



OPINION OF THE EUROPEAN CENTRAL BANK

of 19 October 2011

on early intervention measures and on amendments to the resolution and winding-up regime for credit and financial institutions subject to supervision by the Banco de Portugal

(CON/2011/83)

Introduction and legal basis

On 4 October 2011, the European Central Bank (ECB) received a request from the Portuguese Ministry of Finance for an opinion on a draft Government decree-law (hereinafter the ‘draft decree-law’) amending (i) the Legal Framework for Credit and Financial Institutions¹, (ii) Decree-Law No 345/98 of 9 November regulating the Mutual Agricultural Credit Guarantee Fund, (iii) Decree-Law No 199/2006 of 25 October on the winding up of credit and financial institutions, and (iv) the Organic Law of the Banco de Portugal.

The Portuguese Constitution requires prior Parliamentary approval of the scope and terms of such delegated legislation by means of an enabling law on which the ECB is not being consulted.

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 on 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 provisions², as the draft decree-law relates to the Banco de Portugal and 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 and contents of the draft decree-law

The purpose of the draft decree-law is to amend several laws to, *inter alia*: (i) reinforce the supervisory powers of the Banco de Portugal by empowering it to act in case of financial distress of an institution under its supervision, namely through a set of reinforced and expanded preventive and early intervention measures and also through specific resolution measures; (ii) establish a resolution fund to finance the application of the resolution measures provided for in the draft decree-law; (iii) adapt the rules applicable to the deposit guarantee schemes (DGSs); and (iv) amend the winding-up regime for supervised credit and financial institutions to cover reorganisation aspects.

¹ Approved by Decree-Law No 298/92 of 31 December.

² OJ L 189, 3.7.1998, p. 42.

1.1 *Preventative and early intervention measures*

The supervisory powers of the Banco de Portugal are reinforced through an amendment to its Organic Law and several amendments and additions to the Legal Framework for Credit and Financial Institutions regarding bank reorganisation and resolution.

The proposed early intervention measures are intended to prevent the aggravation of developing signs of financial distress and must be implemented as soon as a credit institution fails to meet, or is at risk of not meeting, any of the legal or regulatory requirements governing its activity.

In particular, the draft decree-law empowers the Banco de Portugal to require all authorised institutions to draw up and submit for its approval contingency plans for recovery and resolution scenarios, under the conditions and within the deadlines specified by the Banco de Portugal. Such plans should aim at restoring in a timely manner the financial situation of a credit institution showing signs of distress (recovery) and, if necessary, at ensuring the orderly winding-up of the credit institution before entering into liquidation (resolution).

At the early intervention stage, the Banco de Portugal may adopt the following measures with regard to an institution: (i) to appoint, early on, own representatives and/or interim members of the management board, whose performance will be subject to its guidelines; (ii) to appoint new auditors; (iii) to impose restrictions on the granting of credit and the investment of funds by the credit institution, especially in the context of intra-group or offshore transactions; (iv) to impose additional reporting requirements; (v) to require the submission of a debt restructuring plan to be negotiated with the creditors; (vi) to require an independent general or partial audit of the business of the authorised institution, at the latter's expense; and/or (vii) to call a general meeting of the shareholders of the authorised institution and to submit proposals to it.

1.2 *Resolution measures*

Currently only the judicial liquidation of already insolvent credit institutions is regulated in Portugal. The Legal Framework for Credit and Financial Institutions is now being amended to introduce resolution mechanisms for the orderly winding-down of a credit institution in serious financial distress as a going concern under official control, to promote financial stability, prevent systemic risk and protect public funds and depositors. Therefore, the draft decree-law provides that whenever remedial actions do not achieve the financial recovery of the credit institution, or if a credit institution does not comply with an approved recovery plan and fails to meet, or is at risk of not meeting, its licensing requirements, the Banco de Portugal may: (i) withdraw the banking license, which will automatically lead to judicial liquidation; or (ii) appoint a new interim administration whose members will have additional powers and duties, without prejudice to its right to order the transfer of the business (total or partial sale of assets and liabilities, off-balance sheet commitments and assets under management) to other duly authorised credit institutions or to one or more bridge banks (fully held by the Resolution Fund and authorised by the Banco de Portugal) independently of, or in addition to, imposing any other corrective measure.

