EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 27 May 2009

on measures to mitigate financial turmoil

(CON/2009/49)

Introduction and legal basis

On 12 May 2009 the European Central Bank (ECB) received a request from the Slovak Ministry of Finance for an opinion on a draft law on measures to mitigate the effects of the global financial crisis on the banking sector and on amendments to certain laws (hereinafter the 'draft law').

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[1], as the draft law 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 law

1.1 The main purpose of the draft law is to establish a legal framework laying down the conditions under which aid may be granted to banks to remedy serious shortcomings in the functioning of the economy by mitigating the impact of the global financial crisis on the banking sector and strengthening the conditions for maintaining the stability of the whole financial system. The draft law also provides for the procedure to be followed by national authorities, in particular by the Slovak Ministry of Finance and Národná banka Slovenska (NBS), when granting such stabilisation aid and for checking compliance with the conditions under which it is granted.

1.2 Article 5(5) of the draft law lays down an enabling provision pursuant to which the details of prices and other conditions for State support (e.g. a fee amount or methods for returning the stabilisation aid) will be provided for in the form of an implementing measure to be adopted by the Slovak Ministry of Finance in agreement with NBS.

1 OJ L 189, 3.7.1998, p. 42.

1.3 Stabilisation aid may be granted to banks with their registered office in Slovakia that perform their activities on the basis of a banking licence, including subsidiaries of foreign banks, by virtue of the draft law and the Law on banks[2]. It may take the form of a capital contribution from the State's financial assets managed by the Slovak Ministry of Finance to the bank's registered capital but must not exceed 50% of the bank's own funds requirements. Alternatively it may take the form of a special guarantee: (a) for bonds issued by the bank, where the maturity period of the nominal value is not less than three months and not more than three years; and/or (b) for a loan with a maturity of up to one year provided to the bank by another bank, NBS or another entity.

1.4 While the final approval of stabilisation aid falls within the competence of the Slovak Government, the Slovak Ministry of Finance is responsible for its implementation. Given NBS's importance and its role as the single supervisory authority, implementation of stabilisation aid is subject to NBS's prior consent by means of delivery of its opinion to the Slovak Ministry of Finance. Stabilisation aid may be granted on more than one occasion and concurrently. Before stabilisation aid may be granted, the parties must conclude a stabilisation aid agreement. Such agreements must be concluded by 31 December 2010 at the latest.

1.5 The draft law also amends eight other laws[3]. This opinion concentrates on legislative provisions that relate directly to the Slovak national rescue scheme, and does not fully assess the other amendments contained in the draft law.

2. General observations

2.1 The ECB has issued a number of opinions at the request of the competent authorities of the Member States on national measures adopted in response to the global financial crisis[4]. The ECB therefore invites the Slovak Ministry of Finance to take into account the relevant observations made in its recent opinions on similar draft legislative provisions in other Member States.

2.2 The ECB also draws attention to the guidance provided by the Ecofin Council to the Member States in the conclusions of its Meeting of 7 October 2008[5] as well as the Declaration issued by the

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2 The Law No 483/2001 Coll. on banks (including amendments to certain laws), as amended.

3 The Law No 513/1991 Coll. (the Commercial Code), as amended; the Law No 530/1990 Coll. on bonds, as amended; the Law No 483/2001 Coll. on banks (including amendments to certain laws), as amended; the Law No 566/2001 Coll. on securities and investment services (including amendments to certain laws), as amended; the Law No 386/2002 Coll. on state debt and state guarantees (including amendments to certain laws), as amended; the Law No 747/2004 Coll. on financial market supervision (including amendments to certain laws), as amended; the Law No 7/2005 Coll. on bankruptcy and restructuring (including amendments to certain laws), as amended; and the Law No 8/2008 Coll. on insurance (including amendments to certain laws), as amended.

4 All ECB opinions are available on the ECB's website at www.ecb.europa.eu.

5 See 'Immediate Responses to Financial Turmoil', Ecofin Council Conclusions of 7 October 2008, available on the former French Presidency's website at www.ue2008.fr. The Ecofin Council recommended that: (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 interests of competitors must be protected, in particular through the State aid rules; and (viii) negative spill-over effects should be avoided.

Heads of State of the euro area on 12 October 2008 (hereinafter the 'Declaration')[6]. In particular, the ECB emphasises that any initiatives put in place by the competent national authorities to restore confidence in the financial markets should be coordinated and should aim to implement the common principles in question, in a spirit of close cooperation with other Member States and the Community institutions[7]. The principles contained in the Declaration as well as the conclusions raised by the Ecofin Council were endorsed by the European Council of 15 and 16 October 2008[8]. Moreover, measures taken by competent national authorities in relation to financial institutions in the context of the current global financial crisis have been object of further coordination at European Union level[9]. As a general remark in this context, the ECB, in line with its previous opinions[10], notes the importance of putting a transparent and predictable framework in place by defining the terms and conditions for financial institutions to have recourse to it and the parameters of and limitations to the exercise by the authorities of their powers when deciding whether to apply such aid measures[11].

