



OPINION OF THE EUROPEAN CENTRAL BANK

of 29 April 2014

on the legal framework for the recapitalisation through the HFSF of credit institutions in Greece

(CON/2014/29)

Introduction and legal basis

On 24 March 2014 the European Central Bank (ECB) received a request from the Greek Ministry of Finance for an opinion on legislative provisions amending Law 3864/2010 on the establishment of the Hellenic Financial Stability Fund¹ (HFSF) (hereinafter the ‘draft provisions’). On 30 March 2014, in accordance with an expedited parliamentary procedure, the Greek Parliament adopted the draft provisions as part of the law entitled ‘Measures for the support and growth of the Greek economy in the context of implementation of Law 4046/2012 and other provisions’².

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/EC³, as the draft provisions relate to the Bank of Greece 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 European Central Bank, the Governing Council has adopted this opinion.

1. Purpose of the draft provisions

- 1.1 The purpose of the draft provisions is to reform the legal framework governing the provision of capital support to credit institutions in Greece through the HFSF, with a view to maintaining financial stability in the banking sector in Greece for the sake of the public interest, following restructuring of that sector in recent years. Furthermore, the draft provisions aim to align that legal framework with the guidance set out in the Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis⁴ (hereinafter the ‘Banking Communication’).
- 1.2 The proposed reform concerns mainly: (a) the objective of the HFSF and the rules and principles governing its function; (b) the circumstances in which the HFSF can provide support; (c) the

¹ FEK A 119/21.7.2010.

² FEK A 85/7.4.2014.

³ Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions (OJ L 189, 3.7.1998, p. 42).

⁴ Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis (‘Banking Communication’), OJ C 216, 30.7.2013, p. 1.

adoption of mandatory measures aimed at reducing the capital needs of credit institutions requesting capital support from the HFSF, in line with the Banking Communication; (d) the procedure and conditions for the provision of capital support to credit institutions through the subscription by the HFSF for shares or other contingent convertible bonds; (e) the exercise of the shareholding rights of the HFSF in credit institutions to which it has provided capital support; (f) the procedure and conditions for the disposal of the HFSF's holding in credit institutions; and (g) rules on the corporate governance and operation of the HFSF.

- 1.3 The draft provisions clarify that the objective of the HFSF is to contribute to the maintenance of the stability of the Greek banking system for the sake of the public interest⁵. The draft provisions expressly provide that the HFSF shall act in line with the commitments of Greece under Law 4046/2012 on the approval of the draft financing agreements between the European Financial Stability Fund, the Hellenic Republic and the Bank of Greece and of the draft Memorandum of Understanding between the Hellenic Republic, the European Commission and the Bank of Greece and other provisions of utmost importance for reducing the public debt and saving the national economy^{6 7}. The draft provisions specify that, with a view to achieving its objective, the HFSF exercises the following main tasks: (a) it provides capital support to credit institutions and to transitional credit institutions under terms and conditions which take account of rules on the prudent management of its assets; (b) it monitors and assesses the compliance of credit institutions with their restructuring plans, safeguarding their business autonomy, their operation on market terms and increasing private sector participation in such credit institutions in a transparent manner and in accordance with the State aid rules of the Union; (c) it exercises its shareholder rights in credit institutions to which it has provided capital support in compliance with the rules on the prudent management of its assets and in line with the State aid rules of the Union; (d) it disposes of financial instruments issued by the credit institutions in which it has a holding in accordance with the specific requirements set out in the draft provisions; and (e) it exercises its rights in transitional credit institutions in accordance with the specific requirements set out in the Law on the HFSF and the Law on Banking (Law 3601/2007⁸)⁹. The draft provisions state that monitoring and supervision of tasks performed by bodies responsible for the special liquidation of credit institutions do not fall within the functions of the HFSF¹⁰.
- 1.4 The procedure to activate support by the HFSF is redefined in line with the Banking Communication. A credit institution assessed and deemed as viable by the Bank of Greece may request capital support from the HFSF for an amount not exceeding its capital needs as identified by the Bank of Greece¹¹. The request must be accompanied by a restructuring plan and a letter from

⁵ See draft Article 2(1).

⁶ FEK A 28/14.12.2012.

⁷ See draft Article 2(1).

⁸ FEK A 178/1.8.2007.

⁹ See draft Article 2(2).

¹⁰ See draft Article 2(3).