1.3 *Establishment of a resolution fund within the Banco de Portugal to finance the resolution measures*

The draft decree-law establishes a resolution fund as an independent public institution with its head office at the premises of the Banco de Portugal, to provide financial assistance for the application of the resolution measures adopted by the Banco de Portugal. The draft decree-law regulates the composition, administration and funding regime of the Resolution Fund, specifying that financial resources may not be granted by the Banco de Portugal.

1.4 *Further amendments to the Legal Framework for Credit and Financial Institutions:*

The draft decree-law sets out early reporting obligations, and penalties for failure to contribute to the Deposit Guarantee Fund or to the Resolution Fund and for non-compliance with reporting requirements, corrective action or resolution measures imposed by the Banco de Portugal.

1.5 *Deposit Guarantee Funds*

The roles of the DGSs (Deposit Guarantee Fund and Guarantee Fund for Mutual Agricultural Credit Institutions) are enhanced, the protection of guaranteed depositors is strengthened, and the rules applicable to both schemes are harmonised. On request by the Banco de Portugal and under certain conditions, the funds may be involved in the resolution of distressed credit institutions, in particular by cooperating with the Resolution Fund in the sale of insured deposits or in the transfer of insured deposits to a bridge bank. Guaranteed depositors and/or the funds (directly or through subrogation) are granted priority ranking over unsecured creditors in the credit institution's insolvent estate.

1.6 *Amendment to the Organic Law of the Banco de Portugal*

Article 17 of the Organic Law of the Banco de Portugal is amended to reinforce its supervisory powers by authorising it to apply preventive, corrective and resolution measures.

2. General observations

2.1 The draft decree-law is a structural benchmark under the EU/IMF support programme to Portugal, in particular with regard to strengthening the framework for early intervention, resolution and deposit insurance³.

2.2 The ECB welcomes the introduction of a comprehensive bank resolution framework, aiming at safeguarding the financial soundness of credit institutions, the interest of guaranteed depositors and the stability of the financial system. This Opinion proposes technical improvements to the overall good quality of the draft decree law.

2.3 The ECB understands that the enactment of a legal framework on bank recovery and resolution is somewhat complicated due to the absence of a stable legislative proposal at Union level, and invites the consulting authority to review the content of the law in light of the future Union regulatory framework on bank recovery and resolution, in particular with regard to resolution tools

³ See the Economic Adjustment Programme for Portugal – First review, available at http://ec.europa.eu/economy_finance/publications/occasional_paper/2011/pdf/ocp83_en.pdf, and in particular paragraph 22 of the Memorandum of Economic and Financial Policies.

and powers of resolution authorities, and of the forthcoming recast Directive on deposit guarantee schemes.

- 2.4 The ECB also notes that while the Legal Framework for Credit and Financial Institutions applies to credit and financial institutions, the extent to which each measure of the draft decree-law would apply to both types of supervised entities depends on the concrete provision relating to the measure concerned.
- 2.5 While the ECB takes note of the Portuguese authorities' wish to address the legal matters related to bank recapitalisation by a separate law, it notes with some concern that Law No 63-A/2008 of 24 November establishing the legal framework for mandatory recapitalisation of credit institutions is in force only until 31 December 2011. The ECB expects the Portuguese authorities to take urgent steps to adopt the new legal framework before the end of the year, after having consulted the ECB. This would, *inter alia*, facilitate Portugal's recourse to the Bank Solvency Support Facility in line with the Memorandum of Economic and Financial Policies.
- 2.6 The ECB notes that, for legality and consistency reasons, the contents of the enabling law, on which it is not being consulted, may need to be amended in the light of this opinion.

3. Preventative and early intervention (corrective action) measures

The draft decree-law requires deposit-taking credit institutions to prepare and submit recovery and resolution plans to the Banco de Portugal. However, as regards the resolution plans, the ECB understands that such plans will be thoroughly reviewed by the Banco de Portugal, as the resolution authority, based on the information provided and regularly updated by the credit institution⁴.

