



**OPINION OF THE EUROPEAN CENTRAL BANK**  
**of 9 December 2014**  
**on amendments to the Law on the bank deposit guarantee**  
**(CON/2014/86)**

**Introduction and legal basis**

On 14 November 2014, the European Central Bank (ECB) received a request from Българска народна банка (the Bulgarian National Bank) (BNB) for an opinion on a draft law amending the Law on the bank deposit guarantee (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 third and sixth indents of Article 2(1) of Council Decision 98/415/EC<sup>1</sup>, as the draft law relates to the BNB 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 law**

- 1.1 The draft law amends the Law on the bank deposit guarantee by introducing new measures to address the financing of a shortfall in the financial resources of the Bulgarian Deposit Guarantee Fund (hereinafter 'the Fund').
- 1.2 Pursuant to the Law on the bank deposit guarantee, each bank is obliged to pay an annual premium to the Fund equal to 0.5 % of its total deposit base for the preceding year, as determined on an average daily basis. If there is a shortfall in the Fund's financial resources, its board of management may decide to establish a higher annual premium of up to 1.5 % of a bank's total deposit base.
- 1.3 The draft law provides that in the event that the Fund's financial resources are insufficient to cover its liabilities under the Law on the bank deposit guarantee, its board of management must, within three days of identifying the shortfall, take a decision to cover the shortfall by increasing the annual premium up to a limit of 2 % of each bank's total deposit base, for a period of up to 3 years. The Fund's board of management will require the banks to make such annual premium payments in advance, within a set period of time and at an increased rate. The amount payable in advance by each bank is to be deducted from the annual premium due for the following years. The amount that

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<sup>1</sup> 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).

has been overcharged will be refunded within the time limit set out in the Law on the bank deposit guarantee.

- 1.4 The draft law further stipulates that, in the event of an additional shortfall after the measure described in paragraph 1.3 above has been applied, the BNB must cover the additional shortfall within 10 days. The BNB is obliged to provide a loan to the Fund in the amount required to cover this additional shortfall, at the basic interest rate applicable at that time. The loan will be provided out of the financial resources of the BNB's Banking Department and from the BNB's 'reserve'.
- 1.5 Pursuant to the draft law, the Fund is also authorised to obtain loans from Bulgarian and foreign banks in accordance with the terms and conditions set out by its board of management. Loans obtained by the Fund may be secured on its assets, including future claims on banks for annual premiums.

## **2. Prohibition on monetary financing**

- 2.1 The ECB underlines the importance of safeguarding compliance with the prohibition on monetary financing laid down in Article 123(1) of the Treaty. This prohibits central banks from providing overdraft facilities or any other type of credit facility to the public sector, including any financing of the public sector's obligations vis-à-vis third parties.
- 2.2 The ECB has consistently emphasised that the only compatible forms of central bank financing of a national deposit guarantee scheme for credit institutions 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 central bank's discretion<sup>2</sup>. Provisions to this effect need to be inserted into the draft law<sup>3</sup>. The draft law does not contain such conditions and makes no reference to the maximum duration of a loan provided by the BNB to the Fund. Therefore, the BNB's obligation to provide a loan to the Fund in an amount required to cover the additional shortfall in the Fund's financial resources is incompatible with the prohibition on monetary financing.

## **3. Central bank independence**

- 3.1 The draft law provides that the loan that the BNB is obliged to provide to the Fund should be granted from the financial resources of the BNB's Banking Department and from the 'reserve'. The draft law does not provide any indication as to what this 'reserve' contains. Furthermore, the draft law does not provide for an upper limit on the value of the loan and does not provide the BNB with the discretion to decide whether or not to grant the loan.

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<sup>2</sup> See the ECB's Convergence Report 2014, p. 31, and in particular paragraph 3.1.3 of Opinion CON/2011/76. All ECB Opinions are available on the ECB's website at [www.ecb.europa.eu](http://www.ecb.europa.eu).

<sup>3</sup> See paragraphs 2.2 to 2.8 of Opinion CON/2008/5.

