry for Economic Affairs and Finance on a draft order implementing Royal Decree-Law 7/2008 authorising State guarantees.

<sup>11</sup> See paragraph 18 of the Commission's guidance, specifying that 'The eligibility criteria of financial institutions ... must be objective, taking due account of their role in the relevant banking system and the overall economy, and non-discriminatory so as to avoid undue distortive effects on neighbouring markets and the internal market as a whole. In application of the principle of non discrimination on the grounds of nationality, all institutions incorporated in the Member State concerned, including subsidiaries, and with significant activities in that Member State should be covered by the scheme.'

### 3.3 *Scope of the obligations covered by State guarantees*

Pursuant to Article 2 of the draft regulation, a guarantee may be issued in respect of existing loans with a maturity of no more than three years, and in respect of loans taken out to refinance such loans with a maturity of no less than six months and no more than three years. The ECB understands that the draft regulation could not be intended to apply to interbank deposits, subordinated liabilities and collateralised liabilities such as covered bonds<sup>12</sup>. The ECB notes however that this intention is not made expressly clear in the text of the draft regulation and that it is unclear in particular whether the guarantees provided by the Latvian State cover interbank deposits. The ECB therefore recommends that the draft regulation further clarifies the coverage of State guarantees. In this respect, the ECB reiterates that State guarantees to cover interbank deposits should be avoided as they have the potential to interfere with the conduct of a central bank's liquidity-providing operations, and thus with the transmission of monetary policy decisions<sup>13</sup>.

### 3.4 *Charges imposed on receiving credit institutions*

Pursuant to Articles 11 and 12 of the draft regulation, remuneration for the provision of guarantees will consist of a credit risk margin based on five-year credit default swap spreads of 40 large euro area banks. In addition the Ministry of Finance will charge 50 basis points for processing the fee and a 10 basis points annual servicing fee. In its previous opinions<sup>14</sup>, the ECB has emphasised that it is crucial to ensure the coordination of the pricing of State guarantees within the euro area and the EU, given that a level playing field is of the essence. The price of a State guarantee should be risk-based and market-oriented, and determined on the basis of the costs of a corresponding guarantee in the market. In this respect, the ECB appreciates the additional information provided. It is important that the pricing of the State guarantee should link the level of charges to be paid by the receiving credit institutions with the residual maturity of the guaranteed obligations and with maturities exceeding one year. The ECB also stresses the need for further harmonisation within the euro area to ensure that government support measures do not have a negative impact on the single monetary policy of the euro area<sup>15</sup>.

### 3.5 *Central bank involvement in the support measures*

The ECB understands that the Ministry of Finance will consult Latvijas Banka in order to prepare a draft decision to issue a guarantee or refusal to issue a guarantee. The ECB appreciates that the draft regulation recognises Latvijas Banka's expertise in this way and that it is expected that

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<sup>12</sup> See the Commission's Press release of 23 December 2008, IP/08/2054.

<sup>13</sup> See paragraph 3.2 of ECB Opinion CON/2008/80 of 28 November 2008 at the request of the Polish Minister for Finance on a draft law on the provision of State Treasury support to financial institutions.

<sup>14</sup> See paragraph 3.4 of ECB Opinion CON/2008/76.

<sup>15</sup> See e.g. paragraph 3.2 of ECB Opinion CON/2008/52 and paragraph 3.7 of ECB Opinion CON/2008/81 of 1 December 2008 at the request of the Hungarian Ministry of Finance on a draft law on strengthening the financial intermediary system, as well as paragraph 3.2 of ECB Opinion CON/2008/88 of 19 December 2008 at the request of the Slovenian Ministry of Finance on a draft decree laying down criteria and conditions for granting guarantees under Article 86.a of the Law on public finance.

Latvijas Banka's involvement will not go beyond an advisory and procedural role. The ECB also expects that Latvijas Banka will fully comply with the prohibition on monetary financing laid down in Article 101(1) of the Treaty<sup>16</sup>, interpreted in line with Council Regulation (EC) No 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<sup>17</sup> and that Latvijas Banka will conduct such function in a manner fully compatible with its institutional and financial independence thereby safeguarding the proper performance of its tasks under the Treaty and the Statute of the European System of Central Banks and of the European Central Bank.

This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 7 January 2009.

[signed]

*The President of the ECB*

Jean-Claude TRICHET

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<sup>16</sup> See paragraph 3.2 of ECB Opinion CON/2008/52.

<sup>17</sup> OJ L 332, 31.12.1993, p. 1.