2.3 With these general observations in mind, and against the background of the guidance previously given by the ECB and the Community institutions in this regard, the ECB has the following observations on the draft law.

3. Specific observations

Provision of emergency liquidity assistance by NBS

3.1 The provision of emergency liquidity assistance is a central bank function, which consists in giving support in exceptional circumstances and on a case-by-case basis to temporarily illiquid but solvent credit institutions. One of the specific tools available to central banks in a crisis situation is the provision of emergency liquidity assistance (ELA) to individual banks[12].

6 The text of the Declaration is available on the former French Presidency's website at www.ue2008.fr. The Member States agreed to: (i) ensure appropriate liquidity conditions for financial institutions; (ii) facilitate the funding of banks; (iii) provide financial institutions with additional capital resources to continue to ensure the proper financing of the economy; (iv) allow for an efficient recapitalisation of distressed banks; (v) ensure sufficient flexibility in the implementation of accounting rules; and (vi) enhance cooperation procedures among European countries.

7 See ECB Opinion CON/2009/12.

8 See Brussels European Council of 15 to 16 October 2008, paragraph 3 of the Presidency Conclusions.

9 Communication from the Commission — The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis (OJ C 270, 25.10.2008, p. 8); Communication from the Commission — The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition (OJ C 10, 15.1.2009, p. 2); Recommendations of the Governing Council of the European Central Bank on government guarantees for bank debt and Recommendations of the Governing Council of the European Central Bank on the pricing of recapitalisations, both latter documents available on the ECB's website at www.ecb.europa.eu.

10 See paragraph 3.1.2 of ECB Opinion CON/2009/18.

11 In this regard the ECB notes that Article 4(5) of the draft law contains a direct reference to the Communication from the Commission — Community guidelines on State aid for rescuing and restructuring firms in difficulty (OJ C 244, 1.10.2004, p. 2) and the obligation of the Slovak Ministry of Finance to report regularly to the European Commission on the review of the justification of the State aid scheme established by the draft law pursuant to Article 8(6) thereof.

12 See the ECB Financial Stability Review, December 2006, pp. 171-172 and the ECB's Annual Report 1999, p. 98.

3.2 The extension of ELA falls within NBS's task of contributing to the stability of the financial system, as set out in Article 24 of the Law on NBS[13]. Under the second subparagraph of Article 2(1)(b) of the draft law, the State will provide a special guarantee for a loan with a maturity of up to one year provided to a bank. Since the NBS, as expressly stated in the explanatory notes to the draft law, is potentially one of the entities entitled to provide such a short-term loan, it is of crucial importance to ensure –that, under Slovak law, the provision of the loan complies with the rules on the provision of ELA. In particular, the decision whether to provide ELA against a State guarantee must remain at NBS's discretion and must strictly respect the following criteria in order to comply with the prohibition on monetary financing laid down in Article 101(1) of the Treaty, read in conjunction with Council Regulation (EC) No 3603/93 of 13 December 1993 specifying definitions for the application of the prohibitions referred to in Articles 104 [now 101] and 104b(1) [now 103(1)] of the Treaty[14]. First, as expressed in previous ECB opinions addressing the provision of ELA by a Eurosystem central bank[15], the ECB is of the view that the draft law should unequivocally guarantee NBS's independence to decide on the provision of ELA. Second, it should be ensured that the credit provided by NBS is as short-term as possible. Third, there must be systemic stability aspects at stake for ELA to be granted. Fourth, there must be no doubts as to the legal validity and enforceability of the State guarantee. Fifth, there must be no doubts as to the economic adequacy of the State guarantee, which should cover both principal and interest on the loans, thereby fully preserving NBS's financial independence.

3.3 Against this background, the ECB is of the view that the position in respect of ELA should be clarified, at least in the explanatory memorandum to the draft law. In particular, the current wording of the second subparagraph of Article 2(1)(b) of the draft law is unclear, especially if read in conjunction with the explanatory notes, which, as stated above, explain that NBS is potentially one of several entities entitled to grant a loan to a bank. In this context, the maturity of the ELA should remain at the central bank's discretion. Similarly, NBS may not be involved in State operations which are incompatible with the Treaty provision[16], and the draft law should be more precise in this regard in order to clarify the link to the provisions of the Law on NBS relating to ELA[17].

