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EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 21 October 2008

at the request of the Banque de France

on a draft amending finance law for the financing of the economy

(CON/2008/56)

Introduction and legal basis

On 14 October 2008 the European Central Bank (ECB) received a request from the Banque de France, acting on behalf of the French Ministry for Economic Affairs, Industry and Employment, for an opinion on a draft amending finance law for the financing of the economy (hereinafter the 'draft law'). Given the turbulence in the international financial markets, the consulting authority has requested the ECB to provide its opinion urgently.

The ECB's competence to deliver an opinion is based on Article 105(4) of the Treaty establishing the European Community 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, and in particular Article 6 thereof, 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 of the draft law

1.1 The draft law is motivated by the current financial market crisis. It concerns the provision of several State guarantees[2] in the context of the measures taken in France in order to restore confidence and to create the conditions for the normal functioning of the system that finances the economy[3].

1.2 The first State guarantee[4] (hereinafter the 'first State guarantee') is an integral part of a measure designed to re-inject liquidity into the economy[5]. The State guarantee may be granted, against consideration, to debt securities issued by a refinancing company whose purpose is to grant loans to credit institutions that are authorised and supervised under the Monetary and Financial Code

1 OJ L 189, 3.7.1998, p. 42.

2 In accordance with Article 34-II-5 of the Organic Law No 2001-692 of 1 August 2001 on finance laws.

3 See the explanatory memorandum to the draft law.

4 Article 6-II of the draft law.

5 See the explanatory memorandum to the draft law.

(hereinafter the 'refinancing company'). The statutes of the refinancing company will be authorised by an order of the Minister for the Economy. Only credit institutions that satisfy the capital requirements under the Monetary and Financial Code may be granted funds by the refinancing company. In addition, the institutions concerned will enter into an agreement with the State specifying the consideration to be provided for the guarantee. The loans granted by the refinancing company will be collateralised in accordance with the draft law.

1.3 In addition, a State guarantee (hereinafter the 'second State guarantee') may be given in exceptional circumstances, in particular in urgent cases, in relation to securities issued by credit institutions against consideration and provided that the State receives collateral security (from the credit institution) equivalent to that which the refinancing company has[6].

1.4 The third State guarantee[7] (hereinafter the 'third State guarantee') is an integral part of the measure designed to reinforce the own funds of financial entities[8] in order to guarantee the stability of the French financial system[9]. The State guarantee may be granted to financing raised by a separate company whose sole shareholder is the State and whose aim is to subscribe to securities that have been issued by financial entities and which constitute regulatory own funds (the 'recapitalisation company').

1.5 The fourth State guarantee[10] (hereinafter the 'fourth State guarantee') may be granted, against consideration, on financing raised by companies of the Dexia group from credit institutions and institutional depositors, as well as bonds and debt securities that they issue for institutional investors, provided that the financing, bonds or securities have been raised or subscribed for between 9 October 2008 and 31 October 2009 included and mature before 31 October 2011. This State guarantee will be dependent on a guarantee being sought at the same time from Belgium and Luxembourg and will be limited to 36.5 % of the eligible amounts.

2. General observations

2.1 The draft law was adopted by the Council of Ministers on 13 October 2008, i.e. on the day following the summit of Paris of 12 October 2008. The French authorities consulted the ECB on the draft law on 14 October 2008. On 15 October 2008, the French Parliament adopted the draft law. The law was finally published in the *Journal officiel de la République française* on 17 October 2008. The ECB understands that the application of an accelerated procedure during the preparation and adoption of the draft law did not leave room for the normal consultation process. This does not, however, prejudice the duty under Article 105(4) of the Treaty to consult the ECB on national draft legislative provisions falling within its advisory fields of competence. This opinion

6 It is noted that the two categories of State guarantees mentioned in paragraphs 1.2 and 1.3 of this opinion are granted to debt securities issued before 31 December 2009 having a maximum duration of five years.

7 Article 6-III of the draft law.

8 See the explanatory memorandum to the draft law.

9 Article 6-III of the draft law.

10 Article 6-IV of the draft law.

should therefore be taken into account in the context of any further legislative provisions complementing or implementing the adopted legislation. The ECB will need to be consulted on any such draft legislative provisions which substantially affect the adopted legislation and fall within its advisory fields of competence.

2.2 The ECB notes that there is an ongoing discussion at both the international and European levels with a view to coordinating actions of countries aimed at preserving confidence in and stability of the international financial markets. More specifically, on 12 October 2008 the Heads of States of the euro area issued a 'Declaration on a concerted European action plan of the euro area countries' (hereinafter the 'Declaration')[11], in which they confirmed their commitment to act together in a decisive and comprehensive way in order to restore confidence and proper functioning of the financial system, aiming at restoring appropriate and efficient financing conditions for the economy. They agreed on common principles to be followed by the EU and euro area governments, central banks and supervisors to avoid national measures adversely affecting the functioning of the single market and the other Member States. Such coordinated approach includes initiatives aimed at: (i) ensuring appropriate liquidity; (ii) facilitating the funding of banks through various means; (iii) providing additional capital resources to financial institutions; and (iv) recapitalisation of distressed banks. These principles were also endorsed by the European Council on 16 October 2008. The ECB highlights that all the initiatives put in place by national governments to restore the confidence in financial markets should be aimed at implementing such common principles, in the spirit of close cooperation with other Member States and EU institutions.

