



EUROPEAN CENTRAL BANK
EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 19 September 2011

on amendments to the Greek resolution regime for credit institutions

(CON/2011/72)

Introduction and legal basis

On 5 September 2011, the European Central Bank (ECB) received a request from the Greek Ministry of Finance for an opinion on a draft law entitled ‘Enhanced supervisory and resolution measures for credit institutions, regulation of financial issues, ratification of the European Financial Stability Facility Framework Agreement and amendments thereto and other provisions’ (hereinafter the ‘draft law’). On 16 September 2011, the Ministry submitted another request in relation to a set of draft legislative provisions amending the legal framework governing the Hellenic Financial Stability Fund (HFSF) (hereinafter the ‘draft provisions on the HFSF’), which also form part of 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 ECB by national authorities regarding draft legislative provisions¹, as the draft law relates to the Bank of Greece (BoG) 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 ECB, the Governing Council has adopted this opinion.

1. Purpose and contents of the draft law

The purpose of the draft law is to enhance the framework for the supervision and control of credit institutions and to introduce resolution powers to protect financial stability and public confidence in the Greek financial system. For this purpose, the draft law will: (i) reinforce the BoG’s supervisory powers in addressing an actual or potential breach by credit institutions of the draft law following adoption and relevant BoG decisions; (ii) extend the role and powers of the Commissioner appointed to manage troubled credit institutions; (iii) empower the BoG to take specific resolution measures vis-à-vis credit institutions; and (iv) establish a resolution branch within the Hellenic Deposit and Investment Guarantee Fund (HDIGF) to finance the resolution measures in the draft law.

¹ OJ L 189, 3.7.1998, p. 42.

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- 1.1 *Prudential supervisory measures*: the BoG requires any credit institution actually or potentially failing to comply with the draft law and/or the BoG's relevant decisions to take the necessary actions or corrective measures at an early stage to address any possible defects or weaknesses.
- 1.2 *Appointment of a commissioner*: the BoG may appoint a commissioner to a credit institution for a renewable term of up to 12 months. The Commissioner will assess the credit institution's situation and take the necessary action for its recovery, preparing it for any of the resolution measures under the draft law or putting it into special liquidation. The Commissioner will be subject to the BoG's oversight and report to it.
- 1.3 *Extension of the time limit for the fulfilment of obligations*: following the appointment of a commissioner, the BoG may extend by up to 20 days the period for the fulfilment of part or all of the credit institution's obligations, if the credit institution's liquidity is significantly reduced and it is likely that its own funds are inadequate².
- 1.4 *Resolution measures and their activation*: the BoG may trigger certain resolution measures to ensure financial stability and strengthen public confidence in the Greek financial system. In particular, it may: (a) instruct the Commissioner to decide on a capital increase within a specified time limit, disapplying any pre-emptive rights of the existing shareholders; (b) oblige a credit institution to transfer certain assets and liabilities to a transitional credit institution (TCI) to another credit institution or entity, against consideration and within a specified time limit; (c) recommend that the Minister for Finance establish on grounds of public interest a TCI to which all or part of the assets and liabilities of the credit institution will be transferred. The credit institution's licence will be revoked and the credit institution will be placed under special liquidation. The intrinsic value of its shares will be set to negative. Any rights emanating from the shares will cease to apply. The HFSF will pay the TCI's share capital in full. The TCI will be subject to State control, regardless of the mandatory participation of other entities in its share capital or its funding in other ways.
- 1.5 *Special liquidation of credit institutions*: where a credit institution's licence is withdrawn, the BoG will appoint a special liquidator to manage the credit institution. Following the communication to the credit institution of the BoG's decision placing it under special liquidation, the credit institution may not accept deposits, and the BoG may also restrict other operations.
- 1.6 *Establishment of a resolution branch within the HDIGF to finance the resolution measures*: the draft law amends Law No 3746/2000³ (hereinafter the 'Law on the HDIGF'), extending its scope to the provision of financial assistance to credit institutions for the purposes of resolution measures. In addition to the existing Depositors' Coverage Branch and the Investors' Coverage Branch, a new

² Such extension will not apply to the fulfilment of the credit institution's obligations under proposed Article 63A(2), such as transactions in financial instruments carried out on the money or capital markets.

³ FEK Vol A 27/16.2.2009.

separate resolution branch⁴ will be created within the HDGIF and financed by contributions paid by credit institutions.