¹¹ See draft Article 6(1).

the Bank of Greece determining the capital needs of the relevant credit institution and confirming that the credit institution, subject to meeting its capital needs, is viable. Credit institutions that have already received capital support from the HFSF are required to submit an amended restructuring plan. The restructuring plan must set out voluntary measures to be undertaken by the credit institution in order to raise capital or mitigate its capital needs. These measures may include the retention of earnings, the implementation of a share capital increase, the voluntary conversion of subordinated debt instruments into Tier 1 capital instruments and the compilation of a list of instruments that may be subject, where necessary, to mandatory measures aimed at reducing the credit institution's capital needs¹². Following consultation with the Bank of Greece, the HFSF may request amendments to the restructuring plan. The provision of HFSF support is conditional on European Commission approval of the restructuring plan and, where necessary, the implementation of mandatory measures aimed at reducing the credit institution's capital needs, in line with the Banking Communication¹³.

- 1.5 To reduce the use of public funds in support of credit institutions to a minimum, the draft provisions authorise the Cabinet of Ministers to enforce, following a recommendation by the Bank of Greece, mandatory measures aimed at allocating the capital needs of credit institutions requesting capital support from the HFSF to their capital holders and subordinated creditors in line with the Banking Communication (hereinafter the 'mandatory measures'). Such measures shall be adopted where: (a) the voluntary measures set out in the credit institution's restructuring plan are insufficient to address its total capital needs as determined by the Bank of Greece; and (b) the liquidation or resolution of the credit institution concerned, which would be required under Greek law were the institution unable to restore its capital position, could result in serious disturbances to the economy with adverse effects upon the public¹⁴. The mandatory measures may include, under the specific conditions set out in the draft provisions: (a) a reduction in the nominal value of common shares, following a decision of the credit institution's competent body; (b) a reduction in the nominal value of preference shares and other Tier 1 liabilities; and (c) the conversion of preference shares, other Tier 1 liabilities and subordinated liabilities into Tier 1 capital instruments¹⁵. The mandatory measures may apply also to subordinated liabilities of the credit institution concerned that stem from agreements it has concluded with third entities included in its consolidated financial statements (guarantees for the issue of debt or equity instruments and credit arrangements)¹⁶. The draft provisions allow the authorities, subject to the approval of the European Commission, not to enforce mandatory measures where their implementation would endanger financial stability or lead to disproportionate results. The draft provisions require that, following the implementation of mandatory measures, the financial position of the capital holders or subordinated creditors affected should not be worse than it would be were the credit institution

12 See draft Article 6(1)(b).

13 See draft Article 6(4).

14 See draft Article 6a(1).

15 See draft Article 6a(2).

16 See draft Article 6a(3).

placed into liquidation ('no-creditor-worse-off-than-in-insolvency' principle)¹⁷. The draft provisions set out publication requirements in relation to the implementation of mandatory measures¹⁸. A Cabinet act will set out the necessary details for the implementation of mandatory measures of this kind¹⁹.

- 1.6 The draft provisions clarify that the HFSF may provide capital support to credit institutions only to the extent that their capital needs, as determined by the Bank of Greece, remain uncovered following the application of voluntary and mandatory measures aimed at reducing such and following any participation of private sector investors²⁰. The HFSF shall provide capital support through the subscription of shares or contingent convertible bonds or other convertible instruments issued in the context of a capital increase²¹. The subscription price for these instruments shall be determined by a decision of the General Council of the HFSF on the basis of two valuation reports prepared by independent financial advisers. New shares in the relevant credit institution offered to the private sector in the context of the same issuance shall have an offer price no lower than the subscription price for the HFSF. In contrast, the offer price may be lower than the price at which the HFSF previously subscribed for shares in the credit institution or lower than the current stock market price²². The independent financial advisers shall be requested to take account of all relevant information, including any available asset quality review and stress test results, as well as market conditions. A summary of the elements and methodology used by the advisers will be published on the HFSF's website within 10 days of completion of the transactions²³.
- 1.7 According to the draft provisions, the HFSF shall be entitled to exercise without limitations the voting rights attached to the common shares it acquires in the context of the provision of capital support to credit institutions²⁴. The draft provisions specify certain cases where the HFSF may exercise its voting rights only in relation to decisions amending the bylaws of the credit institution, including decisions concerning capital increase, merger, extension of duration and dissolution²⁵. The draft provisions introduce certain amendments regarding the notification of information relating to shareholding and voting rights in credit institutions to which the HFSF has provided capital support, in accordance with Law 3556/2007 on transparency requirements for companies with stock listed on a regulated market^{26 27}.

