EUROPEAN CENTRAL BANK

EUROSYSTEM

**OPINION OF THE EUROPEAN CENTRAL BANK**

**of 20 July 2011**

**on crisis intervention measures for financial institutions in difficulty**

**(CON/2011/60)**

## Introduction and legal basis

On 19 April 2011, the European Central Bank (ECB) received a request from the Dutch Minister for Finance for an opinion on the draft law on crisis intervention measures (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 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 law relates to De Nederlandsche Bank (DNB) and 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 draft law introduces, *inter alia*, a number of amendments to the Law on financial supervision. In particular, it grants new powers to DNB and the Minister for Finance to intervene in situations where an institution[2] faces financial difficulty[3] or where there is a serious and immediate risk to the stability of the financial system caused by an institution in difficulty.

1.2 Pursuant to the draft law, DNB may prepare a plan for the partial or total transfer of the shares, and/or assets and liabilities, including deposits, of an institution in difficulty to a private purchaser[4]. The plan becomes effective upon the district court's approval. Transfers and related measures do not trigger the rights of the contracting parties of a credit institution to exercise early termination, set off and netting[5].

1.3 Furthermore, the draft law grants the Minister for Finance the power to take 'special measures related to the stability of the financial system'. Accordingly, the Minister may expropriate the assets of an institution in difficulty for the purpose of stabilising the financial system. The draft law

1 OJ L 189, 3.7.1998, p. 42.

2 Under the draft law, an 'institution' refers to credit institutions and insurance companies.

3 Defined in the new Article 3:159a(g), in conjunction with the new Article 3:159b, of the Law on financial supervision.

4 The new Section 3.5.4A of the Law on financial supervision. Pursuant to the new Article 3:159f of the Law on financial supervision, the State cannot be the purchaser.

5 The new Article 3:267f of the Law on financial supervision.

provides for a right of indemnification for such action, based on the actual value of the assets or securities seized. The value will be determined by estimating the market price at the time of the expropriation, less the amount of any financial support[6].

1.4 In addition to the amendments to the Law on financial supervision, the draft law amends the Law on bankruptcy[7], the Civil Code[8], the Law on general administration[9] and the Law on securities bank giro transactions[10].

## 2. General observations

2.1 In line with its previous opinions, the ECB emphasises that, when adopting measures to deal with a financial crisis, Member States should act in a coordinated manner to avoid significant differences in national implementation, which could have a counterproductive effect and cause distortions in global financial markets. Moreover, it is crucial to ensure consistency with the Eurosystem's operational framework and liquidity management[11]. Against this background, any national measure should ensure a sufficiently level playing field within the euro area, which is of key importance to maintaining the integrity of the euro area financial system.

2.2 The ECB supports the plans put forward by the European Commission to develop a crisis management and resolution framework for Union financial institutions. The Union clearly needs better tools with well-designed triggers to tackle problems faced by financial institutions more effectively. National regimes should be as harmonised as possible and there should be better coordination between Member States in crisis situations. In particular, the ECB shares the view that the overriding policy objective of the new Union regime should be to allow any institution to fail in a way that safeguards the stability of the Union financial system as a whole and minimises public costs and economic disruptions.

## 3. The role of DNB and measures taken

3.1 The ECB understands that the tasks allocated to DNB under the draft law do not interfere with the performance of any of DNB's Eurosystem-related tasks provided for by the Treaty and do not prejudice the financial means necessary for carrying out DNB's Eurosystem-related tasks[12].

3.2 Any involvement of DNB and its Governor in the application of measures to strengthen financial stability must be compatible with the Treaty and consequently with DNB's institutional and financial independence, as well as with the Governor's personal independence to safeguard the

6 The new Article 6:8 and 6:9 of the Law on financial supervision.

7 Article II of the draft law.

8 Article III of the draft law.

9 Article IV of the draft law.

10 Article V of the draft law.

11 See paragraph 2.1.1 of Opinion CON/2009/ 54**.** All ECB Opinions are published on the ECB's website at www.ecb.europa.eu.

12 The ECB's Convergence Report May 2010, p. 22.

proper performance of their tasks under the Treaty and the Statute of the European System of Central Banks and of the European Central Bank[13].