4. Resolution measures

- 4.1 According to proposed Article 145-D(1), the application of a resolution measure by the Banco de Portugal automatically leads to the suspension of the members of the management and supervisory boards, and possibly also the auditors, of the credit institution. The Banco de Portugal is invited to consider whether in certain cases the retention of key members of the management may at least temporarily be helpful to the resolution process and to ensuring continuity of banking services.
- 4.2 The ECB welcomes that pursuant to proposed Article 153-C, resolution measures are financed by the Resolution Fund. Along these lines, the ECB understands that the reference in proposed Article 145-F(7) to the fact that the Banco de Portugal 'may invite' the Deposit Guarantee Fund or the Guarantee Fund for Mutual Agricultural Credit Institutions, as the case may be, to cooperate in the sale of insured deposits, is to be interpreted as conferring a limited role for the Deposit Guarantee Fund. In particular, it is understood that this possibility can be activated only (i) on the basis of a thorough evaluation by the Banco de Portugal, (ii) following an autonomous decision by the relevant fund's management committee, (iii) taking into account the limits on the amount of

⁴ European Commission's public consultation on the technical details of a possible EU framework for bank recovery and resolution - ESCB Contribution, May 2011.

permissible financing by the Deposit Guarantee Fund set forth in proposed Article 167-A, and (iv) provided that the participation of the Deposit Guarantee Fund in the financing of resolution measures does not jeopardise its original mission.

- 4.3 The ECB draws the attention of the consulting authority to the possibility of improving the wording of proposed Article 145-G, by expressly providing that, as regards the disposal of the shares of the bridge bank which are fully owned by the Resolution Fund, the Resolution Fund should abide by the instructions of the Banco de Portugal.
- 4.4 Concerning the sale of the portfolio of the bridge bank, the ECB notes that pursuant to proposed Article 145-I(6), if it is not possible to sell the business transferred to the bridge bank, the Banco de Portugal may decide to put the bridge bank into voluntary winding up. If the Banco de Portugal - as the resolution authority - considers that there are serious public interest grounds, such as financial stability, for the bridge bank to continue in existence, it should not be obliged to liquidate the bridge bank.

5. Broad temporary waiver

Among the other measures which the Banco de Portugal may take under proposed Article 145-J, support resolution measures, is ‘temporary waiving of compliance with prudential rules’. The ECB considers that such a broad temporary waiver is inappropriate and is not mandated by either Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions⁵ or the Commission’s proposed legislative package to strengthen regulation in the banking sector⁶. Although the measures in proposed Article 145-J are not in themselves resolution measures, they are strictly linked with the adoption of resolution measures, subject to the restrictive conditions laid down in Article 145-A and Article 145-C(1) and (2), and therefore must satisfy the objectives and pre-conditions for resolution measures, such as public interest. Thus, when applying any waiver of compliance with prudential rules, the Banco de Portugal is under a legal obligation to comply with mandatory Union law requirements. Furthermore, the draft decree law should clarify that any temporary waiver of compliance with prudential rules must be limited not only in time, but also in scope. That is, such waiver must clearly indicate which specific prudential rules are being waived and to what extent.

6. Deposit Guarantee Fund and Resolution Fund

- 6.1 The ECB acknowledges that proposed Article 166-A of the draft decree law provides for preferential ranking of claims in respect of deposits covered by the Deposit Guarantee Fund. Such

⁵ OJ L 177, 30.6.2006.

⁶ Proposal for a regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms, COM(2011) 452 final and proposal for a directive of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate, COM(2011) 453 final.

claims will rank above other preferential rights, but below those related to judicial costs, claims of the financial institution's employees arising from employment contracts and the tax claims of the State, local authorities and social security entities. This provision is in line with the requirements set out in the economic adjustment programme for Portugal. Proposed Article 166-A furthermore provides for preferential ranking of claims of the Deposit Guarantee Fund and of the Resolution Fund arising from the financial support provided for application of resolution measures.