- 1.7 The draft provisions on the HFSF empower the HFSF to provide capital support to a TCI established under proposed Article 63E in the draft law. They also specify and extend the competence and procedure for the HFSF to recruit its staff independently, including salaried lawyers. Further, they amend the provisions activating the HFSF by stating that capital support may only be provided to a credit institution, including any TCI, if: (a) there is well founded risk of it not being able to continue to meet minimum capital requirements under Article 27 of Law No 3601/2007⁵ (hereinafter the ‘Law on banking’), and (b) the institution’s efforts to increase its capital, even at a price significantly below the average market price, have failed. The draft provisions on the HFSF also specify that TCIs which have been recapitalised by the HFSF have to submit a business plan guaranteeing that they are viable, and that the HFSF must approve the business plan. Other important provisions state that the HFSF receives common shares in consideration for any capital increase in the credit institution that it funds, and that the HFSF appoints at least one member of the board of the credit institution.

2. General observations

- 2.1 The draft law is a structural benchmark under the EU/IMF support programme for Greece⁶. It is intended to enhance the authorities’ powers of intervention in and resolution of ailing credit institutions. The introduction of amendments to the legal framework governing the HFSF, *inter alia*, to strengthen its role in bank resolution, is another of the structural benchmarks.
- 2.2 The ECB also notes that one of the guiding principles for implementation of the resolution framework should be to resolve ailing institutions without severe systemic disruption and to avoid taxpayer exposure to loss.
- 2.3 The ECB welcomes the provisions specifying the conditions and objectives to be met before the BoG activates any of the resolution measures and the BoG’s enhanced role as the resolution authority for credit institutions. The ECB also understands that, under the draft law, the BoG will have exclusive responsibility for supervision and resolution and that, when taking any of the resolution measures under the draft law, the Commissioner will act as the BoG’s agent.

⁴ ‘Branch’ means a separate operational unit within the HDGIF availing of a segregated account for the purposes of resolution financing as specified in proposed Article 13A of the Law on the HDGIF.

⁵ FEK Vol A 178/1.8.2007.

⁶ See the Economic Adjustment Programme for Greece – Fourth Review available at: http://ec.europa.eu/economy_finance/publications/occasional_paper/2011/op82_en.htm. In particular, paragraph 12 of the Memorandum of Financial and Economic Policies in the Annex iterates the need, in the context of ongoing initiatives at the EU level, to strengthen the resolution framework for problem banks and to allow timely and effective intervention and resolution consistent with EU Treaty rules and international sound practices. In this context, a broad set of tools is to be prepared to ensure that a resolution regime for financial institutions is put into place to safeguard financial stability and ensure effective depositor protection.

2.4 The ECB considers that the draft provisions on the HFSF are broadly consistent with and reinforce the effectiveness of the resolution measures under the draft law. However, there are several areas where specific further amendments will be required.

3. Recovery and resolution plans

The draft law rightly acknowledges the importance of the preparation of recovery and resolution plans as a preventive supervisory measure. The ECB underlines that the preparation, submission and approval of recovery plans should be an ordinary supervisory measure to be complied with by all credit institutions irrespective of a crisis⁷. The draft law should expressly distinguish recovery from the resolution plans. Each institution will draw up and maintain recovery plans, whereas the supervisory authority will draw up resolution plans on the basis of information provided by the credit institution⁸.

4. Commissioner

The BoG will appoint a commissioner from among persons of recognised standing and professional experience in banking matters to perform certain statutory duties on a full-time basis, subject to confidentiality requirements⁹. To avoid conflicts of interest, the ECB considers it essential for the Commissioner to also be independent from the credit institution to which it is appointed. The ECB also notes that the Commissioner is deemed to act as a ‘quasi-corporate’ body when participating in or exercising management of the credit institution, and as a public official when exercising BoG supervisory activities¹⁰. For the sake of legal certainty, the ECB considers that the draft law should ensure there is no ambiguity in the Commissioner’s status, role and powers under Greek law, and, in this regard, the consulting authority should consider deleting the reference to the dual role of the Commissioner.

5. Recapitalisation in resolution

5.1 Proposed Article 63C in the draft law should be based on the principle that the credit institution’s shareholders and not the taxpayer bear the costs of resolution. The ECB notes that this principle should apply to all resolution measures. On the draft law’s exclusion of the pre-emption rights of existing shareholders in any new share issue by the credit institution in resolution, the ECB notes that proposed Article 63G in the draft law caters for the compensation of shareholders in institutions affected by resolution measures.

⁷ See proposed Article 62(2)(i) in the draft law.

⁸ See also DG Internal Market and Services Working document on ‘Technical details of a possible EU framework for bank recovery and resolution’, January 2011, available on the European Commission’s website at www.ec.europa.eu.