3.3 The draft law defines 'transitional institution' as an institution whose role is to purchase, on a temporary basis, deposit agreements, assets or liabilities (other than pursuant to deposit agreements), and shares of an institution in difficulty. The draft law does not specify who is responsible for setting up a transitional institution or the procedure to be used. Moreover, it is unclear under which circumstances a transitional institution would play a role. Under the draft law, the new Article 3:159f(2) of the Law on financial supervision provides that 'Rules can be established by general administrative regulation with respect to the transfer to a transitional institution', but does not offer an explanation regarding the transitional institution itself. The ECB would welcome clarification with respect to these open issues, as without clear specifications, the transitional institutions cannot serve as effective tools and their function and design cannot be coordinated among the Member States. It should also be made clear how the transitional institutions relate to the 'bridge bank tool' discussed at Union level[14].

## 4. Prohibition of monetary financing and financing of resolution measures

4.1 It is important to safeguard compliance with the monetary financing prohibition under Article 123 of the Treaty. This prohibition of monetary financing is designed to prevent central banks from providing overdraft facilities or any other type of credit facility to the public sector, which includes any financing of the public sector's obligations vis-à-vis third parties. The draft law provides for the possibility for DNB to furnish an amount for the transfer of deposit agreements[15] and allows DNB to subsequently recover such amount from credit institutions[16]. The ECB notes that the amount that DNB may provide for the transfer of deposit agreements under the draft law may not exceed the total amount of the guaranteed deposits held by an institution in difficulty[17]. It should be explicitly spelled out that a transfer of a deposit agreement may only be financed by funds from the deposit guarantee scheme. From this perspective, the ECB notes that the draft law does not change in substance the regime currently in force, envisaging that the Dutch deposit guarantee scheme is financed by advance payments from DNB, with a collection of contributions from credit institutions at a later point in time.

4.2 Advance payments by DNB in the context of the operation of the Dutch deposit guarantee scheme are generally considered incompatible with the monetary financing prohibition and legislation is required to make the deposit guarantee scheme compliant with the monetary financing

13 See paragraph 3.1.4 of Opinion CON/2009/93.

14 See the Commission's consultation document 'Technical details of a possible EU framework for bank recovery and resolution', p. 52, available at http://ec.europa.eu (hereinafter the 'Commission's consultation on crisis resolution'). A 'bridge bank' is an institution or other legal person that is wholly owned by one or more public authority.

15 New Article 3:159g(1) of the Law on financial supervision.

16 New Article 3:159l of the Law on financial supervision.

17 The new Article 3:159g(2) of the Law on financial supervision.

prohibition[18]. The ECB understands that a law is being prepared that will provide for ex ante funding as regards the deposit guarantee scheme. Until such legislation is in place, advance payments by DNB and the resulting claims for DNB in relation to the transfer of deposit agreements, even though financed ex post by contributions from credit institutions, would in principle not be compatible with the prohibition of monetary financing.

4.3 Also from a financial stability perspective, the ECB calls for the relevant authorities to set up an ex ante funding scheme for institutions in the deposit guarantee scheme[19], which would have, *inter alia*, the advantage of greater reliability and availability. It would avoid the risk of being an additional strain on the banking sector in times of crisis. An ex ante funding scheme should also include the possibility to call upon the private sector for additional financial support, as it cannot be excluded that in a crisis situation, pre-collected funds from the industry may be insufficient and that supplementary use of public funds may be necessary. This principle of ex post recovery from the private sector should promote additional market discipline and address the risk of moral hazard.

## 5. Shareholder rights

5.1 Under the draft law, the transfer plan prepared by DNB may provide for the transfer of deposit agreements, assets and liabilities, and shares from the institution in difficulty to a private sector purchaser.

5.2 The draft law[20] sets out the procedure for the transfer of shares from an institution in difficulty to a private sector purchaser, according to which consent or cooperation on the part of the shareholders is not required. The new Article 3:159q(c) of the Law on financial supervision requires that a transfer plan include the price the purchaser is willing to pay and the reason that price is considered reasonable for the shares.