17 See draft Article 6a(8).

18 See draft Article 6a(10).

19 See draft Article 6a(11).

20 See draft Article 7(1).

21 See draft Article 7(2).

22 See draft Article 7(5)(a).

23 See draft Article 7(5)(b).

24 See draft Article 7a(1).

25 See draft Article 7a(2).

26 FEK A 91/30.4.2007. Law 3556/2007 implements Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (OJ L 390, 31.12.2004, p. 38).

27 See draft Article 7a(6).

- 1.8 The draft provisions specify that the HFSF shall decide on how to dispose of its shareholding in a credit institution to which it has provided capital support within five years of acquiring that holding. The relevant decision shall be taken by the General Council of the HFSF on the basis of a report prepared by a financial expert, accompanied by a comprehensive time schedule for the disposal. The disposal shall be carried out in compliance with the objectives of the HFSF²⁸. The HFSF may sell its shares to the market or to specific investors or groups of investors through different procedures, including through an open tender procedure, the exchange of shares for cash or other securities and book building²⁹. The disposal price, which may be lower than the price at which the shares were acquired by the HFSF or their current market price, shall be determined by the General Council of the HFSF on the basis of two valuation reports of independent advisers³⁰. With regard to the exchange and adjustment of warrants issued by the HFSF, a Cabinet act shall determine the methodology to adjust their terms and conditions in the case of corporate actions consisting of a split, a reverse split and a share capital increase without abolition of pre-emptive rights³¹. In the latter case, the draft provisions allow for an adjustment only as regards the price and only up to the amount of the proceeds realised from the sale of pre-emption rights of the HFSF.
- 1.9 The draft provisions amend certain rules relating to the corporate governance and operation of the HFSF. These amendments include in particular: (a) an increase in the number of the independent members of the General Council of the HFSF from five to seven³²; (b) strengthening of the eligibility criteria for members of the governing bodies of the HFSF³³; (c) broadening of the limitations to which the members of the governing bodies of the HFSF are subject when taking up a position subsequent to their employment at the HFSF³⁴; and (d) further specification of the liability of the members of the governing bodies of the HFSF³⁵.

2. Appropriate time to consult the ECB

- 2.1 According to Article 4 of Decision 98/415/EC, the ECB must be consulted at an appropriate stage in the legislative process enabling the consulting authority to take the ECB's opinion into consideration before the draft provisions are adopted. This requires, in turn, that the ECB should have sufficient time to adopt its opinion.
- 2.2 The ECB notes that, in this case, the consultation request was submitted a few days before the adoption of the draft provisions into law. As the ECB appreciates this urgency, the observations made in this opinion are limited to what is considered strictly necessary, having regard to the fact

28 See draft Article 8(1).

29 See draft Article 8(2) and (3).

30 See draft Article 8(4).

31 See draft Article 8(6).

32 See draft Article 4(2).

33 See draft Article 4(6) and (7).

34 See draft Article 16C(3).

35 See draft Article 16C(4).

that the draft provisions have already been voted into law and entered into force.

3. General observations

- 3.1 The ECB welcomes the reform of the legal framework governing the operation of the HFSF and the recapitalisation of credit institutions, which aims at safeguarding the stability of the Greek banking system for the sake of the public interest³⁶. In the context of the current economic and financial crisis, the proposed reform should generally contribute to reducing the amount of State aid that the beneficiary credit institutions may require and to safeguarding and protecting taxpayers' interests more effectively.
- 3.2 The ECB wishes to emphasise the importance it attaches to the stabilisation of the financial system in Greece, such that the latter may resume lending to the real economy and support growth, while also restoring a sustainable broad-based funding model. The timely and efficient recapitalisation of Greece's financial system is crucial to the achievement of this objective. Furthermore, the ECB reiterates that it is equally essential to ensure that the amended recapitalisation framework will allow credit institutions to benefit from capital support provided by the HFSF only after having fully exhausted all possibilities to generate capital through mitigating measures (such as divestments) and through private capital-raising. This will enable the HFSF to maintain significant State resources as a safety net against the challenges that Greek banks continue to face as a result of the recession and the problems of some borrowers to service their debt obligations, to the benefit of the financial system, the economy and the public at large. Without prejudice to these general observations, the ECB has the following specific observations to make.

