EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 17 December 2010

on emergency stabilisation of credit institutions

(CON/2010/92)

Introduction and legal basis

On 10 December 2010, the European Central Bank (ECB) received a request from the Irish Minister for Finance for an opinion on the Credit Institutions (Stabilisation) Bill 2010 (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 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 the Central Bank of Ireland (hereinafter the 'Central Bank') and contains 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

The draft law, amongst other things, intends to facilitate and implement the programme agreed between the Minister for Finance, the European Commission, the ECB and the International Monetary Fund (IMF), protect the State's interest in respect of the guarantees issued by the State, restore confidence in the banking sector and achieve financial stability in the Irish economy.

The draft law grants far-reaching powers to the Minister and provides that, amongst other things, the Minister may (i) make direction orders with the intention of preserving or restoring the financial position of a credit institution, (ii) propose special management orders to appoint a special manager to an institution, (iii) propose subordinated liabilities orders on matters, such as the payment of interest, the repayment of principal, events of default and the timing of obligations, (iv) propose transfer orders relating to all or any part of a relevant institution's assets and/or liabilities, (v) apply general powers to matters relating to companies, when an institution is formed as such, including the removal of directors and/or officers and the appointment of directors and/or officers. It also contains various other

1 OJ L 189, 3.7.1998, p. 42.

miscellaneous provisions including, but not limited to, a provision overriding inconsistent provisions in any agreement by which an institution or any of its subsidiaries are bound.

2. General observations

2.1 The Minister for Finance has requested the ECB to deliver an opinion by 17 December 2010. The ECB notes that, in cases of particular urgency which do not allow for the normal consultation period, the consulting authority may indicate such urgency in its consultation request and ask for a shorter deadline for the adoption of the ECB's opinion. However, even though the ECB welcomes this consultation request and understands the need for an accelerated legislative procedure, it would have appreciated being consulted by the authority preparing the draft legislation at an earlier stage.

2.2 Article 4 of Decision 98/415/EC requires Member States to ensure that the ECB is consulted at an appropriate point in time to allow the consulting authority to take its opinion into consideration before deciding on the substance of the draft legislative provisions. The ECB therefore expects that the consulting authority will take any additional measures necessary to reflect the ECB's opinion to the extent appropriate. It also encourages further consultation on any new amendments to the adopted Act or any related implementing measures which fall within its field of competence, provided that such measures do not merely constitute the implementation of the ECB's recommendations. More generally, internal administrative procedures should be in place to ensure that timely consultation of the ECB is taken into account whenever such consultation is mandatory.

2.3 The ECB would like to stress that, given the very short time in which it has been consulted on this important legislation, it has not been possible to assess all the many constitutional, other legal and regulatory issues which this draft law undoubtedly raises. In particular, the ECB has serious concerns that the draft law is insufficiently legally certain on a number of critical issues for the Eurosystem. For example, problems of legal uncertainty relate to the impact of, *inter alia*, Article 61 (effects of orders on certain other obligations) of the draft law on the rights of the Central Bank, the ECB and possibly other central banks within the ESCB, the scope of collateral rights of central banks given as security against ELA, as well as other issues. The ECB would expect that nothing in this Act would affect operations, rights or entitlements of the Central Bank or the European Central Bank, or any other central banks within the ESCB.

2.4 In line with its previous opinions, the ECB emphasises that, when adopting measures to deal with the financial crisis, Member States should act in a coordinated manner in order to avoid significant differences in national implementation having a counter-productive effect, which may involve distortions in global banking markets. Moreover, it is crucial to ensure consistency with the Eurosystem's management of liquidity and its operational framework[2]. Against this background, any national measure should ensure a sufficiently level playing field within the euro area, which is of key importance to maintain the integrity of the euro area banking system.

2 See, for example, Opinion CON/2009/54. All ECB Opinions are published on the ECB's website at ww.ecb.europa.eu.

The ECB welcomes the wider powers under the draft law that will be available to the Irish authorities to manage and solve a financial institution crisis. They will include, for instance, the appointment of special managers with the intent of preserving or restoring a credit institution's financial position. This is in line with the consensus emerging at EU level. At the same time these emergency powers interfere significantly with the property rights of institutions' shareholders and creditors. Thus it is important for any regime to properly balance these fundamental rights with the general interest in the financial system's stability. The Irish framework may have to be adapted in the light of the forthcoming Commission's legislative proposals on a Union crisis management and bank resolution regime. Second, the draft law is a temporary emergency measure which will cease to have effect, unless prolonged, by the end of 2012. In view of the expected introduction in Ireland of legislation on bank resolution by the first quarter of 2011, the draft law needs to clarify how it will interact with the powers and tools under the future bank resolution regime.