5.3 In order to strike the right balance between the need for prompt and effective action by the authorities on the one hand and the preservation of shareholders' property rights on the other, safeguards need to be put in place to render such a procedure compatible with the right to property, as guaranteed in Article 17 of the Charter of Fundamental Rights of the European Union[21]. In this respect, the ECB notes that the draft law and in particular the new Article 3:159u of the Law on financial supervision, provides for such safeguards. Given the importance of timely and effective crisis management, inclusion of an ex ante hearing of large shareholders is undesirable and the new Article 3:159t of the Law on financial supervision should be amended accordingly[22].

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18 See ECB Annual Report 2010, p. 120. See also the ECB's convergence report, May 2010, p. 25.

19 An introduction of partial ex ante funding arrangements for the deposit guarantee schemes is also considered crucial from a financial stability perspective, as already stated in Opinion CON/2011/12.

20 New Articles 3:159p to 3:159r of the Law on financial supervision.

21 See also the ESCB's contribution to the Commission's consultation document 'Technical details of a possible EU framework for bank recovery and resolution', p. 3, available at http://ec.europa.eu (hereinafter the 'ESCB's response to Commission's consultation').

22 New Article 3:159t of the Law on financial supervision provides for the possibility for shareholders, holding more than 10% of the shares, to be heard by the district court ex ante, before the court approves the transfer plan and pronounces that the transfer agreements may proceed. The shareholders may challenge DNB's assessment that the trigger conditions

## 6. Close-out netting and set off rights

6.1 The new Article 3:267f of the Law on financial supervision provides that measures taken in the context of a transfer are not considered trigger events for early termination, set off or netting rights. In this respect, as stated in recommendation 9 of the Report and Recommendations of the Basel Committee on Banking Supervision's Cross-border Bank Resolution Group (CBRG)[23], 'the ability of relevant [national] authorities to impose a brief delay on the exercise of early termination and netting rights would maximise the possibility of transfer to a sound company, a bridge bank or another public entity provided that: the period of time during which the authorities can delay immediate operation of contractual early termination rights pending a transfer is clearly defined and limited, after which full termination and close-out rights would be available for all financial contracts not transferred to a solvent transferee'.

6.2 The ECB notes that a solution aligned with the CBRG recommendations has been contemplated as part of the proposed Union framework on crisis resolution[24]. The response of the European System of Central Banks (ESCB) to the Commission's consultation, states that it 'supports the proposal to give the resolution authority the legal power to temporarily delay the exercise by any party of close-out netting rights under a netting agreement with the institution in difficulty to complete a transfer of certain financial markets contracts to another sound company, a bridge bank or other public entity'[25]. Until this recommendation is incorporated into Union law, due regard needs to be paid to ensuring compliance with resolution measures introduced into the national legislation of the Member States with the relevant elements of the existing Union legal framework, as specified below.

6.3 Against this background, the ECB notes that the rejection of counterparties' close-out netting or other rights following a 'measure'[26] should not jeopardise rights protected under financial collateral arrangements, as defined in Article 2(1)(a) of Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements[27] as well as further rules specified in 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[28] and Directive 1998/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems[29].

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justifying the intervention are met and the adequateness of the price for the shares. Furthermore, new Article 3:159u of the Law on financial supervision provides for the possibility for those shareholders the district court did not hear ex ante, to oppose the court decision approving the transfer plan ex post.

23 Report and recommendations of the Cross-border Bank Resolution Group, March 2010, available on the Bank for International Settlement's website at www.bis.org.

24 See the Commission's consultation on crisis resolution, p. 64.

25 See the ESCB's response to the Commission's consultation, p.12.

26 As defined in the new Article 3:267e of the Law on financial supervision.

27 OJ L 168, 27.6.2002, p. 43.

28 OJ L 125, 5.5.2001, p. 15.

29 OJ L 166, 11.6.1998, p. 45.

6.3.1 Article 7(1)(b) of Directive 2002/47/EC requires Member States to ensure that for a financial collateral arrangement, a close-out netting provision can take effect in accordance with its terms notwithstanding the commencement or continuation of winding-up proceedings, reorganisation measures or any other type of judicial proceeding, attachment, assignment or other disposition concerning such rights. Until draft amendments to Union law related to the preparation of a Union crisis management framework are adopted, the above rules should continue to be fully implemented in national legislation. As specified in the explanatory memorandum to the draft law[30], the ECB understands that the exclusion of 'financial collateral arrangements' from the operation of new Article 3:267f of the Law on financial supervision, as introduced in paragraph 4(b) of this Article, is intended to achieve this result.

