EN

EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 28 May 2010

on amendments to the financial stability regime

(CON/2010/45)

Introduction and legal basis

On 16 April 2010 the European Central Bank (ECB) received a request from the Danish Ministry of Economic and Business Affairs for an opinion on a draft law amending the Law on financial stability, the Law on a Guarantee Fund for Depositors and Investors, and the Law on payment of State income tax (the treatment of failing credit institutions after the expiry of the general State guarantee) (hereinafter the 'draft law').

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union 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 the 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 draft law will establish a new winding-up regime for failing credit institutions from the expiry date of the Law on financial stability until the normalisation of conditions in the financial markets.

1.2. On 9 October 2008 the ECB was consulted on a draft law on financial stability[2], and on 21 January 2009 it was consulted on a draft law on State investments in credit institutions and a draft law amending the Law on financial stability[3]. The Law on financial stability established a general State guarantee scheme for ordinary individual creditors and depositors, which expires on 30 September 2010.

1.3. As pointed out in the General Comments on the draft law[4], the financial crisis has demonstrated to all stakeholders the benefits of a controlled winding-up of a failing credit institution compared to

1 OJ L 189, 3.7.1998, p. 42.

2 See Opinion CON/2008/54. All ECB opinions are published on the ECB's website at www.ecb.europa.eu.

3 See Opinion CON/2009/6.

4 See General Comments on the draft law (available only in Danish), 2 (Background), and Comments on the specific provisions, Re.: § 1, subsection 1.

the traditional and often lengthy winding-up procedures and compulsory sales in a bankruptcy. Against this background and also in view of the relatively large number of smaller credit institutions in the Danish banking system, the purpose of the draft law is to provide for the continuation of the Financial Stability Company (hereinafter the ‘Company’), established by the Law on financial stability, as a basis for a more permanent and general regime for handling failing credit institutions. This will facilitate greater transparency in the market on how to value credit default risk and also ensure that the Danish banking sector will continue to benefit from the accumulated expertise on how to handle failing credit institutions.

1.4. In cases where a credit institution is unable to meet the capital adequacy requirements it will have the choice either to transfer its activities to a buyer designated by the Company or to enter normal bankruptcy proceedings. In the former case, the Company will set up a new subsidiary to take over the activities of the failed credit institution with the clear aim of winding it up and of transferring existing customers to other institutions. The Company’s subsidiary will purchase the assets of the failed credit institution, at their realisation value[5], against payment in the form of the acquisition of a proportional share of its unsubordinated unsecured liabilities. The liabilities exceeding the assets and, therefore, not taken over will remain with the failed credit institution and will be realised according to normal credit institution insolvency rules. Creditors not accepting the change of debtor will remain creditors of the failed credit institution, and they will retain the right to set-off assets against liabilities. The Company injects capital into the new subsidiary in accordance with the capital adequacy requirements of the Law on Danish financial business. If more liquidity is required than can be raised in the central bank’s regular market operations, the Company can provide a liquidity facility, to ensure that the liquidity adequacy requirements are met. The injected capital will earn a market return, to be borne by the subsidiary, which will also cover the Company’s administration costs.

1.5. As a second leg of the new winding-up regime, the Danish Guarantee Fund for Depositors and Investors (hereinafter ‘the Fund’) will set up a Winding-Up Department of the Fund, separated by Chinese walls from the Fund’s ordinary guarantee obligations. This new Winding-Up Department may guarantee loans for the capitalisation and liquidity, and it will bear any losses incurred by the winding-up of the Company’s subsidiary. The capital of the Winding-Up Department will be provided through guarantees from Danish credit institutions, amounting to DKK 3.2 billion (approx. EUR 430 million), and limited to 0.2 percent of the deposits of each institution within one financial year. In the event that the capital requirements exceed the guarantees, the Winding-Up Department can raise loans guaranteed by the State in agreement with the Danish Parliament’s Finance Committee[6].

---

5 See the draft law § 1, subsection 3, Re.: § 16g, subsection 3; and Comments on specific provisions of the draft law (only in Danish) § 1, subsection 3,Re.: § 16g, paragraph 7.

