



OPINION OF THE EUROPEAN CENTRAL BANK
of 16 April 2012
on the Deposit Guarantee Fund and the bank resolution regime
(CON/2012/30)

Introduction and legal basis

On 2 March 2012 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 a guarantee fund for depositors and investors, the Law on financial business, the Law on securities trading, the Law on financial stability and the Law on tax assessment (amending the funding of the Guarantee Fund for depositors and investors, extending the compensation scheme, upholding banking licences as a resolution measure and the disclosure of confidential information by the Financial Supervisory Authority)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 provisions², 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 has the following objectives: First, it amends the method of financing of the Danish Guarantee Fund for depositors and investors (hereinafter ‘the DGS’). Second, it strengthens the possibility of winding up a banking institution in distress without the non-subordinated creditors incurring a loss, by amending the bank resolution powers and tools available to the Danish Financial Supervisory Authority (FSA) and the Financial Stability Company A/S, a State-owned bridge bank³.

¹ The Law on a guarantee fund for depositors and investors, see Consolidated Law No 133 of 22 February 2011 with later amendments; Law on financial business, see Consolidated Law No 885 of 8 August 2011 with later amendments; Law on securities trading, see Consolidated Law No 883 of 9 August 2011; Law on financial stability, see Consolidated Law No 875 of 15 September 2009 with later amendments and the Law on tax assessment, Consolidated Law No 1017 of 28 October 2011 with later amendments.

² OJ L 189, 3.7.1998, p. 42.

³ The draft law implements the political agreement of 25 August 2011 (the ‘Bank Package IV’), initially adopted by the Financial Committee of the Danish Parliament on 7 September 2011 as Document No 181. The current draft law is related to a previous draft law on the issuance of a loss guarantee in connection with an extended compensation scheme

- 1.2 With regard to the financing of the DGS, the draft law provides for ex-ante annual contributions⁴ to be paid to the Bank Department of the DGS by the member banking institutions. The draft law also requires the standing liquidity facility of the DGS's Bank Department to be maintained at 0.75% of the covered net deposits, in order to address situations where the annual contribution by the member banking institutions does not cover payments liable to be made by the DGS⁵. The standing liquidity facility may be used as collateral by the DGS to raise loans, including loans with a State guarantee.

The draft law also extends the scope of the DGS's Winding-up Department so that the Winding-up Department may cover the costs of a banking institution having to withdraw from a data-handling centre in connection with the merger or transfer of assets between the distressed bank and another bank⁶.

- 1.3 With regard to amendments related to bank resolution powers and tools, the draft law proposes two changes:

First, the draft law extends the existing compensation scheme in order to create sufficient incentives for sound banking institutions to take over all or parts of a banking institution in distress⁷. The extended compensation scheme will involve the Financial Stability Company A/S which may provide compensation in connection with the winding-up or take-over of a distressed banking institution, in whole or in part, by a sound credit institution, i.e. the Model I and Model II resolution⁸. Such compensation may amount to the level of losses, which the State would incur, based on the state guarantees issued to the distressed banking institution under resolution.

Second, the draft law amends the rules by which the FSA can withdraw a banking licence from a banking institution which no longer fulfils the statutory solvency requirements by a set date. This is to ensure the continued functioning of a banking institution in distress where the FSA assesses that there are on-going serious negotiations with one or more potential acquirers. Furthermore, the draft law brings forward the time at which the FSA may disclose confidential information concerning the

on which the ECB issued an Opinion on 9 November 2011; see Opinion CON/2011/90. All ECB Opinions are published on the ECB's website at www.ecb.europa.eu.

⁴ The draft law provides for a total annual contribution of 0.25% of the banks' covered net deposits at 1 October of the preceding year. This rate may be changed under extraordinary circumstances in which the contribution may be increased. See §1 subsection 7 of the draft law and pages 14 to 16 of the Explanatory Memorandum to the draft law.

⁵ See §1 subsection 7 of the draft law and page 15 of the Explanatory Memorandum.

⁶ The Winding-Up Department was set up by Section 3 of Law No 721 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 DGS. The capital of the Winding-Up Department is provided entirely through mandatory contributions from the banking sector. See paragraph 1.5 of Opinion CON/2010/45. As a consequence of the extended scope in the draft law the Winding-Up Department will change its name to 'the Winding-Up and Restructuring Department'.

⁷ The existing compensation scheme allows the DGS, subject to certain conditions, to provide funds or a guarantee covering all depositors and non-subordinated creditors of a distressed banking institution in connection with the complete transfer of assets and liabilities of a distressed bank to another financially sound bank. The ECB issued Opinion CON/2011/45 on this scheme on 24 May 2011.

