EUROPEAN CENTRAL BANK

EUROSYSTEM

# OPINION OF THE EUROPEAN CENTRAL BANK

## of 9 November 2011

## on a loss guarantee in connection with an extended compensation scheme

## (CON/2011/90)

**Introduction and legal basis**

On 12 October 2011, the European Central Bank (ECB) received a request from the Danish Ministry of Business Affairs and Growth for an opinion on a law amending the Law on the Guarantee Fund for depositors and investors and the Law on tax assessment (the issuance of a loss guarantee in connection with the use of an extended compensation scheme)[1] (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[2], 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 relates to the guarantee provided by the Winding-Up Department of the Danish Guarantee Fund for Depositors and Investors[3], which is a deposit-guarantee scheme (DGS) funded by the contributions by member banking institutions (hereinafter the 'Winding-Up Department of the Danish DGS'). This guarantee is given to the Financial Stability Company, a State-owned bridge bank, and covers potential losses resulting from resolution procedures for banking institutions[4]. The draft law will widen the scope of this guarantee by allowing the Winding-Up Department of the Danish DGS to issue a guarantee against losses incurred by the Financial

1 The Law on the Guarantee Fund for depositors and investors, see Consolidated Law No 133 of 22 February 2011and the Law on tax assessment, see Consolidated Law No 1365 of 29 November 2010.

2 OJ L 189, 3.7.1998, p. 42.

3 The Winding-Up Department was set up by Section 3 of Law No 712 of 25 June 2010 amending the Guarantee Fund for Depositors and Investors of 1 October 2010, and is financially and organisationally separate from the ordinary guarantee obligations of the Danish DGS. The capital of the Winding-Up Department is provided entirely through mandatory contributions from the banking sector. See paragraph 1.5 of the ECB Opinion CON/2010/45. All ECB Opinions are available on the ECB's website at www.ecb.europa.eu.

4 See Section 2(a) of the Law on the Guarantee Fund for depositors and investors.

Stability Company A/S where it provides capital and liquidity support to its subsidiary taking over the non-performing assets of a failing banking institution in the form of 'bad bank' arrangement.

1.2 The winding-up process will be conducted in accordance with the extended compensation scheme, Model II, which was part of the political agreement (the so-called 'Bank Package IV') concluded in August 2011 and introduced by the Financial Committee of the Danish Parliament in September 2011[5]. The resolution instruments introduced on this occasion address the risk that small and medium-sized banking institutions might encounter liquidity or solvency problems once their current individual guarantees provided by the State expire in 2012 and 2013. More specifically, Model II of the extended compensation scheme establishes a regime under which the Financial Stability Company A/S, via the subsidiary company, may wind up the unsound part of a distressed banking institution[6]. Under the draft law, Model II is conditional on the Winding-Up Department of the Danish DGS issuing a guarantee to the Financial Stability Company A/S, which will cover any losses incurred after the final winding up of the distressed banking institution. This guarantee ensures that the financial sector, via the Winding-Up Department of the Danish DGS, bears any loss stemming from the winding-up process and that no further burden is placed on the State by the expected losses related to individual State guarantees provided earlier to banking institutions.

1.3 The draft law also amends the Law on tax assessment to ensure that the tax exemption under the current compensation scheme also comprises compensation disbursed to the subsidiary company of the Financial Stability Company A/S in connection with the winding-up of the unsound part of the distressed banking institution.

## 2. General observations

2.1 The ECB welcomes the introduction of a widened loss guarantee scheme in connection with the extended compensation scheme, Model II, as this initiative will improve the possibilities for handling banking institutions in distress and avoid any depositors or other non-subordinated creditors incurring losses in connection with the resolution process. The ECB supports the arrangement under which the Winding-Up Department of the Danish DGS, which is providing the loss guarantee to the Financial Stability Company A/S, is organisationally and financially separate from the Guarantee Fund operated by the Danish DGS with the view to ensuring payouts of the guaranteed deposits. Such arrangement is aligned with Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes[7] which requires

5 The compensation scheme was originally introduced in April 2011 to provide greater incentives for sound banking institutions to take over distressed institutions. For a detailed description of the extension of the compensation scheme, see document No 181 of 7 September 2011 of the Financial Committee of the Danish Parliament and the political agreement of 25 August 2011.

6 Under Model II, a sound banking institution purchases the sound assets of the banking institution under resolution, and funds obtained from this purchase are counted towards the winding-up of the banking institution under resolution. With the application of Model II no depositors or other unsubordinated creditors incur losses, whereas shareholders and subordinated creditors are not covered by the compensation scheme.

7 OJ L 135, 31.5.1994, p. 5.

deposit-guarantee schemes to be in a position to pay duly verified claims by depositors in the periods specified by this Directive[8].

2.2 The ECB understands that the resolution process to which the draft law relates will be conducted in accordance with Union State aid rules in respect of the legal requirement for banking institutions to contribute financially to the extended functions of the Winding-Up Department of the Danish DGS and in respect of the involvement of the State-owned Financial Stability Company A/S in the resolution process. In addition, the ECB understands that Document No 181 of 7 September 2011 of the Financial Committee of the Danish Parliament establishing the extended compensation scheme has already been notified to the Commission and that a similar notification will be made in relation to the draft law.

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

Done at Frankfurt am Main, 9 November 2011.

[signed]

*The President of the ECB*

Mario DRAGHI

8 See Article 10(1) of the Directive 94/19/EC.