3.2 The draft law impairs the institutional and financial independence of the BNB and may also impair its functional independence. In this respect, the following elements are relevant. First, it interferes with the investment, management and reporting of reserves, which is a task of the BNB under the Law on the BNB in order to guarantee the soundness of the national currency and the fixed exchange rate in Bulgaria<sup>4</sup>. Second, depending on the amount of the loan and the period of time for which it is granted, which remain unspecified in the draft law, granting such a loan may considerably limit the financial resources available to the BNB and its reserves, posing a threat to the performance of its tasks relating to the European System of Central Banks, as well as to the stability of the currency board in Bulgaria and thus to the BNB's price stability mandate. Third, the provision specifying the exact source within the BNB's financial resources to be used by the BNB to grant a loan to the Fund interferes with the BNB's powers to administer its own financial resources.

#### **4. Financing by credit institutions of a shortfall in the financial resources of the Fund**

4.1 The draft law provides for ex-post contributions by member banks to be paid in advance in the event that the Fund's resources are insufficient to cover its liabilities<sup>5</sup>. In this respect, an adequately funded deposit guarantee scheme provides protection for smaller depositors, while enhancing financial stability. Sound funding arrangements ensure an effective deposit guarantee and foster the maintenance of public confidence.

4.2 The ECB supports the requirement that banks pay increased annual premiums and make such payments in advance where the Fund's available financial resources are insufficient to repay depositors. Indeed, as stated in earlier ECB opinions<sup>6</sup>, an ex-ante funding scheme should also include the possibility to call on the private sector for additional financial support, as pre-collected funds from the industry may be insufficient in a crisis situation. The ECB notes that the principle of ex-post financing from the private sector should promote additional market discipline and address the risk of moral hazard.

4.3 Nevertheless, the ECB recommends that the measures described in paragraph 1.3 above should be carefully assessed as they have the potential to influence the stability of credit institutions and the banking sector. In particular, too high ex-post funding requirements might become procyclical, if required during an economic downturn. In this vein, Directive 2014/49/EU of the European Parliament and of the Council<sup>7</sup>, scheduled for transposition into national law by mid-2015, envisages extraordinary contributions by credit institutions of up to 0.5 % of covered deposits per calendar year, unless higher contributions are warranted due to exceptional circumstances with the consent of the competent authority<sup>8</sup>. Furthermore, it contains a provision according to which the competent authority may defer, in whole or in part, a credit institution's payment of extraordinary

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4 See Chapters II and V of the Law on the BNB.

5 See paragraph 1.3 above.

6 See paragraph 3.2.2 of ECB Opinion CON/2011/76 and CON/2011/12.

7 Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (OJ L 173, 12.6.2014, p. 149).

8 See Article 10(8) of Directive 2014/49/EU.

ex-post contributions if such contributions would jeopardise its liquidity or solvency<sup>9</sup>. In accordance with these observations, the ECB recommends that the powers under the draft law be exercised in a manner ensuring a well-funded deposit guarantee scheme, while preserving credit institutions' ability to maintain sufficient liquidity and regulatory capital.

- 4.4 The ECB notes that additional temporary financing going beyond the ex-post contributions by the member credit institutions may be needed in a severe crisis requiring, for example, activation of deposit guarantees for a major credit institution<sup>10</sup>. While the primary responsibility for adequately funding the deposit guarantee scheme should lie with the banks<sup>11</sup>, opportunities for backup funding for liquidity purposes may be available, e.g. market borrowing by the Fund (possibly supported by a government guarantee) or a line of credit from the Government. The ECB understands that the authorities are currently taking steps to make available to the Fund a significant line of credit from the central budget that is secured on assets of the Fund, including future claims against banks for annual premiums<sup>12</sup>.

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

Done at Frankfurt am Main, 9 December 2014.

[signed]

*The President of the ECB*

Mario DRAGHI

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9 See Article 10(8) of Directive 2014/49/EU. This principle is also applied in related areas of Union law (see Article 104(3) of Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12.6.2014, p. 190).

10 See paragraph 3.2.2 of ECB Opinion CON/2011/76.

11 See Essential Criterion no. 3 of Principle 11 of the Basel Committee on Banking Supervision/International Association of Deposit Insurers, 'Core Principles for Effective Deposit Insurance Systems', December 2010.

12 See paragraph 5 of the draft law amending and supplementing the Law on the state budget of the Republic of Bulgaria 2014, available on the Bulgarian National Assembly's website at [www.parliament.bg](http://www.parliament.bg).