4. Objective and operation of the HFSF

- 4.1 The ECB welcomes the clarification that the objective of the HFSF is to contribute to the maintenance of the stability of the Greek banking system, for the sake of the public interest, and that the HFSF shall act in line with the commitments of Greece under the second economic adjustment programme for Greece. Moreover, the ECB welcomes the specification of the tasks conferred upon the HFSF for the fulfilment of this objective, and the principles governing the performance of these tasks. Of particular importance is the requirement that, in exercising its tasks, the HFSF shall take account of rules on the prudent management of its assets. The prudent use and management of the assets of the HFSF is crucial from a financial stability perspective, as these assets include both the holdings of the HFSF in credit institutions that have benefited from HFSF support and the capital of the HFSF, paid in by the Greek Government with funds raised from the European Union and International Monetary Fund (IMF) financial assistance for Greece. The ECB supports the financial sector strategy set out in the Memorandum of Economic and Financial

³⁶ In relation to the development of the relevant legal framework, the ECB refers to its previous relevant opinions. See in particular opinions CON/2010/54, CON/2011/72, CON/2012/14, CON/2012/25, CON/2012/39, CON/2012/90, CON/2013/17 and CON/2013/38. All ECB opinions are available on the ECB website at www.ecb.europa.eu.

Policies³⁷ and the recent statement on Greece by the Eurogroup to strengthen Greek banks by meeting ‘capital needs swiftly first and foremost from private investors’³⁸. Private capital injections should help to strengthen the management, efficiency and solvency of Greek banks, thereby also contributing to the prudent use and management of the existing assets of the HFSF.

- 4.2 The ECB notes that the draft provisions increase the number of members of the General Council of the HFSF, other than the representative of the Ministry of Finance and the person appointed by the Bank of Greece, from five to seven, and understands that this amendment aims at increasing the participation of persons with international experience in banking matters in the governing bodies of the HFSF. As regards the role of the person appointed by the Bank of Greece, the ECB notes that as a full voting member of the General Council of the HFSF, the Bank of Greece appointee might be required to take a position on issues falling outside the tasks and responsibilities of the Bank of Greece as national supervisory authority. This might give rise to perceived conflicts of interest, such as in connection with business decisions relating to the exercise of the shareholding rights of the HFSF. The ECB considers that the role of the person appointed by the Bank of Greece could be usefully transformed into that of a representative of the Bank of Greece without voting rights, who would act in an observer capacity, and who would, in practice, be called to provide input only from a prudential supervisory perspective.

5. Procedure and conditions for the provision of capital support by the HFSF

5.1 Circumstances in which the HFSF may provide support

- 5.1.1 The ECB welcomes the fact that, under the draft provisions, only credit institutions that have been assessed and deemed viable by the Bank of Greece are deemed eligible to receive support from the HFSF. In addition, it welcomes the fact that the draft provisions require credit institutions requesting capital support to submit a restructuring plan setting out the measures that they will undertake in order to raise capital from private resources or mitigate their capital needs, so as to minimise State aid support. These safeguards are necessary to ensure that the provision of State support will strengthen the capital position of fundamentally sound financial institutions in order to improve the functioning and stability of the banking system and to foster an adequate flow of credit to the economy.
- 5.1.2 The ECB is of the view that the Bank of Greece, as the national supervisory authority, is the institution best placed to: (a) assess whether there is a residual shortfall in capital; (b) assess the viability of credit institutions facing capital shortfalls, taking into consideration their restructuring plans also including measures relating to voluntary liability management; and (c) instruct credit institutions that have been deemed viable, subject to meeting their capital needs, to submit a request for capital support to the HFSF.

³⁷ Annex V to Law No 4046/2012, as revised from time to time (FEK A 28/14.12.2012).

³⁸ See Eurogroup statement on Greece of 1 April 2014, available at: <http://www.eurozone.europa.eu/newsroom/news/2014/04/eurogroup-statement-on-greece/>.