6.3.2 Article 25 of Directive 2001/24/EC provides that netting agreements are governed by the law of the contract which governs such agreements. Following the new Article 3:267d of the Law on financial supervision this section 'applies to agreements … regardless of the law that governs the agreement'. The ECB notes that the master agreements on which close-out netting rights are based are often concluded by Dutch credit institutions under the laws of other jurisdictions such as England or New York. It is unclear under Union law whether the proposed stay could be enforced against a Dutch credit institution that has entered into a netting agreement governed by English, New York or other third country's laws. In view of these legal uncertainties, any statutory powers to impose a temporary stay on such contracts or a rejection of counterparties' close-out netting rights should be coordinated closely at Union level.

6.3.3 Article 9 of Directive 1998/26/EC protects rights to collateral security to which the central banks and participants in the systems are entitled within the scope of this Directive. As specified in the explanatory memorandum to the draft law[31], the ECB understands that the new Article 3:267f (4)(a) of the Law on financial supervision is intended to maintain this protection in that it will exclude from the operation of Article 3:267f 'a right to which a central bank or, in connection with participation in a system as referred to in Article 212a, part b, of the Bankruptcy Act, another institution that participates in the system is entitled pursuant to a legal relationship as referred in the first paragraph of [Article 3:267f]'.

## 7. Measures to ensure the stability of the financial system, including the right of expropriation

7.1 A new Part 6 of the Law on financial supervision establishes a special expropriation regime to ensure stability of the financial system, which specifies that the Dutch Expropriation Act will not be applicable[32]. The ECB notes that the new Article 6:1(1) of the Law on financial supervision gives the Minister for Finance the power to 'take immediate measures' without specifying which kind of measures are covered by this power. In this respect, the draft law should specify if those 'immediate

30 See comments on the new Article 3:267f of the Law on financial supervision.

31 See comments on Article 3:267f. of the Law on financial supervision.

32 See the new Article 6:2(7) of the Law on financial supervision.

measures' cover other measures besides expropriation and, if this is the case, it should clearly define the scope of these other measures.

7.2 The power of the Minister to expropriate assets of an institution in difficulty is laid down in the new Article 6:2 of the Law on financial supervision. The ECB highlights that expropriation is a severe measure with far-reaching effects on market participants. For this reason, expropriation by the State in relation to institutions in difficulty should remain a tool for use in clearly defined and exceptional circumstances. The new Article 6:2(1) specifies that the expropriation can take place if the Minister 'is of the opinion that the stability of that system is coming into serious and immediate risk by the situation of an institution domiciled in the Netherlands'. It should be made clear that such expropriation is a last resort measure and can only take place if there is no other less intrusive, equally effective measure available.

7.3 It is very important that indemnification for an expropriation provides for a transparent valuation of the assets, which adequately reflects market conditions. The new Articles 6:8 and 6:9 of the Law on financial supervision provide that the value will be determined by estimating the market price at the time of the expropriation, less the amount of any financial support. The ECB welcomes that the new Article 6:9(2) provides for a discount of any public financial support previously received by an institution. Moreover, the ECB understands that expropriation under the draft law will ultimately not amount to a bailout or state aid.

7.4 Any State's role taken with respect to an institution should be clearly limited in time[33]. It is therefore important to have an adequate exit strategy in place. The new Article 6:1(3) of the Law on financial supervision, which provides that the Minister 'will determine the period of those measures' and that he 'can extend this period by a separate decision', is not clear enough in order to limit the time of expropriation and to define a clear exit strategy. In this respect, the draft law should contain clearer and more detailed provisions.

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

Done at Frankfurt am Main, 20 July 2011.

[signed]

*The President of the ECB*

Jean-Claude TRICHET

33 See also paragraphs 3.2.1 and 3.2.6 of Opinion CON 2009/24 and paragraph 3.3 of Opinion CON/2009/6.