



OPINION OF THE EUROPEAN CENTRAL BANK

of 6 November 2012

on government guarantees for credit institutions

(CON/2012/85)

Introduction and legal basis

On 17 October 2012, the European Central Bank (ECB) received a request from the Cypriot Ministry of Finance for an opinion on a draft law establishing a scheme for the granting of government guarantees to Cypriot credit institutions (hereinafter the 'draft law') and an accompanying draft decree in the same matter (hereinafter the 'draft decree' and, jointly, 'the draft legal acts').

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 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,¹ as the draft law relates 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 and main features of the draft legal acts

1.1 According to the explanatory memorandum to the draft law, its purpose is to establish a government guarantee scheme for loans and bonds issued by credit institutions, thereby enhancing their access to liquidity and helping them overcome the impact of the ongoing economic crisis. Credit institutions have six months from the entry into force of the draft decree within which to request support in the form of a government guarantee. Government guarantees are to be granted for a term of no less than three months and no more than five years. The scheme's total budget is EUR 6 billion, which the Cypriot authorities consider sufficient to cover the needs of the Cypriot banking sector. Government guarantees are to be provided against: (a) the payment of an appropriate commission by the requesting credit institution; and (b) adequate collateral for the benefit of the Cypriot Government, except in extraordinary cases, and based on the reasoned opinion of the Central Bank of Cyprus.

¹ OJ L 189, 3.7.1998, p. 42.

- 1.2 The draft decree lays down rules for the scheme, the terms for the granting of government guarantees and their pricing, the type and adequacy of eligible collateral, the criteria concerning the allocation of the government guarantees and compliance monitoring and coordination procedures relevant to the draft law.

2. General observations

- 2.1 The ECB welcomes the draft legal acts as a means of enhancing financial stability in Cyprus.
- 2.2 The ECB reminds the consulting authority that government guarantees for bank debt should, when implemented: (a) address the funding problems of liquidity-constrained solvent banks by improving the functioning of the market for bank debt of longer-term maturity; (b) preserve the level playing field among financial institutions and avoid market distortions; and (c) ensure consistency in the management of Eurosystem liquidity². With the above general considerations in mind, the ECB has the following specific observations to make on the draft legal acts.

3. Interaction with other legislation

3.1 Interaction with the Law on the management of financial crises

In a previous opinion, the ECB commented on certain draft legislative provisions, which are similar to those set out in the draft legal acts³. The provisions in question have since been enacted in the Law on the management of financial crises (hereinafter the ‘Law’)⁴. It follows from Section 4(1) of the Law that the Ministerial Council may, following a recommendation of the Central Bank of Cyprus, take any of a number of support measures in relation to troubled financial institutions, including granting government guarantees for loans to be taken by financial institutions and/or government guarantees for bonds to be issued by financial institutions, at an appropriate price. In the interests of legal certainty, and with a view to avoiding legislative duplication, the consulting authority may wish to carefully consider the interaction between the Law and the draft legal acts.

3.2 Interaction with forthcoming legislation

The ECB notes that the choice of the type and eligibility criteria of collateral, as well as the haircuts applied, may influence the restructuring activities envisaged by troubled Cypriot credit institutions, in particular as regards any decision to dispose of certain assets or wind down certain activities. In light of the long duration of guarantees issued under the draft law and the prospective restructuring of banks in receipt of state aid, the consulting authority may therefore wish to ensure

² In this regard see most recently Opinion CON/2012/4, paragraph 3. All ECB Opinions are published on the ECB’s website at www.ecb.europa.eu

³ See Opinions CON/2009/12 and CON/2011/93.

⁴ Law 200(I)/2011.

that the draft decree would not interfere with the aims of any forthcoming legislation designed to facilitate the restructuring of credit institutions and the wider banking system.

4. Eligible credit institutions and scope of guarantees

- 4.1 The ECB understands that, with the exception of branches of credit institutions registered outside Cyprus, which are ineligible to benefit from government guarantees, the draft law applies to credit institutions incorporated in Cyprus and licensed by the Central Bank of Cyprus or the Commissioner⁵, including the Cyprus-based subsidiaries of foreign credit institutions⁶. In addition, the ECB understands that the government guarantees will be allocated on the basis of domestic deposits and loans (excluding interbank deposits and loans) irrespective of the nationality or place of residence of the depositors or borrowers⁷. The ECB welcomes the non-discriminatory application of the draft law, which is conducive to maintaining a level playing field in the treatment of domestic and foreign financial institutions in Cyprus. The draft law is, in this respect, also in line with the Commission's guidance on the eligibility criteria for beneficiary institutions⁸.
- 4.2 Moreover, the ECB understands that guarantees can only be issued to cover loans made to Cypriot credit institutions and bonds issued by those credit institutions, to the exclusion of interbank deposits, as well as subordinated or collateralised liabilities (such as covered bonds)⁹. The ECB reiterates its view that State guarantees should not cover interbank deposits, since this could: (a) entail a substantial distortion in the various national segments of the euro area money market by potentially increasing, across Member States, short-term debt issuance activity, to the detriment of the implementation of the single monetary policy; and (b) affect the transmission of monetary policy, making it difficult to maintain the necessary level playing field between financial institutions that benefit from State guarantees and those that do not¹⁰.