Prohibition on monetary financing and NBS

3.4 The ECB understands that, under the draft law, NBS will be directly involved in granting stabilisation aid. In particular, NBS will be responsible for assessing the need for and appropriateness of applying State measures to a credit institution, indicating whether the credit

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13 The Law No 566/1992 Coll. on Národná banka Slovenska.

14 OJ L 332, 31.12.1993, p. 1.

15 See paragraphs 4.9 to 4.11 of ECB Opinion CON/2008/42 . See also ECB Opinion CON/2008/46.

16 It is the ECB's view that 'national legislation foreseeing the financing by [national central banks] of credit institutions other than in connection with central banking tasks (such as monetary policy, payment systems or temporary liquidity support operations), in particular to support insolvent credit and/or other financial institutions, is incompatible with the monetary financing prohibition': see the ECB's May 2006 Convergence Report, p. 68; the December 2006 Convergence Report, p. 30; the May 2007 Convergence Report, p. 22; the May 2008 Convergence Report, p. 24.

17 The ECB notes that this could be achieved by inserting a footnote in the second subparagraph of Article 2(1)(b) of the draft law referring to Article 24 of the Law on NBS.

institution concerned fulfils the conditions set by the State under the law. In line with previous ECB opinions, it is noted that NBS's involvement in the procedures provided for in the draft law will not go beyond the proper performance of its existing tasks and that it will comply fully with the prohibition on monetary financing laid down in Article 101(1) of the Treaty.

NBS's advisory role

3.5 As regards NBS's advisory role pursuant to the draft law, the ECB understands that it will be limited to providing advice through consultation on stabilisation aid. While the ECB appreciates that provisions of the draft law recognise NBS's expertise in this field, the ECB restates that functions to be performed by NBS in the context of granting stabilisation aid should be conducted in a manner fully compatible with NBS's institutional and financial independence in order to safeguard the proper performance of its existing tasks under the Treaty and the Statute of the European System of Central Banks and of the European Central Bank[18].

Selection of beneficiary credit institutions

3.6 Pursuant to Article 1(1)(a) of the draft law, all credit institutions as defined by the Law on banks with their registered office in Slovakia are entitled to benefit from the measures under the draft law. The ECB understands, therefore, that the term 'bank' applies to any bank with its registered office in Slovakia that has been licensed by NBS to provide banking services, including subsidiaries of foreign banks but excluding branches of foreign banks. The ECB welcomes the above provisions, as they avoid preferring specific credit institutions and distorting the level playing-field as regards the treatment of Slovak financial institutions and subsidiaries of foreign institutions[19]. The ECB notes that, in the specific context of provision of State guarantees, the Commission's guidance includes detailed rules on the eligibility criteria for beneficiary institutions[20].

Interaction of the draft law with the single monetary policy of the euro area

3.7 In line with the Declaration, Member States have to act in a coordinated manner to avoid significant differences in national implementation having a counter-productive effect and creating distortions in global banking markets. The euro area Heads of State also acknowledged the need to cooperate with the ECB to ensure consistency in liquidity management by the Eurosystem and compatibility with the Eurosystem's operational framework. Against this background, the ECB notes that uncoordinated decisions among Member States should be avoided as they may lead to a fragmentation of the euro area money market. The ECB therefore reiterates the points made in its previous opinions. In particular, the ECB reminds the consulting authority of the specific

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18 See paragraph 3.7 of ECB Opinion CON/2008/68.

19 On these aspects see, in particular, the following ECB Opinions: CON/2008/44, CON/2008/48, CON/2008/52 and CON/2008/55.

20 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'.

recommendations made by the Governing Council in relation to government guarantees for bank debt[21] and in relation to recapitalisations[22]. In this context, the ECB has the following remarks.

3.8 Pursuant to Article 5(5) of the draft law the 'details regarding the determination of, changes to, and method of paying the amount of the fee, and details regarding the method of returning stabilisation aid, shall be laid down in a generally binding legal regulation to be issued by the Ministry of Finance on agreement with Národná banka Slovenska'. The ECB would like to emphasise how important it is for the pricing of stabilisation aid and other measures under the draft law to be harmonised with measures within both the euro area and the EU so as to create the essential conditions for a level playing-field. In particular, it is important to ensure that the price of stabilisation aid is risk-based and market-oriented in that it is determined on the basis of the costs of a corresponding guarantee in the market.