2.5 Regarding the features and implementation modalities of asset support schemes, the Eurosystem has developed a number of guiding principles[3] to: (i) safeguard financial stability and restore the provision of credit to the private sector while limiting moral hazard, (ii) ensure a level playing field within the single market to the extent possible, and (iii) contain the impact of possible asset support measures on public finances.

2.6 Previous ECB Opinions noted that it is appropriate to maintain a clear distinction between procedures leading to antitrust and banking supervision decisions[4] and that draft national laws should reflect in these circumstances the principle of allocating powers to authorities in accordance with their respective objectives[5]. In the present case, the dual competence of the Minister in banking mergers and the consultative or advisory role conferred on the Governor[6] could conflict with these principles.

2.7 Moreover, previous ECB Opinions pointed out the need to balance the potentially conflicting objectives of market competition and financial stability by introducing safeguards similar to those which apply under Union law[7]. While acknowledging that cases might occur in which a merger in the form of a balance sheet merger would be necessary on stability grounds, although it raises concerns for its effects on competition[8], the ECB stressed that these cases should remain exceptional and should not unduly restrain competition[9]. The ECB recommends applying the

3 Guiding principles for bank asset support schemes, 25 February 2009, available on the ECB's website at www.ecb.europa.eu.

4 See, for example, paragraph 8 of ECB Opinion CON/2005/58 and paragraph 4.1 of ECB Opinion CON/2008/44.

5 See, for example, paragraph 4 of ECB Opinion CON/2007/17 and paragraph 4.1 of ECB Opinion CON/2008/44.

6 Section 7(2), Section 13(2), Section 28(1)(a) and Section 33(2) of the draft law.

7 See, for example, paragraph 3.3, last sentence, of ECB Opinion CON/2006/51 and paragraph 4.2 of ECB Opinion CON/2008/44.

8 See for example paragraph 8, second sentence, of ECB Opinion CON/2005/58 and paragraph 4.2 of ECB Opinion CON/2008/44.

9 See, for example, paragraph 3.3, last sentence, of ECB Opinion CON/2006/51 and paragraph 4.2 of ECB Opinion CON/2008/44.

Minister's prerogatives under the draft law in accordance with the principle of proportionality and with appropriate safeguards.

2.8 The measures intended to safeguard financial stability should involve cooperation with the relevant Member State authorities, in line with Union legislation and the arrangements in place, such as the Memorandum of Understanding on cooperation between the financial supervisory authorities, central banks and finance ministries of the European Union on cross-border financial stability[10].

2.9 The ECB recommends referring to the Eurosystem's 'operations' rather than to its 'functions', in line with ECB Opinion CON/2008/37. In particular, references to the Eurosystem should include all actions, rights, arrangements and agreements relating to it by all participants.

2.10 The draft law does not contain any general provision protecting the rights of the Central Bank and the ECB under any relevant agreements from the effects of Article 61 and other provisions of the draft law, such as regarding transfer orders, which potentially may impact on the Eurosystem's operations and the functions and interests of its members. Article 5 of the draft law recognises that the draft law has no effect on the performance of the Central Bank Governor's or the Central Bank's 'functions' in relation to any credit institution authorised or regulated in Ireland. However, this appears to refer only to the supervisory functions of the Central Bank and its Governor and does not include the potential impact of the draft law provisions on the Central Bank, the ECB or any other central bank within the ESCB when appearing as counterparty in a monetary policy or emergency liquidity operation concluded with a relevant institution. It is essential that such a general carve out provision is contained in the draft law to protect Eurosystem operations and the rights of the Central Bank, the ECB and any other central bank within the ESCB.

3. Specific observations

Role of the Central Bank of Ireland

3.1 Any involvement of the Central Bank and its Governor in the application of the measures to strengthen financial stability must be compatible with the Treaty and consequently with the Central Bank's institutional and financial independence, as well as with the Governor's personal independence to safeguard the proper performance of their tasks under the Treaty and the Statute of the European System of Central Banks and of the European Central Bank[11]. The draft law specifies in Section 5 that nothing in its provisions prevents the performance by the Governor or the Central Bank of their functions in relation to any credit institution authorised or regulated in the State, or affects any obligation arising under the Treaties or the ESCB Statute[12]. Section 5 of the draft law should make clear that the Treaty principle of central bank independence prevails over any incompatible draft law provision.

10 As published on the ECB website, www.ecb.europa.eu.

11 See also similar observations in paragraph 3.1.4 of CON/2009/93.

12 Section 5 of the draft law.

This provision should also specify that nothing in the draft law will prejudice the compliance by the Central Bank with the prohibition on monetary financing under Article 123 of the Treaty[13]. Furthermore, the ECB suggests further clarification that the rights of the Central Bank and the ECB, as creditors of any relevant institution, will not be affected. The ECB also recommends reinserting the general provision with respect to the preservation of the operations, rights or entitlement of the Central Bank, the ECB or any other central banks within the ESCB regarding the provisions of the draft law which was included in a previous version of the draft law, on which the ECB was consulted.