2.3 Against this background, the ECB notes that the draft law is aimed at implementing in France several of the principles listed in the Declaration. However, the ECB also notes that the draft law provisions relating to the third State guarantee, in order to be in line with one of the conclusions of the Ecofin meeting of 7 October 2008[12], namely that the support should be temporary, should contain an expiry date. Although the references in the explanatory memorandum to the draft law to the temporary nature of the measures seems to indicate that the State guarantee will be provided for a limited period of time, a clear time limit in the draft law itself, following the example of the provisions of the draft law relating to the first, second and fourth State guarantees, would remove any expectation that the scheme is permanent.

3. Specific comments

3.1 *Prohibition of monetary financing*

The ECB reminds the French authorities that compliance of the State guarantee arrangements with the monetary financing prohibition laid down in the Treaty needs to be ensured. With regard to the first State guarantee, the ECB notes that the draft law does not specifically address the legal status

11 The Declaration is available on the French Presidency's website at www.ue2008.fr.

12 See the press release of the 2894th Council meeting (13784/08), available on the Council's website at www.consilium.europa.eu.

of the refinancing company and the nature of its shareholding. Should this company be considered as a public undertaking within the meaning of Article 101(1) of the Treaty[13], the prohibition of monetary financing would apply. In the context of the third State guarantee, the prohibition of monetary financing applies, since the recapitalisation company is an entity whose sole shareholder is the State[14].

The ECB notes that, to ensure compliance with the prohibition of monetary financing, both companies cannot benefit from overdraft facilities or any type of credit facility[15] with the Banque de France (or any other central banks of the European System of Central Banks (ESCB)) while ESCB central banks are prohibited from purchasing debt instruments directly from these companies. The ECB also notes that the draft law does not foresee any specific role for the Banque de France. However, in case the Banque de France would be led to perform certain activities for the refinancing company (or the recapitalisation company) at the request of the State, these activities would also need to comply with the above prohibition and the relevant provisions of the Statute of the Banque de France as regards their remuneration.

3.2 *The scheme's relationship with the single monetary policy of the euro area*

First, the ECB notes that, in line with the Declaration, Member States must act in a coordinated manner to avoid significant differences in national implementation from having a counter-productive effect and creating distortions in global banking markets. The Declaration acknowledges the need to work in cooperation with the ECB to ensure consistency with the Eurosystem's management of liquidity and compatibility with its operational framework. Against this background, the ECB notes that uncoordinated decisions among Member States should be avoided as they may involve a fragmentation of the euro area money market.

Regarding the first State guarantee, the ECB notes that the refinancing company will acquire from financial institutions financial assets and/or will grant loans to credit institutions. Although such measures should restore confidence in the French banking system, it is important that the price applied by the refinancing company to its transactions with credit institutions be determined in a coordinated manner within the euro area and the EU. The ECB notes the importance of the price determination of the transactions conducted by the refinancing company and their potential implications on the transmission of the single monetary policy decisions within the euro area. Indeed, uncoordinated price determination between all euro area Member States could lead to possible segmentation of the euro area money market. Moreover, the pricing of the transactions conducted by the refinancing company should not interfere with the implementation and/or the transmission of the Eurosystem's monetary policy.

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13 In order to qualify as a 'public undertaking' within the meaning of Article 101(1) of the Treaty, the State must exercise dominant influence over the company by controlling its financial resources and governing bodies in accordance with Article 8(1) of 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 Treaty (OJ L 332, 31.12.1993, p. 1).

14 See Article 6-III of the draft law.

15 In accordance with Regulation (EC) No 3603/93.

Second, the ECB considers that extending the guarantees to cover all interbank deposits should be avoided. It could entail a substantial distortion in the various national segments of the euro area money market by potentially increasing short-term debt issuance activity across Member States and thereby impairing the implementation of the single monetary policy, which is an exclusive competence of the Eurosystem under Article 105(2) of the Treaty. It also appears crucial to ensure the harmonisation of the price determination of such guarantee within the euro area and the EU, as a level-playing-field is of essence. The ECB should be involved in such concertation and coordination, and would welcome the explicit provision for this in subsequent legislation. In this context, the ECB notes that the fourth State guarantee as regards financing raised by companies of the Dexia group from credit institutions and institutional depositors, as well as bonds and debt securities that they issue for institutional investors (to be raised or subscribed for between 9 October 2008 and 31 October 2009 and mature before 31 October 2011), is an exceptional measure that is part of a rescue package arranged with the participation of the French Government, which will be assessed by the Commission under the Treaty State aid rules.

Third, the ECB understands that under French law, the refinancing company will not be a credit institution[16]. Therefore, the refinancing company will not be an eligible counterparty for Eurosystem monetary policy operations.

Fourth, since it cannot be excluded that the refinancing company will receive as collateral assets that are on the list of the assets eligible as collateral for Eurosystem monetary policy operations, it may be advisable to put in place a mechanism whereby information can be exchanged in order to avoid the risk that collateral is mobilised twice.

3.3 *Recapitalisation of credit institutions*

As regards the third State guarantee, the draft law provides that it may be granted to the debt securities issued by the recapitalisation company to subscribe to securities that have been issued by financial entities and which constitute regulatory own funds. The ECB draws attention to the conclusions adopted by the Declaration which highlighted some common principles so as to guide the action of euro area Member States when providing for recapitalisation of relevant financial institutions, in particular stressing the need to ensure that financial institutions to which Member States make available additional capital resources should be obliged to accept additional

16 See Article 6-II.A of the draft law.

restrictions, notably to preclude possible abuse of such arrangements at the expense of non-beneficiaries. Against this background, the ECB would suggest that the specific suggestions set out above be included in any subsequent related legislation.

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

Done at Frankfurt am Main, 21 October 2008.

[signed]

The President of the ECB

Jean-Claude TRICHET