EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 25 June 2009

on changes to financial support measures for credit institutions

(CON/2009/56)

Introduction and legal basis

On 18 June 2009 the European Central Bank (ECB) received a request from the Irish Minister for Finance (hereinafter the 'Minister') for an opinion on a draft Credit Institutions (Guarantee of Eligible Debt Securities) Scheme 2009 (hereinafter the 'draft scheme'), and Section 17 of the Financial Measures (Miscellaneous Provisions) Bill 2009 (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 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 scheme and the draft law relate to the stability of Ireland's financial system and the Central Bank and Financial Services Authority of Ireland (hereinafter the 'CBFSAI'). 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 scheme

1.1 The draft scheme is made pursuant to the Credit Institutions (Financial Support) Act 2008 (hereinafter the '2008 Act'). Financial support may only be granted under the 2008 Act until 29 September 2010[2]. Section 17 of the draft law extends that provision to allow for a later date as specified by the Minister, after consulting the Governor of the CBFSAI (hereinafter the 'Governor') and the Irish Financial Services Regulatory Authority (hereinafter the 'Regulatory Authority'). This extension will allow financial support to be granted under the draft scheme, which will, *inter alia*, provide credit institutions with access to a stable funding stream and to longer term funding from the capital markets in order to maintain the stability of the Irish financial system[3].

1 OJ L 189, 3.7.1998, p. 42.

2 Section 6(3) of the 2008 Act

3 Paragraphs 1 and 2 of the draft scheme.

1.2 Under the draft scheme, credit institutions may apply to the Minister for certain debt securities to be guaranteed by the Minister[4]. The Minister has discretion whether or not to guarantee unconditionally and irrevocably senior unsecured certificates of deposit and commercial paper, other senior unsecured bonds and notes, and other debt securities specified by the Minister[5]. These debt securities must be issued during a six-month issuance period from the commencement date specified by the Minister (hereinafter the 'commencement date'), subject to any extension of this period specified by the Minister, consistent with European Union State aid rules[6]. Further, an eligible security must not have a maturity in excess of five years[7]. The guarantee will terminate five years after the end of the issuance period, unless extended at the Minister's discretion, also subject to EU State aid requirements[8].

1.3 The draft scheme alters the Credit Institutions (Financial Support) Scheme 2008 (hereinafter 'the existing Scheme') under which the Minister guarantees an extensive range of liabilities of covered credit institutions, including retail, corporate and interbank deposits, as well as unsecured debt, asset covered securities and dated subordinated debt (Lower Tier 2) for the period from 30 September 2008 to 29 September 2010[9]. Under the draft scheme, all retail, corporate and interbank deposits remain unconditionally and irrevocably guaranteed in accordance with the terms of the existing Scheme[10]. However, asset covered securities and dated subordinated debt (Lower Tier 2) will no longer be guaranteed after the commencement date[11]. Any other debt securities issued by credit institutions from the commencement date onwards may only be guaranteed in accordance with the draft scheme, as described in paragraph 1.2 of this opinion[12].

1.4 The draft scheme provides that participating credit institutions will have to abide by the Minister's directions to comply with restrictions on the wide range of commercial conduct, governance, transparency and reporting requirements applicable under the existing Scheme[13]. In addition, the Minister, after consultation with the Governor and the Regulatory Authority, may direct a participating credit institution to draw up a restructuring plan to ensure compliance with the objectives of the draft scheme, and will do so if a participating institution's applicable solvency ratio falls below the minimum regulatory standards on a material basis. Any such plan must comply with EU State aid and competition law[14].

4 Paragraph 8 of the draft scheme.
5 Paragraphs 10 and 12 of the draft scheme.
6 Paragraph 10 of the draft scheme.
7 Paragraph 13 of the draft scheme.
8 Paragraph 16 of the draft scheme.
9 Credit Institutions (Financial Support) Scheme 2008 (hereinafter 'the existing Scheme').
10 Paragraph 28 of the draft scheme.
11 Paragraph 27 of the draft scheme.
12 Paragraph 26 of the draft scheme.
13 Paragraph 24 of the draft scheme.
14 Paragraph 25 of the draft scheme.

1.5 The draft scheme is subject to review by the Minister at no later than six-month intervals, the results of which are to be provided to the Commission of the European Communities[15]. The Minister will also monitor the amount of eligible securities guaranteed under the draft scheme, and will also be able to vary its terms; however, any such variation will not affect any guarantee in issue at the date of that variation[16]. The draft scheme describes the fee arrangement between relevant institutions and the Minister in respect of each guaranteed security, which is broadly in line with the Recommendations of the Governing Council of the ECB on government guarantees for bank debt issued on 20 October 2008 (hereinafter the ECB's recommendations on government guarantees'), as further discussed in paragraph 3.2 of this opinion.

1.6 Credit institutions will have to take certain actions to participate in the draft scheme, including filing an application and executing certain documentation, following which the Minister may issue a security guarantee certificate in respect of the guaranteed securities[17]. The Minister may delegate the operation of the draft scheme to the National Treasury Management Agency[18].

2. General observations

2.1 The ECB has issued opinions on both the 2008 Act and the existing Scheme[19]. In its opinion on the existing Scheme, the ECB stressed that it is of utmost importance to ensure harmonised and coordinated decisions throughout the EU. In this context, the ECB wishes to again draw the consulting authority's attention to the 'Declaration on a concerted European action plan of the euro area countries' of 12 October 2008[20] (hereinafter the 'Declaration') which states that Member States' actions 'will be designed in order to avoid any distortion in the level playing-field', which is a crucial element for the integration of European financial markets.

