EUROPEAN CENTRAL BANK

EUROSYSTEM

EN **ECB-PUBLIC**

OPINION OF THE EUROPEAN CENTRAL BANK

of 27 March 2019

on judicial relief granted to former holders of qualified bank credit

(CON/2019/13)

Introduction and legal basis

On 1 February 2019 the European Central Bank (ECB) received a request from the Slovenian Ministry of Finance for an opinion on a draft law on judicial relief granted to former holders of qualified bank credit (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[1] as the draft law relates to Banka Slovenije, rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets and the tasks conferred upon the ECB pursuant to Article 127(6) of the Treaty. 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 main objective of the draft law is to remedy the unconstitutionality, as declared by the Slovenian Constitutional Court in decision No U-I-295/13-260, dated 19 October 2016 (hereinafter the '2016 Decision'), of certain provisions of the Law on banking (hereinafter the 'ZBan-1')[2] governing Banka Slovenije's liability for damages with respect to extraordinary measures imposed by Banka Slovenije. The provisions assessed by the Constitutional Court[3] authorised Banka Slovenije to adopt extraordinary measures to write-down or convert qualified liabilities during the reorganisation of a bank that failed or was likely to fail, to meet minimum requirements for capital and liquidity, to an extent that could result in the withdrawal of their banking authorisation.

1.2 While the Constitutional Court confirmed that the legal basis for the extraordinary measures imposed in 2013 and 2014 by Banka Slovenije in respect of the write-down of subordinated instruments was in line with the Constitution of the Republic of Slovenia,[4] it held that the provisions of Article 350.a of the ZBan-1 providing for judicial relief to be unconstitutional. This conclusion was

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1 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).

2 *Zakon o bančništvu*, *Uradni list Republike Slovenije št.* 131/06.

3 Articles 253, 253.a, 253.b, 260.a, 260.b, 261.b, 261.c, 261.d, 261.e, 262.a, 262.b(2), 346, 347, 350 and 350.a of ZBan-1.

4 Ustava Republike Slovenije, *Uradni list Republike Slovenije* št. 33/91-I.

based on the Constitutional Court's finding that exercising judicial relief under Article 350.a of the ZBan-1 did not afford effective judicial protection to former holders of qualified bank credit affected by Banka Slovenije's extraordinary measures. The Constitutional Court decided that the legislator must remedy the unconstitutionality within six months of the publication of the Constitutional Court's decision, and provided the legislator with further guidance on how best to ensure more effective judicial protection.

1.3 The main purpose of the draft law is to remedy the unconstitutionality of the judicial relief afforded to former holders of qualified bank credit affected by Banka Slovenije's extraordinary measures, as declared by the Slovenian Constitutional Court. The key points of the draft law are summarised below.

1.4 The draft law codifies special procedural rules of judicial redress for the former holders of qualified bank credit, which deviate from the general rules and, inter alia, enable legal proceedings affecting similarly-placed litigants to be joined together to achieve a joint and uniform assessment of claims regarding a specific bank that was subject to Banka Slovenije's extraordinary measures. Any action for compensation may be filed after three months have elapsed from the entry into force of the draft law and at the latest within fifteen months from the entry into force of the draft law. The draft law prescribes a two-stage decision procedure. First, a decision establishing that there is a basis for a claim against Banka Slovenije would be issued by the court in the form of an interlocutory judgment. The claimant would then file a claim stipulating the level of damages at the latest sixty days from the date on which the interlocutory judgement becomes final. Banka Slovenije would, within thirty days of the interlocutory judgment becoming final, prepare and present a list of amounts of individual damages to the court and an individual assessment to the relevant claimant. The claimants would have the possibility to comment on the list made by Banka Slovenije within the claimants' sixty day deadline. The court would then issue a final judgement deciding on the amount of damages for each individual claimant.

1.5 The draft law regulates those proceedings that were already pending or will be pending in which the former holders of qualified bank credit are seeking judicial protection under civil law based on Article 350.a of the ZBan-1.