⁹ See proposed Article 63(4) in the draft law.

¹⁰ See proposed Article 63(15) in the draft law.

5.2 In the same vein, to prevent banks' moral hazard and minimise the public sector's burden from a bank resolution, the ECB invites the consulting authority to consider the interaction between proposed Article 63C of the Law on banking and the draft provisions on the HFSF. In particular, the ECB recommends only allowing the possibility for an ailing credit institution to apply to the HFSF by decision of the BoG. Therefore, the application of the last paragraph of Article 7 of the draft law on the HFSF should expressly be excluded.

6. Transitional credit institution

- 6.1 The ECB welcomes the proposal to establish a TCI as a resolution tool¹¹, with the aim of preserving the continuity of financial services, ensuring financial stability and protecting depositors. The ECB understands that the 'assets' to be transferred to the TCI also extend to liabilities including deposits, which represent an important part of the systemic function of credit institutions. Moreover, the ECB understands that the reference to the TCI being controlled by the Greek State is to be construed as an indication that the TCI is State-owned. The ECB underlines that the proposed Article 63E(3), according to which the share capital of the TCI is entirely to be provided by the HFSF, and in Article 1 of Law No 3864/2010¹² (hereinafter the 'Law on the HFSF'), providing that the HFSF is a private legal entity not forming part of the public sector, may not fulfil the requirement that the TCIs should be State-owned. The ECB takes the view that the HFSF should finance the capital injection into the TCI, while the shares corresponding to this capital increase should only be subscribed by the State. This is notably because the voting and other rights attaching to these shares should belong to the Greek State and be exercised in the public interest, and not belong to the HFSF, being a private law entity.
- 6.2 Accordingly, the ECB considers that the proposed Article 63E(3) should specify that the State should exercise control over the TCI as the TCI's sole shareholder. The ECB also understands that the HFSF's contribution of the entire capital to the TCI should be exclusively based on the Minister's decision, following a recommendation by the BoG.
- 6.3 In the light of the above, the ECB also notes that the TCI's governance should be clarified. The members of the Board of Directors of the TCI appointed by the Minister for Finance must convene within 20 days a general shareholders meeting to elect of the new Board of Directors¹³. Given that the HFSF contributes the whole share capital of the TCI¹⁴, the ECB understands that the TCI's new Board of Directors will be appointed by and represent the HFSF, i.e. a private law entity legally independent from the public sector. This would contrast with the requirement for the TCI to be State-owned.

11 See proposed Article 63E in the draft law.

12 FEK Vol A 119/21.7.2010.

13 See proposed Article 63E(5) in the draft law.

14 See proposed Article 63E(4) in the draft law.

6.4 Along the same lines, to ensure the resolution's efficiency, the ECB notes that the draft law needs to clarify the BoG's relationship as the resolution authority, and/or the Minister, with the HFSF as regards the TCI.

7. Resolution branch

7.1 The ECB welcomes the establishment of a separate resolution branch of the HDGIF to fund resolution measures, in particular the transfer of assets and liabilities to a third party or to the TCI. The ECB welcomes the segregation of the Resolution Branch from the Deposit Coverage Fund and the Investor Coverage Fund managed by the HDGIF. The ECB notes, however, that to fully satisfy the segregation requirement, the provision should also expressly prohibit cross-compensation among each of the funds managed by the HDGIF.

7.2 The ECB welcomes the banking sector's responsibility for funding the HDGIF's Resolution Branch through special levies, distinct from the contributions to the Deposit Coverage Fund¹⁵. To finance this Resolution Branch, the ECB suggests that the choice of liabilities, net of equity (not to discourage the accumulation of internal buffers against unforeseen idiosyncratic shocks) and other insured sources of funding, such as insured deposits to avoid double imposition of levies in the presence of the deposit coverage part of the HDGIF, appears to be an appropriate basis. The ECB notes, however, that during the early stages of the Resolution Branch, its funds will consist of public financing by the Greek State, the HFSF or other entities of private or public law guaranteed by the State¹⁶.

7.3 In the same context, the ECB notes that where the Resolution Branch is activated for the purposes of the resolution measures¹⁷, its claims will be satisfied in absolute priority over any other claims in the event of special liquidation of an ailing credit institution¹⁸. The ECB understands that the priority right statutorily established in favour of the Resolution Branch would only be warranted during the early stages of its existence, when its funding is to still be provided by the State or a State-controlled entity. Once the Resolution Branch has built up its own funds through contributions by the participating credit institutions, no such priority right would be warranted.