- 6.2 Directive 94/19/EC of the European Parliament and of the Council of 13 May 1994 on deposit-guarantee schemes⁷ does not provide for any harmonisation of matters related to ranking of depositor claims and/or DGSs. The only harmonisation in this context is contained in Article 11 of Directive 94/19/EC – schemes which make payments under guarantee have the right of subrogation to the rights of depositors in liquidation proceedings for an amount equal to their payment. The latest available proposal for a recast directive on deposit guarantee schemes⁸ does not provide for any further harmonisation regarding the ranking of claims. The proposed recast Directive, however, considerably strengthens and harmonises the funding requirements applicable to DGSs: (i) DGS members will be required to pay extraordinary contributions up to 0,5% of eligible deposits; (ii) a mutual borrowing scheme between DGSs may be activated, provided such arrangements are established on a voluntary basis and that the borrowed funds are only used for payment of depositors claims⁹; and (iii) Member States will ensure that DGS have in place adequate alternative funding arrangements to enable them to obtain short-term funding where necessary to meet claims against those DGSs. The above provisions, once transposed by the Member States, will significantly improve the ability of the DGS to always meet their obligations vis-à-vis the guaranteed depositors. Such *ex ante* funding arrangements for DGSs strengthen their capacity to ensure that depositor claims are adequately covered. From this perspective, the introduction of depositor preferences may be seen as aligned with the objectives of the recast Directive.
- 6.3 Currently, four Member States – Bulgaria¹⁰, Latvia¹¹, Romania¹² and recently also Greece¹³ – have granted priority ranking to claims that the DGS has acquired by subrogation after having paid out the amounts corresponding to covered deposits, thus further contributing to ensuring that sufficient funding is always available to the DGS.
- 6.4 Views on the impact of granting preferential ranking are highly divergent, as it is believed that preferential ranking of depositors may have an impact on the funding costs available to banks and that greater efforts will be made by other creditors to secure their claims. On the other hand, this would be somewhat mitigated to the extent that priority claims extend to guaranteed deposits only.

⁷ OJ L 135, 31.5.1994, p. 5.

⁸ COM(2010) 369 final; SEC(2010)834; SEC(2010)835 final available at http://ec.europa.eu/internal_market/bank/docs/guarantee/20100712_proposal_en.pdf.

⁹ CON/2011/12, paragraph. 9.2.

¹⁰ See Article 94 of the Law on bank bankruptcy.

¹¹ See Article 192 of the Law on credit institutions.

¹² See Article 38 of Government Ordinance No 10/2004 on the proceedings of judicial reorganisation and bankruptcy of credit institutions.

¹³ See Article 4(16) of Law No 3746/2009.

Furthermore, a legal regime that establishes priority ranking of guaranteed depositors should facilitate the use of resolution measures provided for in proposed Article 145-C of the Legal Framework for Credit and Financial Institutions (total or partial sale of business to another authorised credit institution or to a bridge bank). From a financial stability perspective, the priority claim in respect of the covered deposits is also supported as it reduces the risks of bank runs, potential losses of the insured depositors in a liquidation phase as well as the excessive depletion of the DGS.

7. Protection for whistleblowers

According to proposed Article 116-F, there is a duty to communicate information to the Banco de Portugal about the financial distress of an institution or the risk thereof and about other situations and any serious irregularities within the management of the credit institution. According to the draft decree-law, the persons to whom this duty applies are protected from disciplinary sanctions by the credit institutions, but this protection may not be sufficient. To facilitate the communication of necessary information and the reporting of breaches, it would be necessary to provide appropriate protection for all persons within the credit institution who denounce breaches committed within the institution¹⁴. For example, the conditions under which this communication will not give rise to any sanctions or liability could be clarified. Furthermore, the extent to which it is appropriate to impose sanctions on persons who do not have any high level managerial responsibilities, where there is failure to report promptly to the Banco de Portugal, should be examined.