Article 350.a of the ZBan-1 stipulates that shareholders, creditors, and other persons whose rights are affected due to the effects of an order by Banka Slovenije on an extraordinary measure may claim damages from Banka Slovenije in accordance with Article 223.a of the ZBan-1, if they prove that the loss that has arisen due to the effects of the extraordinary measure is higher than it would have been had the extraordinary measure not been adopted. Article 223.a of the ZBan-1 stated that Banka Slovenije and all of the persons acting on its behalf should be acting with the diligence of a good expert when exercising their supervisory functions. As confirmed by the Constitutional Court, and also noted in the explanatory memorandum to the draft law, the liability of Banka Slovenije as provided for in Article 350.a of the ZBan-1 is a sui generis liability (specially determined liability)[5].

5 See paragraph 120 of the 2016 Decision and page 16 of the explanatory memorandum.

The draft law specifically refers to the material provisions of the ZBan-1 for the court to consider in establishing whether a claimant has a right to compensation. Article 19 of the draft law provides guidelines for the court on how to establish a right to compensation in the most economically efficient way[6]. When determining whether a claimant has a right to compensation, the court must establish whether extraordinary measures relating to qualified liabilities were adopted by Banka Slovenije in accordance with the conditions laid down in the ZBan-1[7]. Under the draft law, the court must, inter alia, verify whether the assessment of the conditions necessary for imposing extraordinary measures, as laid down in Article 253.a of the ZBan-1[8], including the respective bank's asset quality review (AQR), was carried out in accordance with the relevant provisions of the ZBan-1. In doing so, the main aspects that the court must verify, in accordance with the conditions laid down in the draft law, are whether: (i) the method and the premises on which the method was based, to an extent that impacted the assessment were in breach of the ZBan-1, the rules of the European Union on state aid and the standards for the supervision of banks as stipulated by the ECB, the European Commission, and the European Banking Authority (EBA); (ii) the methods and premises on which the method was based were used wrongly and this affected the assessment; (iii) the method of obtaining the data used in the preparation of the assessment raises a reasonable doubt as to whether source data were used and this affected the assessment; and (iv) there is reasonable doubt concerning the professionalism and the independence of the person who, or the entity which, performed the valuation of the assets of the bank that was used for the assessment to such an extent that it would be an unsuitable basis for a decision[9].

In the event of a dispute regarding the fulfilment of the conditions for the extraordinary measures, Banka Slovenije must, in connection with the write-off or conversion of qualified credit of the bank, ensure that an individual creditor does not, as a result of such actions, suffer greater losses than he would have suffered if the bank had been declared insolvent, in accordance with the 'no-creditor-worse-off-than-in-insolvency' principle[10]. The burden of proof lies with the Banka Slovenije[11].

1.6 The draft law provides that the action for the recovery of damages based on Article 350.a of the ZBan-1 may only be filed against the Banka Slovenije. Compensation for damages incurred as a result of the extraordinary measures must therefore be paid by Banka Slovenije. As noted in the explanatory memorandum to the draft law, the full amount of the qualified credit that was written off as a result of the extraordinary measures ordered by Banka Slovenije pursuant to the ZBan-1, and as such the potential amount of damages to be covered by Banka Slovenije, amounts to EUR

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6 As noted in the explanatory memorandum in the comments to Article 19 of the draft law.

7 Articles 253.a(1) and Article 261.a to 261.c ZBan-1.

8 The conditions laid down in Article 253.a of the ZBan-1 are as follows: i) an increase in risk is prevailing in relation to the bank; ii) there are no circumstances indicated showing that the reasons for this increased risk are likely to be eliminated within a suitable time period, iii) it is not likely that Banka Slovenije could take other measures on the basis of this act for the bank to achieve short-term and long-term capital adequacy or to achieve a suitable liquidity position within a suitable time; and iv) extraordinary measures are in the public interest to prevent a threat to the stability of the financial system.

9 See Article 19 of the draft law.

10 See the fifth paragraph of Article 261.a of the ZBan-1.

11 See Article 14 of the draft law.

963,197,453.89[12].