⁸ Under Model I a sound banking institution takes over an entire business of the banking institution in distress. Under Model II a sound banking institution purchases the sound part of the distressed banking institution from the Financial Stability Company A/S and funds obtained from this sale are included in the winding-up of the unsound part of the distressed banking institution; this is conditional upon the industry-funded Winding-Up Department of the DGS issuing a guarantee to the Financial Stability Company A/S, covering any losses incurred after the final winding-up of the distressed banking institution. Moreover, the use of Model I or Model II resolution procedures is subject to an assessment by the Financial Stability Company A/S that it does not put the State in a worse financial position than if the distressed banking institution was to be wound up under the special bank resolution regime (the Bank Package III).

distressed banking institution to the interested private sector acquirers and to the public authorities⁹. In this last respect, the FSA is given a broader authority to disclose confidential information to the Financial Stability Company A/S and the committees and groups, appointed by the Minister for Business Affairs and Growth, which are aimed at coordinating measures ensuring financial stability and addressing systemic risks.

- 1.4 The draft law also amends the Law on tax assessment to ensure that State compensation arising as a result of the application of Model I is not included in the calculation of taxable income, as is the case in the application of Model II¹⁰.

2. General observations

The draft law was submitted to the Danish Parliament on 1 February 2012; the ECB only received the request for an opinion on 2 March 2012. The ECB wishes to draw the consulting authority's attention to the second sentence of Article 4 of Decision 98/415/EC which provides that the ECB must be consulted 'at an appropriate stage' in the legislative process. This implies that the consultation should take place at a stage in the legislative process which affords the ECB sufficient time to examine the draft legislative provisions, and to adopt its opinion in the required language versions in sufficient time to enable the relevant national authorities to consider the ECB's opinion before the legislative provisions are adopted.

3. Specific comments

3.1 *Ex-ante funding of the DGS*

The ECB welcomes the proposal for ex-ante funding arrangements to replace the current ex-post funding arrangements for the Danish DGS. This solution takes into consideration the proposed recast of the Directive on deposit-guarantee schemes (hereinafter, the 'proposed Directive')¹¹ which anticipates a specified target level of ex-ante funding available to deposit-guarantee schemes, based on a percentage of deposits held. The ECB supports ex-ante funded deposit-guarantee schemes as a means to ensuring financial stability, where credit institutions participate in the deposit protection costs, and as an exclusive reliance on ex-post contributions may be a source of procyclicality. The ECB notes that the proposed Directive may also introduce risk-based elements into the calculation of the contributions payable into the deposit-guarantee scheme by the individual member credit institutions, which will better reflect the risk profiles of individual credit institutions thereby providing incentives to operate under less risky business models¹². Further, the

⁹ The draft law proposes that the FSA may disclose confidential information at the point in time at which the FSA has received a mandate from the Ministry of Business Affairs and Growth to participate in the management of a banking institution in distress.

¹⁰ See §5 of the draft law.

¹¹ See the proposal by the Commission for a Directive of the European Parliament and of the Council on Deposit Guarantee Schemes (COM(2010) 368), as commented on in Opinion CON/2011/12. See the latest Presidency Compromise proposal of 14 June 2011 and the Commission's proposal and Presidency compromise proposal of 10 February 2012 on key issues with a view to negotiations with the European Parliament, both documents are available on the Council's website at <http://register.consilium.europa.eu>.

¹² See the Commission's staff working document 'Summary of the impact assessment. Accompanying document to the proposal for a Directive of the European Parliament and of the Council on Deposit Guarantee Schemes', p. 5, available on the Commission's website at www.ec.europa.eu.

ECB supports the model of partial risk-based contributions, with provisions ensuring comparability of various asset classes¹³.

3.2 *Bank resolution powers and tools*

The ECB welcomes the enhancements made to the Danish bank resolution regime and how it facilitates private market-based solutions to deal with banking institutions in distress. The ECB understands that the enhanced resolution procedures to which the draft law relates will be conducted in accordance with Union State aid rules, *inter alia*, as regards the involvement of the DGS and the Financial Stability Company A/S in these procedures. More specifically, the ECB understands that the draft law establishing the extended compensation scheme has been notified to the Commission and that the Commission has approved the scheme in its Decision¹⁴. Finally, 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. It invites the consulting authority to review the law in light of the future Union regulatory framework on bank recovery and resolution, in particular with regard to the resolution tools and the powers of resolution authorities, and of the proposed Directive.

3.3 The ECB understands that the possibility of not withdrawing a banking licence from an insolvent banking institution, where serious take-over negotiations are being conducted, is intended to ensure a smooth resolution procedure. However, this should not affect the immediate cessation of central bank credit to any banking institution that does not fulfil national solvency conditions and that could result in the provision of solvency support. Whereas the provision of financial support to illiquid but solvent banks constitutes an inherent central bank task, any public sector solvency support of credit or other financial institutions has to be carried out by the State and not the central bank. Continued provision of central bank credit to such a banking institution would contravene the monetary financing prohibition expressed in Article 123 of the Treaty¹⁵.

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

Done at Frankfurt am Main, 16 April 2012.

[signed]

The President of the ECB

Mario DRAGHI

13 See paragraph 8 of Opinion CON/2011/12.

14 See Commission Decision SA 33757 (2011/N) of 9.12.2011, available on the Commission's website.

15 See the ECB's Convergence Report of May 2010, p. 25.