5 Pricing of guarantees

The ECB welcomes that Article 8 of the draft law explicitly provides that guarantee fees applied to financial institutions benefiting from the State guarantees are to be in line with the criteria established by the Commission, which incorporate the pricing formula recommended by the ECB's Governing

⁵ Commissioner of the Authority for the Supervision and Development of Cooperative Societies.

⁶ See Article 3 of the draft law.

⁷ See Article 5.4 and 5.10 of the draft decree.

⁸ See paragraph 18 of the Communication from the Commission on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis (OJ C270, 25.10.2008, p. 8),

⁹ See Article 3 of the draft law.

¹⁰ In this regard see, most recently, paragraph 3 of Opinion 2012/4.

Council¹¹. The pricing formula in the Annex to the draft decree corresponds to the one established by the Commission.

6 Temporary nature of guarantees

In line with the Commission's criteria¹², the ECB notes the need for national support measures to be temporary in nature, and reiterates the views expressed in its previous opinions that coordination of the duration of national financial support schemes across the Union is of crucial importance in order to ensure a level playing field¹³. The financing to be covered by the guarantee scheme established under the draft law may only be requested within six months from the entry into force of the draft decree¹⁴ and granted for a term not exceeding five years¹⁵. Thus, the guarantee scheme established under the draft law can be considered to be of a temporary nature. The consulting authority may nevertheless want to clarify what the date appearing in Article 4 of the draft decree relates to, as the date in question does not appear to be consistent either with the duration of the government guarantees nor with the duration of their offer to eligible credit institutions.

7. Interaction with the monetary policy of the euro area

The ECB also reiterates that granting government guarantees for bank debt with a maturity of less than three months should be avoided to the extent possible¹⁶. The ECB welcomes that the draft law does not allow government guarantees for bank debt with a maturity of less than three months¹⁷. Moreover, the ECB stresses that it is of the utmost importance that support operations conducted by national authorities do not in any way affect the conduct and the implementation of monetary policy in the euro area¹⁸.

8. Role of the Central Bank of Cyprus

8.1 The ECB notes that, under the draft law, the Minister consults the Governor of the Central Bank of Cyprus prior to deciding whether or not to issue a state guarantee for the benefit of an eligible credit institution. The Governor's advice is also sought in respect of the type and eligibility criteria for the collateral covering the amount of government guarantees granted to eligible credit institutions and for any dispensations from the duty to provide adequate eligible collateral to the

11 See the Recommendations of the Governing Council of the European Central Bank on government guarantees for bank debt, 20 October 2008, available on the ECB's website at www.ecb.europa.eu.

12 See paragraphs 15 and 20 of the Communication from the Commission, on the application, from 1 January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis (OJ C356, 6.12.2011, p. 7).

13 In this regard see, most recently, paragraph 3.2 of Opinion CON/2011/88.

14 See Article 5 of the draft law.

15 See Article 4 of the draft law.

16 In this regard see, most recently, paragraph 3 of Opinion CON/2012/4.

17 See Article 4 of the draft law.

18 In this regard see, most recently, paragraph 3 of Opinion CON/2012/4.

Government. The ECB notes, however, that the Minister does not seek the Governor's advice regarding the extent of collateral haircuts to apply¹⁹. While appreciating the draft law's recognition of the expertise of the Central Bank of Cyprus, the ECB also expects its involvement in the scheme not to extend beyond the provision of advice and to otherwise comply fully with the prohibition on monetary financing laid down in Article 123(1) of the Treaty, read in conjunction with Council Regulation (EC) No 3603/93 of 13 December 1993 specifying definitions for the application of the prohibitions referred to in Articles 104 and 104b(1) of the Treaty²⁰. In particular, the ECB expects that the guarantees envisaged by the draft law will be exclusively financed from the State budget and that, to the extent that their funding may require State borrowing, this will not include pre-financing or refinancing of the State budget by the Central Bank of Cyprus²¹.

8.2 The ECB also expects that the Minister will use the powers under the draft law in a manner fully compatible with the institutional and financial independence of the Central Bank of Cyprus, thereby safeguarding the proper performance of its tasks under the Treaty and the Statute of the European System of Central Banks and of the European Central Bank.

9. Lending to the real economy and monitoring mechanism

9.1 The ECB is of the view that the guarantee scheme should clearly state that one of its legislative objectives is to foster Cypriot banks' lending to the real economy. The consulting authority may therefore consider it beneficial to include this objective, for instance in the draft decree, providing for the terms of conduct for credit institutions benefiting from government guarantees. This would facilitate the monitoring of the lending-behaviour of banks by the Committee set up under Article 7 of the draft decree.

9.2 The ECB notes that the draft decree does not provide for any follow-up to the monitoring activity. Efficient monitoring should allow for control of the beneficiary credit institutions' compliance with the guarantee-scheme and the ECB would welcome more clarity in this respect.

¹⁹ See Article 5(13)(e) of the draft decree.

²⁰ OJ L 332, 31.12.1993, p. 1.

²¹ In this regard see, most recently,, paragraph 3.5 of Opinion CON/2009/12,.

ECB-PUBLIC

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

Done at Frankfurt am Main, 6 November 2012.

[signed]

The President of the ECB

Mario DRAGHI