1.7 The funds for the payment of the damages will be provided independently by Banka Slovenije from its own funds, up to the level of the provisions established for this purpose and general reserves established in accordance with the Law on Banka Slovenije[13]. If the funds required for the payment of damages exceed the level of the provisions established for this purpose and general reserves, the Republic of Slovenia will temporarily cover the difference. The Republic of Slovenia and Banka Slovenije will, within twelve months from the draft law entering into force, enter into an agreement on this temporary provision of funds[14]. The draft law provides that the Banka Slovenije must make arrangements for the reimbursement of the temporarily provided monetary funds in its financial plan and ensure that the reimbursement of these funds does not cause a shortfall in income over expenses that cannot be covered by the existing general reserves of Banka Slovenije[15].

1.8 The draft law provides for one exception from the mandatory application of the draft law, in situations where a criminal offence has been declared to have been committed in relation to a decision of Banka Slovenije on an extraordinary measure by a final judgement of a criminal court. In such cases, the general rules for the recovery of damages and the general procedure will apply, instead of the special provisions of the draft law.

1.9 The draft law lays down rules for a two-stage disclosure of documents and information in relation to any decision on extraordinary measures adopted by Banka Slovenije.

Firstly, Banka Slovenije must publish on its website: (i) the order under which the extraordinary measure was adopted; (ii) documents showing the content of the contractual relationship between Banka Slovenije and the person who, or entity which, performed the valuation of the assets of the bank in accordance with Article 261(b)(1) of the ZBan-1; (iii) documents showing the content of the contractual relationship between Banka Slovenije and the performers of the asset quality review, the stress tests and the property valuators; and (iv) the stress test reports[16]. All personal and confidential information or commercial secrets must be redacted in advance of any such publication on the website of Banka Slovenije[17].

Secondly, Banka Slovenije must establish a data room for each bank in respect of which an extraordinary measure was adopted at discrete sites in the area in which the bank had its registered office at the time the measure was adopted. Former holders of the qualified bank credit (i.e., the claimants) have the right to access all the data and documents that were taken into account in adopting the extraordinary measures[18]. Personal data will be redacted from the documents made available in the data room [19] and persons seeking access to the data room will

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12 See page 7 of the explanatory memorandum to the draft law.

13 Zakon o Banki Slovenije, *Uradni list Republike Slovenije št.* 72/06.

14 In the agreement the parties will stipulate the procedures and criteria for the calculation and determination of the level of the monetary funds that are necessary for the temporary coverage.

15 See Article 24 of the draft law.

16 See Article 6(1) of the draft law.

17 See Article 6(2) of the draft law.

18 See Article 7 of the draft law.

19 See Article 7(2) of the draft law.

have to sign a confidentiality undertaking[20]. Furthermore, the draft law stipulates that the former holders of qualified bank credit may file a motion to the court to oblige Banka Slovenije (and certain other entities, such as the State, the Court of Audit, the Central Securities Clearing Corporation, the Securities Market Agency, the Insurance Supervision Agency, the Bank Assets Management Company and the bank affected by the extraordinary measure) to provide documents to the court without redacting personal or confidential information, whereby the court must limit any disclosure of evidence to what is required and proportionate and must also ensure the adoption of effective measures to protect such information, for example by excluding the public from the court's proceedings and limiting the review to certain entities.

1.10 In order to ensure the effectiveness of the protection of documents and data in a data room, the draft law establishes fines for violations[21]. Under the draft law, Banka Slovenije is also designated as an authority responsible for deciding on breaches of a confidentiality undertaking and the imposition of fines in accordance with the Minor Offences Act[22].

2. Observations

2.1 *Prohibition of monetary financing*

2.1.1 The ECB has already delivered opinions on two earlier versions of the draft law[23]. Under the first version of the draft law, compensation for damages incurred as a result of the extraordinary measures was required to be paid either by Banka Slovenije or the State, and if no liability could be attributed to Banka Slovenije, compensation was required to be paid by the State[24]. Under the second version of the draft law, even though Banka Slovenije would be liable for damages, provision was also made for Banka Slovenije to file an action against the State in order to prove in a separate court procedure that Banka Slovenije was not liable for the damages resulting from the imposition of the extraordinary measures[25]. The current version of the draft law does not make any reference to the liability of the State.