3.9 Pursuant to Article 10 of the draft law, the stabilisation aid agreement, which has to be concluded before any form of stabilisation aid may be granted, must be concluded by 31 December 2010 at the latest. As stated in Article 2(1)(b) of the draft law, stabilisation aid in the form of a special State guarantee for a bond issue or for a short-term loan may be granted for up to three years and up to one year respectively (i.e. until 2013 at the latest). Pursuant to the second subparagraph of Article 2(1)(b) of the draft law, a special State guarantee may be provided for short-term loans with maturity of up to one year. As further explained in the explanatory notes to the draft law, such loans can be provided by one bank to another meaning that interbank deposits are potentially covered by the draft law. In this respect, the ECB has the following observations.

First, the ECB notes that State guarantees may be issued to cover all types of liabilities of domestic financial institutions and national guarantee schemes. The ECB therefore understands that the draft law does not exclude from its material scope of application, expressly or by implication, interbank deposits, subordinated or collateralised liabilities (such as covered bonds). The ECB reiterates that State guarantees should not cover interbank deposits, in particular, as this could entail a substantial distortion in the various national segments of the euro area money market by potentially increasing short-term debt issuance activity across Member States. This would impair the implementation of the single monetary policy, which is an exclusive competence of the Eurosystem under Article 105(2) of the Treaty. It could also affect the transmission of monetary policy decisions[23].

Second, the ECB understands that, by extension, State guarantees may be issued in respect of loans taken out by banks. In this respect, the ECB reminds the consulting authority that such arrangements for the granting of government guarantees on bank debt should, when practically implemented, aim at: (i) addressing the funding problems of liquidity-constrained solvent banks by improving the functioning of the market for bank debt of longer term maturity; (ii) preserving the

21 The reference is to the Recommendations of the Governing Council of the European Central Bank on the government guarantees for bank debt of 20 November 2008, available on the ECB's website at www.ecb.europa.eu.

22 The reference is to the Recommendations of the Governing Council of the European Central Bank on the pricing of recapitalisations of 20 November 2008, available on the ECB's website at www.ecb.europa.eu.

23 See paragraph 3.4 of ECB Opinion CON/2008/52.

level-playing field among financial institutions and avoiding market distortions; and (iii) ensuring consistency with the management of Eurosystem liquidity. In line with its recommendations, the ECB restates its view that euro area governments should make available a Government guarantee of new medium term (up to five years) bank senior debt issuance which must be limited in time. In the same vein, government guarantees on short-term bank debt with maturity of three to 12 months may be provided in order to revitalise the short-term bank debt market.

Third, the ECB also reminds the Slovak authorities that it is important to ensure that the beneficiary financial institutions may not profit from undue use of their guaranteed status to engage in a heightened level of activities which distort the market and facilitate abnormal balance sheet growth. In this regard, the ECB reiterates the importance of establishing appropriate safeguards such as limits on the marketing of financial products or on expansion of activities on the basis of State guarantees.

3.10 As regards stabilisation aid in the form of recapitalisation as provided for in Article 2(1)(a) of the draft law, the ECB notes that recapitalisation measures in the Member States are aimed at strengthening the capital position of fundamentally sound financial institutions in order to improve the functioning and stability of the banking system and to ensure the proper financing of the economy. In particular, there should be a consistent approach to defining the conditions for recapitalisations and the pricing of the instruments intended to provide Tier 1 capital to financial institutions. The ECB underlines the importance of appropriate pricing for recapitalisations with a view to enhancing the stability of the financial system, facilitating a return to normal market conditions and ensuring the proper financing of the economy. Against this background, recommendations of the Governing Council of the ECB on the pricing of recapitalisations[24] have been published. The ECB highlights that the pricing conditions for capital support should be risk-based and market-oriented, determined by taking into consideration the specific risk of both the specific instrument chosen for injecting capital and the institution concerned. Specific features of the instruments for capital injections (such as preference shares) should be appropriately chosen so that, while encouraging an early end to the State's capital support of banks, they should not result in an excessive increase in the cost of capital. In line with the Declaration, the ECB also emphasises that harmonisation regarding the expiry of national financial support schemes throughout the EU, and in particular within the euro area, is of crucial importance, including in relation to State capital investments in financial institutions. Against this background, it is emphasised that the draft law does not currently provide for an exit strategy. In this context, the ECB notes that the Declaration clearly draws attention to the need for any national support scheme to be temporary in nature, even if it may be extended or renewed. The ECB therefore recommends that specific provisions on the time limits in relation to the stabilisation aid measures under the draft law should be adopted[25].

24 Recommendations of the Governing Council of the European Central Bank on the pricing of recapitalisations, issued on 20 November 2008 and available on the ECB's website at www.ecb.europa.eu.

25 See paragraph 3.5 of ECB Opinion CON/2008/76 or paragraph 3.2 of ECB Opinion CON/2009/6.

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

Done at Frankfurt am Main, 27 May 2009.

[signed]

The President of the ECB

Jean-Claude TRICHET