3.2 Section 61 of the draft law details the effect of the various orders that the Minister may make under the draft law on certain other obligations. This should not impair the ability of the Central Bank or the ECB to maintain the Eurosystem's operations and, in particular, to enforce their rights including, without limitation, the enforcement of security over any eligible collateral posted by any relevant institution, any of its subsidiaries, its holding company or any subsidiaries of its holding company. The Section needs to clarify this, in particular since the published Bill does not contain an Article 60 which appeared in a previous version of the draft law and which usefully stated that 'nothing in this Act affects any function, right, or entitlement of the [Central] Bank or the European Central Bank'.

3.3 The draft law should also be consistent with the overall tasks and functions of the Central Bank and of the Governor under the existing Irish legal framework. Further, the ECB recommends drafting any 'relationship framework' under Section 6 of the draft law in agreement with the Governor to ensure that it does not go beyond the overall task and functions of the Central Bank and Governor and that it is consistent with the Central Bank's institutional and financial independence and the Governor's personal independence[14].

3.4 Section 22 of the draft law provides for the appointment of a special manager. It is important to ensure that this would not impair the ability of the Central Bank or the ECB to maintain the Eurosystem's operations and, in particular, to enforce their rights including, without limitation, the enforcement of security over any eligible collateral posted by an institution. In this regard, Section 22(2) excludes certain paragraphs of Section 22(1) from its application to the Central Bank, the ECB or any other central banks within the ESCB. The ECB would, moreover, welcome clarification with respect to the remainder of sub-section (1) of Section 22 in the event that actions not currently excluded were taken by such entities as a result of action taken in the normal course of Eurosystem operations.

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13 The monetary financing prohibition in Article 123 of the Treaty is further clarified in Council Regulation (EC) No 3603/93 of 13 December 1993 specifying definitions for the application of prohibitions in Article 104 and 104b(1) of the Treaty (OJ L 332, 31.12.1993, p. 1) according to which overdraft facilities or any other type of credit facility with the ECB or the national central banks (NCBs) of Member States in favour of Community institutions or bodies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States are prohibited, as is any purchase directly from these public sector entities by the ECB or NCBs of debt instruments.

14 See also similar observations in paragraph 3.1.6 of Opinion CON/2009/93.

Direction orders

3.5 In respect of direction, special management, subordinated liabilities and transfer orders, the Minster may, in exceptional circumstances, waive the requirement to notify in writing the relevant institution, allowing the relevant institution time to make written submissions to the Minister. Under the current draft, exceptional circumstances will exist where: (a) there is an imminent threat to the stability of the institution concerned, (b) there is an imminent threat to the stability of the national financial system, or (c) the Minister has reasonable grounds for believing that the confidentiality of the proposed order or the possibility of making such an order would not be maintained and that the breach of such confidentiality would have significant adverse consequences. The draft law should clarify whether the exceptional circumstances justifying a waiver of the written notice requirement are established when any of either (a), (b) or (c) are satisfied or whether (a) and (b) must both be satisfied, with (c) being an exceptional circumstance on its own[15]. In the ECB's view, waiver of the basic notice requirement for measures interfering with creditors' property rights would only be justified by the additional risk to the stability of the financial system.

Reorganisation of credit institutions

3.6 Section 4(1)(c) provides that a further purpose of the draft law is to continue the process of reorganisation, preservation and restoration of the financial position of Anglo Irish Bank Corporation Limited (Anglo) and, due to the reference in Section 4(1)(d) to the financial position of building societies, potentially also of Irish Nationwide Building Society (INBS). This appears to go beyond the position agreed with the IMF and the European Commission in liaison with the ECB, which envisaged a specific resolution plan for these two non viable banks. The ECB would welcome an amendment to the recital and confirmation that any action taken by the Minister under the draft law with respect to Anglo and INBS will be conditional on agreement by the IMF and the European Commission, in consultation with the ECB, and will relate to the State's commitments under the agreement reached with the IMF and the European Commission, in liaison with the ECB.

Netting agreements

3.7 The ECB welcomes Section 65 of the draft law which provides that nothing in the draft law affects the operation of, among other things: (a) the netting of the Financial Contracts Act 1995, (b) the European Communities (Settlement Finality) Regulations, and (c) the European Communities (Financial Collateral Arrangements) Regulations. In relation to an agreement to which a relevant institution or any of its subsidiaries is a party, Section 65 should ensure that its effect is to exclude the provisions of the draft law, in particular Sections 21 and 61, from the operation of contracts which fall within the scope of the identified excluded legislation.

15 Sections 7(5), 13(5), 28(6) and 33(5) of the draft law.

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

Done at Frankfurt am Main, 17 December 2010.

[signed]

The President of the ECB

Jean-Claude TRICHET