2.1.2 As noted by the ECB in its previous opinions, a requirement that Banka Slovenije must pay compensation for damages, to the extent that it results in Banka Slovenije assuming the liability of the Republic of Slovenia, would not be in line with the monetary financing prohibition laid down in Article 123 TFEU[26]. As repeatedly noted by the ECB, while resolution tasks may be considered to be central banking tasks, provided that they do not undermine an NCB's independence in accordance with Article 130 of the Treaty, the discharge of these tasks by central banks may not

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20 See Article 7(4) of the draft law.

21 See Article 25 of the draft law.

22 Zakon o prekrških, *Uradni list Republike Slovenije*, št. 29/11.

23 See Opinion CON/2017/16 and Opinion CON/2017/41. All ECB opinions are published on the ECB's website at www.ecb.europa.eu.

24 See paragraph 1.4 of Opinion CON/2017/16.

25 See paragraph 1.4 of Opinion CON/2017/41.

26 For the purposes of the monetary financing prohibition, Article 1(1)(b)(ii) of Council Regulation (EC) No 3603/93 defines 'other type of credit facility', inter alia, as 'any financing of the public sector's obligations vis-à-vis third parties'..

extend to the financing of resolution funds or other financial arrangements related to resolution proceedings as these are governmental tasks[27]. In this respect, it is noted that Directive 2014/59/EU of the European Parliament and of the Council[28] provides that the resolution financing arrangements may be used to pay compensation to shareholders and creditors if the valuation carried out for the purposes of assessing whether shareholders and creditors would have received better treatment if the institution under resolution had entered into normal insolvency proceedings determines that any shareholder or creditor has incurred greater losses than it would have incurred under normal insolvency proceedings[29]. It is also noted that Regulation (EU) No 806/2014 of the European Parliament and of the Council[30] envisages that, on the one hand, the resolution fund may be used to pay compensation to shareholders or creditors if, following an evaluation, they have incurred greater losses than they would have incurred under normal insolvency proceedings while on the other hand, in the case of non-contractual liability, the Single Resolution Board would compensate for any damage caused by it or by its staff in the performance of their duties[31]. The draft law should establish liability arrangements which clarify that Banka Slovenije is not liable to pay compensation for damages in circumstances that would mirror the compensation foreseen under Directive 2014/59/EU and Regulation (EU) No 806/2014 to be paid from resolution financing arrangements to shareholders or creditors when a second independent valuation (carried out after resolution actions have been effected) determines that shareholders or creditors have incurred greater losses than they would have incurred under normal insolvency proceedings, as otherwise Banka Slovenije would de facto finance measures akin to resolution proceedings. Banka Slovenije may not finance a government task.

2.2 *Financial independence of Banka Slovenije*

As the ECB has repeatedly stated[32], Member States may not put their central banks in a position where they have insufficient financial resources and inadequate net equity to carry out their ESCB or Eurosystem-related tasks, as well as their national tasks. Consequently, the impact of the draft law on the financial independence of Banka Slovenije should be carefully considered. According to the figures provided in the explanatory memorandum to the draft law, the total amount of the qualified credit written of, pursuant to the orders of Banka Slovenije on extraordinary measures, was EUR 963,197,453.89[33]. However, Banka Slovenije's most recently reported reserves amount

27 See, e.g., paragraph 3.2.3 of Opinion CON/2016/28.

28 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).

29 See Articles 75 and 101(1)(e) of Directive 2014/59/EU.

30 Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (OJ L 225, 30.7.2014, p. 1).

31 See Articles 76(1)(e) and 87(3) of Regulation (EU) No 806/2014.

32 See Opinions CON/2014/24, CON/2014/27, CON/2014/56 and CON/2017/17.

33 See page 7 of the explanatory memorandum to the draft law

to EUR 908,827,000.00[34]. Taking into account the worst-case scenario, Banka Slovenije could lose a significant amount of its reserves and as a consequence it may have a negative effect on the financial resources of Banka Slovenije and its financial independence.