- 5.1.3 The ECB notes that the implementation of HFSF support is further conditional on the adoption of mandatory measures aimed at allocating any residual capital needs, following the adoption of voluntary measures, to capital holders and subordinated creditors of the credit institution concerned, in compliance with the Banking Communication. The ECB understands that the relevant measures aim to address public interest considerations and in particular: (a) the need to ensure that the use of public funds remains at the minimum necessary; (b) the need to prevent serious disturbances to the economy with adverse effects upon the public that in certain cases could result from the liquidation or resolution of the credit institution concerned; and (c) the need to protect the integrity of the single market and ensure a level playing field as well as the State's fiscal strength³⁹.
- 5.1.4 The ECB notes that the Banking Communication requires the adoption of mandatory measures of the kind specified in the draft provisions, provided that fundamental rights are respected and financial stability is not put at risk⁴⁰. In this regard, adherence to the 'no-creditor-worse-off-than-in-insolvency' principle established in the draft provisions will be crucial. Furthermore, the ECB welcomes the fact that the draft provisions refer explicitly to the public interest considerations which underpin the adoption of mandatory measures and allow also for exceptions to the adoption of mandatory measures, where their implementation would endanger financial stability or lead to disproportionate results.
- 5.1.5 The ECB notes that the draft provisions include among the instruments that may be subject to mandatory measures subordinated liabilities of the credit institution concerned that stem from the provision of guarantees to third entities or from credit arrangements with such entities. The ECB understands that these provisions will only be relevant in the event that the guarantee is activated. Implementation of mandatory measures in relation to obligations of that kind requires further specification.
- 5.2 *Provision of capital support and pricing of recapitalisation instruments*
- 5.2.1 The ECB welcomes the fact that, under the draft provisions, the HFSF shall provide capital support only for the purpose of covering the capital shortfall determined by the Bank of Greece and only to the extent that the shortfall remains uncovered following the application of voluntary and mandatory mitigating measures and the participation of private sector investors. This provision is necessary to enable the HFSF to adequately fulfil its objective to maintain the stability of the financial system, for the sake of the public interest.
- 5.2.2 According to the draft provisions, the decision by the HFSF determining the price for its subscription of common shares will take account of its objectives along with the prevailing market conditions. These principles, which require the HFSF, alongside other aims, to take account of the rules on the prudent management of its assets, will enable the HFSF to ensure the appropriate

³⁹ See ECB opinion CON/2013/87, paragraph 3.1 et seq.

⁴⁰ According to paragraph 19 of the Banking Communication, all capital generating measures should be exhausted before the State may recapitalise a credit institution, provided that fundamental rights are respected and financial stability is not put at risk.

pricing of recapitalisations with State support, thus avoiding the situation that private investors prepared to inject capital in line with prevailing market conditions are crowded out as a result of the HFSF setting a price that is too high. The ECB emphasises the importance of ensuring that the valuations provided to the HFSF by independent financial advisers take account of all pertinent information and are subject to all necessary transparency requirements. The reference to that effect in the draft provisions will provide an additional safeguard to promote financial stability.

- 5.2.3 The provision of capital support by the HFSF under the draft provisions will be subject to the assessment and control of the European Commission in accordance with the State aid rules laid down in the Treaty. In particular, the European Commission's role will contribute to ensuring that the recapitalisation of credit institutions with capital support from the HFSF will not result in the granting of State aid which distorts or threatens to distort competition by favouring certain undertakings.

6. Disposal of the HFSF's shareholding in credit institutions

- 6.1 The draft law contains detailed provisions governing the disposal of the HFSF's shareholding in credit institutions. These provisions aim at setting out clear rules and principles to guide the HFSF's decision-making process with regard to increasing private sector participation in credit institutions in which the HFSF holds shares. The ECB considers that the relevant provisions will promote the re-privatisation of Greek banks and thus the operation of the credit institutions concerned on market terms, thereby facilitating the return to normal market conditions and ensuring the proper financing of the Greek economy.
- 6.2 The ECB notes that, according to the draft provisions, the disposal price may be lower than the price at which the shares were acquired by the HFSF or their current market price. The ECB welcomes the fact that, when determining the disposal price, the HFSF will be required to act in compliance with its objective, as specified under the draft provisions. Furthermore, the ECB considers it important that the rules concerning the information to be taken into account by the independent financial advisers and the transparency requirements concerning the elements and

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methodology used by those advisers also apply in relation to the determination of the disposal price. In this connection, it is also noted that disposal of HFSF shareholdings in credit institutions will be subject to the State aid rules.

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

Done at Frankfurt am Main, 29 April 2014.

[signed]

The President of the ECB

Mario DRAGHI