7.4 Finally, a provision on the recovery by the Resolution Branch of any funds it has granted for resolution purposes could be added to the draft law.

7.5 The draft law could also clarify the authority to determine any funding gaps on transferring the assets and liabilities of the credit institution. Consistently with the rationale of the draft law, such authority should be vested in the BoG as the resolution authority. The BoG will take into account,

¹⁵ See proposed Article 13A in the draft law.

¹⁶ See proposed Article 13A(3) in the draft law.

¹⁷ See proposed Article 63(D) and (E) in the draft law.

¹⁸ See proposed Article 13A(3) and (4) in the draft law.

but should not be bound by, the auditors' reports provided for in the draft law as part of the statutory valuation process¹⁹.

8. Compensation

Proposed Article 63G lays down a 'no worse-off' principle for the compensation of stakeholders in institutions affected by resolution measures. The draft law should additionally clarify that compensation will be based on an independent valuation, which may result in no compensation being payable, and that any potential or actual financial assistance from the State or support from the central bank should be disregarded when assessing the credit institution's financial situation. It should also clarify that compensation claims are to be directed against the Hellenic Republic, rather than the BoG or the TCI.

9. Other observations on bank resolution

- 9.1 The ECB notes that the protection of creditors and investors²⁰ should not qualify as an objective for activating the resolution measures. Moreover, the ECB invites the consulting authority to clarify the interaction between paragraph 2 of proposed Article 63B, setting out the grounds for activating resolution measures, and paragraph 3, setting out the considerations that the BoG is to take into account for the same purpose.
- 9.2 The ECB draws the consulting authority's attention to a possible inconsistency between the draft law and the Greek transposition of Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions²¹ as regards the qualification of the appointment of the Commissioner as a reorganisation measure.
- 9.3 Proposed Article 62(2)(g) provides that the BoG may authorise 'certain transactions that may jeopardise the solvency of credit institutions'. The ECB understands that the power in question is to be exercised within the bounds of reason and subject to time restrictions.

10. Observations on the draft provisions on the HFSF

- 10.1 In order to prevent potentially high losses for the HFSF as a result of its participation in the provision of capital support for recapitalised credit institutions, the draft provisions should make it clear that the price at which the HFSF recapitalises credit institutions will be substantially below the market price, and specify further how the issue price of the new shares is to be determined. The ECB also notes that the title of Article 7 of the Law on the HFSF should also be reworded to match its contents, referring to 'common' shares instead of 'preference' shares. Furthermore, the law should specify clearly how the share price will be determined.

¹⁹ See proposed Article 63D(4) in the draft law.

²⁰ See proposed Article 63B in the draft law.

²¹ OJ L 125, 5.5.2001, p. 125.

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- 10.2 In order to provide legal certainty, a sentence should be added to Article 3(4) of the Law on the HFSF, clarifying that the general prohibition on ‘other investments’ does not include the opening of an interest-bearing account with a private credit institution to settle the HFSF’s day-to-day operating costs. Such activities comprise in particular paying out salaries, purchasing office supplies and other operating costs. The money held in this account should be limited to the amount necessary to meet such operating costs and should be earmarked for this purpose.
- 10.3 With regard to the proposed Article 7(3) in the draft provisions on the HFSF, which relates to the determination of the fair value, the ECB recommends that the average value of the two assessments, by the two independent auditing firms, should diverge by more than 10%, and not by 25%, in order for the value to be finally defined by a third independent auditing firm appointed by decision of the Minister for Finance, following the recommendation of the BoG. The proposal to introduce a trigger of 25% divergence is not supported by any factual evidence.
- 10.4 In the proposed Article 7(3)(i) in the draft provisions on the HFSF the ECB recommends that actual or potential support by the Greek State is ‘subtracted’ when calculating the fair value. Furthermore, the calculation in this respect shall ‘in addition’ take into account as a ceiling ‘before the above subtractions’, the average price of the credit institution’s shares. The same criteria and subtractions should be followed by the independent auditing firms for the fair-value assessment. Furthermore, the words ‘outside Eurosystem operations’ should be replaced by the words ‘or by any Eurosystem operations’.
- 10.5 In the light of the extension of the scope of the HFSF’s activities, the ECB invites the consulting authority to consider enhancing the governance structure and effectiveness of the Fund by, *inter alia*, increasing the number of members of the board of directors.

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

Done at Frankfurt am Main, 19 September 2011.

[signed]

The President of the ECB
Jean-Claude TRICHET