2.3 *Professional secrecy*

As noted by the ECB in its opinions on earlier versions of the draft law, national legislation should be compatible with obligations to maintain professional secrecy imposed by Union law, in particular by Article 53 of Directive 2013/36/EU of the European Parliament and of the Council[35]. In this respect, the ECB considers that except for the outcome of stress tests, the publication of which is explicitly permitted under Article 53(3) of Directive 2013/36/EU, the stress test reports, AQR and asset valuations relating to individual supervised banks are to be regarded as confidential information. Disclosure of such confidential information can generally only be permitted in cases specified in Article 53(1) of Directive 2013/36/EU, which does not include disclosure to all the claimants envisaged under the draft law as disclosure is only permitted in cases of civil proceedings in connection with cases where a credit institution has been declared bankrupt or is being compulsorily wound up[36].

In order to ensure the adequate protection of confidential supervisory information, the disclosure of stress test reports without confidential information should be limited only to the shareholders or creditors who were directly affected by the extraordinary measures taken by Banka Slovenije and therefore have a legitimate legal interest as defined by the Constitutional Court of the Republic of Slovenia[37].

2.4 *Miscellaneous*

2.4.1 Regarding the draft law's requirement to verify whether the methods and the basic premises underlying the methods used in the assessment of the conditions necessary for imposing extraordinary measures, as laid down in Article 253.a of the ZBan-1, were consistent with the standards of banking supervision adopted by the ECB, the European Commission and the EBA, the ECB reiterates its previous recommendation that, in order to provide legal certainty, the draft law should specify in more detail the relevant legal sources (e.g. legal acts and best supervisory practices) relevant in this context[38].

2.4.2 Finally, as noted previously by the ECB[39], pursuant to Article 33 of Council Regulation (EU) No 1024/2013[40], from 3 November 2013 onwards, in view of the imminent assumption of its prudential

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34 See Banka Slovenije's Annual Report 2017 (Letno poročilo 2017, leto 28, april 2018).

35 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

36 See the judgement of the Court of Justice of 19 June 2018, *Baumeister*, C-15/16, ECLI:EU:C:2018:464; the judgement of the Court of Justice of 13 September 2018, *UBS Europe and Others*, C-358/16, ECLI:EU:C:2018:715; and the judgement of the Court of Justice of, 13 September 2018, *Buccioni*, C-594/16, ECLI:EU:C:2018:717.

37 See paragraph 123 of the 2016 Decision.

38 See paragraph 2.5 of Opinion CON/2017/16.

39 See paragraph 2.9 of Opinion CON/2017/41.

40 Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

supervisory tasks under Regulation (EU) No 1024/2013, the ECB was authorised to require the national competent authorities, including Banka Slovenije, together with credit institutions, financial holding companies, mixed financial holding companies and mixed-activity holding companies of euro area Member States, as well as persons belonging to these entities and third parties to whom these entities had outsourced functions or activities, to provide all relevant information for the ECB to carry out a comprehensive assessment, including a balance-sheet assessment, of credit institutions in euro area Member States. The comprehensive assessment conducted by the ECB in this context comprised two components, including an AQR, which was a point-in-time assessment of the accuracy of the carrying value of banks' assets as at 31 December 2013. The AQR was undertaken by the ECB and the national competent authorities, including Banka Slovenije, and was based on a uniform methodology and harmonised definitions. The comprehensive assessment was based on Regulation (EU) No 575/2013 of the European Parliament and of the Council[41] and Directive 2013/36/EU[42]. The ECB notes that the judicial review of the comprehensive assessment, including the underlying uniform methodology, conducted by the ECB in this respect falls outside the competence of the national courts, and falls exclusively within the competence of the Court of Justice of the European Union. It would be useful, to avoid any possible doubt on this issue, to introduce a provision into the draft law to clarify this particular point, so that any possible discrepancies between the draft law and Union law in this respect can be avoided.

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

Done at Frankfurt am Main, 27 March 2019.

[signed]

The President of the ECB

Mario DRAGHI

41 Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

42 See pages 2-4 of the European Central Bank, Aggregate Report on the Comprehensive Assessment: Summary (October 2014), available on the ECB's website at www.ecb.europa.eu.