2.2 The ECB welcomes the fact that the draft scheme appears to have been expressly constructed with due regard to ensuring consistency with the requirements of EU State aid and competition law[21].

2.3 The ECB notes that, subject to a number of grandfathering arrangements, the draft scheme reduces the scope of liabilities guaranteed by the Minister, as compared with the existing Scheme. Instead of offering blanket coverage to the debt securities eligible under the existing Scheme, debt securities will only be guaranteed under the draft scheme at the Minister's discretion. Newly issued asset covered securities and dated subordinated debt (Lower Tier 2) will no longer be guaranteed under the draft scheme.

15 Paragraph 5 of the draft scheme.

16 Paragraphs 6 and 11 of the draft scheme.

17 Paragraphs 3 and 10 of the draft scheme.

18 Paragraph 7 of the draft scheme.

19 ECB Opinions CON/2008/44 and CON/2008/48 respectively.

20 Available on the website of the former French Presidency at www.ue2008.fr.

21 See paragraphs 2.3, 10, 12.4, 16, 22 and 25 of the draft scheme.

3. Specific observations

3.1 *Fee arrangements*

The ECB welcomes the fee arrangements detailed by the draft scheme, which largely replicate the ECB recommendations on government guarantees. The ECB notes that the fee arrangements also contain provisions authorising the Minister, at their discretion, to apply an alternative credit default swap spread if the relevant data referred to in the ECB's recommendations on government guarantees are not publicly available, or vary the fee (subject to EU State aid requirements)[22]. Furthermore, an additional fee may be charged in relation to any non-euro denominated guaranteed security[23].

3.2 *Scope of the guarantees and implementation of Eurosystem monetary policy*

The ECB takes the opportunity of this opinion to reiterate the points made in its previous opinions and to reemphasise the key elements of the Declaration. In addition, the ECB reminds the consulting authority of the ECB's recommendations on government guarantees. First, 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. Second, with a view to ensuring a sufficient level playing-field, uncoordinated decisions among Member States should be avoided as they may involve a fragmentation of the euro area money market. Against this background, the ECB has the following observations.

First, the extension of a guarantee to cover interbank deposits, as is the case under the existing Scheme, should be avoided as it 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 and therefore impairing the implementation of the single monetary policy, which is a unique competence of the Eurosystem under Article 105(2) of the Treaty. The ECB has expressed this particular concern in a number of opinions delivered to the authorities of Member States, including Ireland[24].

Second, in line with the Declaration, the ECB reminds the consulting authority that the euro area 'Governments would make available for an interim period … a Government guarantee … of new medium term (up to 5 years) bank senior debt issuance'. In the same vein, the ECB's

22 Paragraphs 20 and 22 of the draft scheme.

23 Paragraph 21 of the draft scheme.

24 See paragraph 3.7 of ECB Opinion CON/2008/48; paragraph 3.2 of ECB Opinion CON/2008/50; paragraph 3.3 of ECB Opinion CON/2008/50; paragraph 3.4 of ECB Opinion CON/2008/52; paragraphs 2.3 and 2.4 of ECB Opinion CON/2008/54; paragraph 3.5 of ECB Opinion CON/2008/55; paragraph 3.2 of ECB Opinion CON/2008/56; paragraph 3.4 of ECB Opinion CON/2008/57; paragraph 3.2 of ECB Opinion CON/2008/58; paragraph 3.3 of ECB Opinion CON/2008/59; paragraph 2.1.2 of ECB Opinion CON/2008/62; paragraph 2.1 of ECB Opinion CON/2008/65; paragraph 3.3 of ECB Opinion CON/2008/67; paragraph 3.4 of ECB Opinion CON/2008/68; paragraph 3.3 of ECB Opinion CON/2008/76, paragraph 3.2 of ECB Opinion CON/2008/79; paragraph 3.2 of ECB Opinion CON/2008/80; paragraph 3.5 of ECB Opinion CON/2008/81; paragraph 3.1 of ECB Opinion CON/2008/88; paragraph 3.3 of ECB Opinion CON/2009/2; paragraph 2.3 of ECB Opinion CON/2009/6; paragraph 3.2.2 of ECB Opinion CON/2009/12; paragraph 3.3.2 of ECB Opinion CON/2009/18; paragraph 2.4 of ECB Opinion CON/2009/28; paragraph 3.4.3 of ECB Opinion CON/2009/32; paragraph 3.9 of ECB Opinion CON/2009/49.

recommendations on government guarantees further state that ‘Government guarantees on short-term bank debt with maturity of three to 12 months could be provided to help revitalise the short-term bank debt market.’ However, it is noticeable that under the draft scheme there is no limit on the maturity of the short-term certificates of deposit and commercial paper that may be guaranteed by the Minister, implying that short-term bank debt with a maturity of less than three months may be guaranteed in practice. While acknowledging the significant challenges currently faced by the banking sector in Ireland, granting government guarantees for bank debt with a maturity of less than three months should be also avoided to the extent possible. In particular, it is essential that the scheme will not impair the implementation of the single monetary policy throughout the euro area.

Finally, the ECB notes that the draft scheme does not specify an end-date, instead suggesting it will terminate at the discretion of the Minister. As stated before, the ECB emphasises that in accordance with the Declaration, harmonisation regarding the expiry of the various financial support measures within a particular country and the national financial support schemes across the EU is of crucial importance in order to ensure a level playing field[25].

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

Done at Frankfurt am Main, 25 June 2009.

[signed]

The President of the ECB

Jean-Claude TRICHET

25 See ECB Opinion CON/2009/6.