8. Independence of the Banco de Portugal

- 8.1 The draft decree-law specifies in proposed Article 92 that powers conferred to the Banco de Portugal by the draft decree-law will not affect its independence in the performance of functions as a central bank and as a member of the European System of Central Banks (ESCB). Although the proposed Article 92 does not expressly refer to the Treaty principle of central bank independence, or provide that it prevails over any incompatible decree-law provision, the ECB understands that Article 92 confirms the obligations arising under the Treaties, including the protection of central bank independence.
- 8.2 Further, and more specifically, the requirement in proposed Article 153-P that the Banco de Portugal provides technical and administrative services for the regular operation of the Resolution Fund should not affect the Banco de Portugal's ability to carry out its ESCB-related tasks from an operational and financial point of view. The involvement of the Banco de Portugal in the operation of the Resolution Fund must be compatible with the institutional and financial independence of the

¹⁴ See Article 70(2)(b) of the Commission's proposal for a directive of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate COM(2011) 453 final, which mandates appropriate protection for employees of institutions who denounce breaches committed within the institution.

ECB-PUBLIC

Banco de Portugal, and to this end it is recommended that the Banco de Portugal be ensured adequate financial and human resources. The ECB has consistently underscored that an NCB must have sufficient means not only to perform its ESCB-related tasks, but also its national tasks¹⁵. Additional tasks under national law need to be accompanied by the allocation of adequate human and financial resources allowing for such tasks to be carried out in a manner which will not affect the Banco de Portugal's operational and financial capacity to carry out its ESCB-related tasks¹⁶. The ECB understands that Article 153-P will be implemented with due respect of the Banco de Portugal's financial and institutional independence.

- 8.3 Proposed Article 153-E provides that the members of the management committee of the Resolution Fund will remain in office for a renewable term of three years. One member of the Board of Directors of the Banco de Portugal is a member of the management committee. Moreover, the term of office as a member of the Board of Directors of the Banco de Portugal is five years, renewable once. The ECB notes that because of the inconsistency in the terms of office, in practice the same member of the Board of Directors of the Banco de Portugal could not, generally, have a renewed term of office of three years as a member of the management committee of the Resolution Fund. The draft-decree law should be clarified as regards the application of Article 153-E to the members of the Board of Directors of the Banco de Portugal.

9. Prohibition on monetary financing

- 9.1 It is important to safeguard compliance with the monetary financing prohibition under Article 123 of the Treaty. This prohibition 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 only compatible forms of central bank financing of DGSs are: (a) intraday credit in line with the general rules on provision of such credit by the central bank, and (b) short-term emergency liquidity financing under strict conditions established in the ECB's Convergence Reports, i.e. if such funding is short term, addresses urgent situations, systemic stability aspects are at stake and decisions are at the NCB's discretion¹⁷. These conditions need to be listed in national law¹⁸ in the cases where emergency liquidity financing of the DGS is foreseen by the national legal system.
- 9.2 Proposed Article 162(8) of the Legal Framework for Credit and Financial Institutions approved by Decree-Law No 298/92 of 31 December) and Article 10(7) of the draft decree-law (amending Decree-Law No 345/98 of 9 November) list conditions for loans from the Banco de Portugal to the Fund. It is understood that these conditions are intended to ensure compliance with the monetary financing prohibition. In this respect, the condition that loans are granted at the full discretion of the

¹⁵ See the ECB's Convergence Report, May 2010, p. 21. All ECB documents are available on the ECB's website at www.ecb.europa.eu.

¹⁶ See for instance paragraph 3.3 of ECB Opinion CON/2011/76.

¹⁷ See ECB's Convergence Report, May 2010, p. 25.

¹⁸ See paragraphs 2.2 to 2.8 of ECB Opinion CON/2008/5.

ECB-PUBLIC

Banco de Portugal would need to be included in the draft decree-law. When exercising its discretion to grant a loan, the Banco de Portugal has to ensure that by doing so it is *de facto* not taking over a State task.

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

Done at Frankfurt am Main, 19 October 2011.

[signed]

The President of the ECB

Jean-Claude TRICHET