6 According to the existing § 6, subsection 4, of the Law on a Guarantee Fund for Depositors and Investors (the unofficial English version is available on the website of the Danish FSA at http://www.ftnet.dk/en/Regler-og-praksis.aspx) the Minister for Economic Affairs may, with the approval of Parliament’s Finance Committee, provide a guarantee for a loan made to the Fund to meet its commitments. With the creation of the new and separate winding-up department of the Fund a similar possibility of taking out a loan with the approval of the Finance Committee will also be provided for, if the

1.6. In order to ensure the proper functioning of the new regime, the draft law requires each credit institution to have internal systems in place to enable it to provide within 24 hours all the necessary information regarding its deposit and loan accounts in case it should need to be wound up through the Company[7].

2. General observations

2.1. The ECB welcomes the fact that the general State guarantee regime will not be extended beyond the expiry date and that it will be replaced by a regime which entails the further disengagement of the State in the winding-up of failing credit institutions in favour of a regime based primarily on financing by the credit institution sector itself. The ECB also welcomes the fact that, as clearly stated in the General Comments on the draft law[8], a credit institution for which the Financial Supervision Authority has set a deadline to fulfil the solvency criteria must first seek a market-based solution, and that the new winding-up regime under the Company will be available only in situations where the credit institution considers that it has lost its capital or either is or must expect to be insolvent and only where the credit institution's own efforts to find a market-based solution have proved unsuccessful.

2.2. The ECB further welcomes the clear mandate for the Minister for Economic and Business Affairs, as set out in the Comments on § 16e, subsection 4, to lay down detailed rules on the conditions for the transfer of the assets and the subsequent winding-up of the failed credit institution which will follow the European Commission's guidelines for restructuring measures[9], in order to be compliant with Article 107(3)(b) of the Treaty, so that domestic support measures to failing credit institutions and their terms of application are in accordance with the principle of non discrimination and with competition law rules, and in particular State aid rules, of the Union.

3. Specific comments

3.1. The ECB notes that § 3, subsection 1, of the draft law lays down that the Fund shall assist in the winding-up of credit institutions in financial difficulties under the Law on financial stability. In this regard, § 3, subsection 3, of the draft law states that the Fund shall be divided up into four departments, one of which is the Winding-Up Department. The ECB welcomes the further clarification laid down in § 3, subsections 4 and 6, of the draft law according to which the Winding-Up Department may not take out loans from the other departments and that it shall have its own, separate resources provided by its mandatory contributors. These provisions are important

---

resources of this department should not suffice to cover the winding-up obligations of the Fund. See the Comments on specific provisions of the draft law (only in Danish) Re.: § 3, subsection 5, and Re.: §6, subsection 4.

7 See the draft law, § 2, subsection 1.

8 See the General Comments, 1 (Introduction), 2 (Background) and 3.1.2. According to Danish legal tradition, as is also the case in the other Nordic countries, the Comments on a draft law when adopted by Parliament will be binding on the Executive in its implementation and administration of the law, and will also be of strong interpretive value for the courts.

9 See the draft law, paragraph 3.1.2. (available only in Danish) citing also the Commission communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules. (OJ C 195, 19.8.2009, p. 9) .

from a legal certainty perspective, as they ensure that ex ante pay-ins by credit institutions to guarantee deposits in case of the insolvency of a credit institution are not used for other purposes such as the voluntary winding-up of credit institutions in financial difficulties.

3.2. The ECB notes that in the event that the capital requirements of the Fund’s Winding-Up Department exceed the guarantees provided, the Winding-Up Department can still raise loans secured by State guarantees in agreement with the Parliament’s Finance Committee. The ECB reminds the consulting authority about the importance of continuing vigilance as to the cost at market rates of this residual State guarantee to raise loans to fund any additional capital requirements of the Winding-Up Department.

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

Done at Frankfurt am Main, 28 May 2010.

[signed]

The President of the ECB

Jean-Claude TRICHET