



OPINION OF THE EUROPEAN CENTRAL BANK

of 2 June 2009

on new measures strengthening financial supervision

(CON/2009/50)

Introduction and legal basis

On 9 April 2009 the European Central Bank (ECB) received a request from the German Federal Ministry of Finance for an opinion on a draft law on strengthening the supervision of the financial market and insurance sector (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 provisions¹, 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

According to the explanatory memorandum accompanying the draft law, the Federal Government intends to reform the existing financial market supervision instruments, which proved insufficient during the financial crisis, and to carry out changes to improve the effectiveness of supervision. In particular, the crisis revealed that the institutions concerned had not taken sufficient precautions with regard to the adequacy of their equity capital and to establishing a liquidity buffer. According to the same explanatory memorandum, in order not to anticipate proposed regulation at Community level, the proposals are limited to targeted amendments to German legislation, namely the Law on banking and the Law on insurance supervision.

Under the amended § 10(1b) of the Law on banking, the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, BaFin) will be able to require higher own funds if otherwise the sustained adequacy of an institution's capital ratio can no longer be guaranteed or if the institution's risk-bearing ability is no longer certain. Further, BaFin will have the right to increase the own funds ratio if an institution does not have an orderly business organisation and no improvement can

¹ OJ L 189, 3.7.1998, p. 42.

be secured by other means (see the amended § 10 and § 45b(1) of the Law on banking). This will enable the possible cyclical development of an institution's own funds ratio to be taken into account (build-up of a buffer for the institution in a favourable economic environment and erosion of the buffer in an unfavourable economic environment). Pursuant to the amended § 11(2) of the Law on banking, BaFin will be able to require a higher liquidity ratio if, in the absence of such a measure, the sustained adequacy of an institution or group's liquidity provision cannot be guaranteed.

Moreover, the leverage ratio (i.e. the relationship between own funds and balance sheet assets that are not risk weighted) will, under the draft law, have to be reported annually and any material change immediately (see the new §§ 24(1)(a) No 5 and 24(1) No 16 of the Law on banking).

Under the draft law, measures such as prohibitions on credit and profit distribution will be possible if there is a threat of failure to meet the supervisory ratios. Currently, such measures are only possible in the case of actual failure, preventing supervisors from stepping in at an early stage if there are indications of a dangerous situation. Moreover, BaFin will be able to forbid not only profit distributions, but also any payments on equity instruments, even if they are based on liabilities that do not count as part of own capital and have to be serviced regardless of whether there are available profits.

Furthermore, under the amended § 46(1) of the Law on banking, BaFin may prohibit or restrict certain payments to companies belonging to a group if these transactions prejudice the institution in question. According to the explanatory memorandum, this should prevent, for example, liquidity being withdrawn in a crisis from a German subsidiary by its foreign parent or foreign associated companies. The argument is that BaFin should be given the right to order such a prohibition on payments in the event of a crisis since other states are also operating ring-fencing in the current crisis.

Finally, further measures under the draft law include a requirement to declare concentrations of risks within groups of institutions and financial holding companies as well as in insurance groups (currently only financial conglomerates have been regulated accordingly), and the obligation for members of the administrative and supervisory boards of an institution to be reliable and technically able to understand the transactions conducted by the institution.

2. General observations

2.1 The ECB welcomes the aim underlying the draft law of reinforcing the supervisory tools available to BaFin. The ECB notes that, following on from other German initiatives to restore short-term confidence in the markets on which the ECB has already been consulted², the draft law is aimed at benefiting from the experience of the financial turmoil and at putting in place measures to improve BaFin's supervisory powers on a long-term basis.

² See Opinions CON/2008/57 and CON/2009/24. All ECB opinions are available on the ECB website at www.ecb.europa.eu/ecb/legal/opinions/html/index.en.html.

- 2.2 In this respect, the ECB welcomes the fact that the explanatory memorandum expressly limits the regulatory scope of the draft law in order to avoid anticipating proposed Community legal measures³.
- 2.3 Moreover, the ECB would like to draw the consulting authority's attention to the need, besides adopting measures such as the draft law, to strengthen coordination of policy measures in response to the crisis⁴.
- 2.4 With these general observations in mind, and against the background of the guidance previously given in its opinions and by the EU institutions and other institutions in this regard, the ECB has the following specific observations on the draft law.

3. Specific observations

Own funds and liquidity requirements

- 3.1 The draft law contains some provisions on own funds and liquidity requirements (amending §§ 10 24, 45 and 45b of the Law on banking). In this respect, the ECB notes that these provisions seem to be in line with the concepts underlying ongoing initiatives at European and international level.

Prohibition or restriction on transfers of funds

- 3.2 The ECB understands that the new § 46(1), third sentence, of the Law on banking introduced by the draft law will enable BaFin to prohibit or restrict certain payments to companies belonging to a group of companies if these transactions prejudice the institution in question. Further, BaFin may specify that payments are only permissible subject to certain requirements. The explanatory memorandum expressly states that the provision should 'in particular counteract the risk that badly needed liquidity is withdrawn from a German subsidiary institution by a foreign group company which needs capital or liquidity'.
- 3.3 In this respect, the ECB emphasises that work is on going at EU level, alongside the review of the Credit Institutions Reorganisation and Winding-Up Directive⁵, aiming at reducing obstacles to the transfer of assets. More specifically, the Ecofin Council of 9 October 2007 requested the Commission of the European Communities 'to perform a feasibility study on reducing barriers for cross-border asset transferability while introducing appropriate safeguards within banking, insolvency and company law, taking into account that the reallocation of assets in a crisis affects the ability of stakeholders in different legal entities to pursue claims. The overall objective is to reinforce the primacy of private solutions, avoid counter-productive ring-fencing of assets, and

³ See, in particular, the proposal for a directive of the European Parliament and of the Council amending Directives 2006/48/EC and 2006/49/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management. On this topic, see also Opinion CON/2009/17.

⁴ See hereto in particular paragraph 2.1 of Opinion CON/2008/57 and paragraph 2.2 of Opinion CON/2009/24.

⁵ Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions (OJ L 125, 5.5.2001, p. 15).

facilitate a smooth management of a crisis⁶.' Following the request by the Ecofin Council, the Commission released a feasibility report on 14 November 2008, concluding that: 'There might be merit in limiting intra-group transfers to limit contagion risks. On the other hand, it is suggested to develop a clear legal framework to allow asset transferability, and to avoid that authorities resort to ring-fencing, in the absence of other alternatives⁷.' In this context, as in previous opinions⁸, the ECB notes that prohibiting or restricting the transfer of funds or other transactions of banks could impair the possibility for banking groups to manage their liquidity. The ECB also recommends that the draft law should fully respect central banks' tasks and should require BaFin to coordinate its actions with the home supervisory authorities of the banking groups concerned as well as with the central banks concerned. Moreover, if such measures concern branches of Member State banks, then Community law obligations, requiring in particular the provision of information to the Commission and the Member States concerned, should be duly complied with.

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

Done at Frankfurt am Main, 2 June 2009.

[signed]

The President of the ECB

Jean-Claude TRICHET

⁶ See the Press Release available at http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ecofin/96375.pdf.

⁷ See the Commission services' feasibility report on 'asset transferability' within cross border banking groups published on 14 November 2008, available at http://ec.europa.eu/internal_market/bank/docs/windingup/rep141108_en.pdf.

⁸ See Opinion CON/2009/34.