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EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 17 October 2008

at the request of the Danish Ministry of Economic and Business Affairs
on a proposed Law on financial stability

(CON/2008/54)

Introduction and legal basis

On 9 October 2008 the European Central Bank (ECB) received a request from the Danish Ministry of Economic and Business Affairs for an opinion on a proposed Law on financial stability, which was adopted on 10 October 2008 (hereinafter the 'Law'). Given the turbulence in the international financial markets, the consulting authority 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 Law 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 Law

1.1 The Law is motivated by the current financial market crisis. It introduces a special resolution regime for banks affected by financial difficulties and ensures that all domestic and foreign claims by depositors, debt holders (senior debt) and other ordinary creditors in relation to banks and savings banks in Denmark are fully covered by a State guarantee from 5 October 2008 until 30 September 2010[2]. Only creditors in relation to covered bonds and holders of subordinated debt (hybrid core capital and subordinate loan capital) are excluded from the State guarantee.

1.2 The Law implements the political agreement on financial stability of 5 October 2008 between the Danish Government, the financial sector and the majority of political parties represented in the Danish Parliament (*Folketinget*)[3]. That political agreement states that the Danish financial sector

1 OJ L 189, 3.7.1998, p. 42.

2 See Sections 1(1) and Section 16(1) of the Law.

3 Available on the website of the Ministry of Economic and Business Affairs, www.oem.dk.

should demonstrate moderation, implying for example that a more moderate approach should be taken in future to management remuneration within credit institutions, and it should also aim at consolidation over the next two years.

1.3 The guarantee scheme set up under the Law supplements the existing Deposit and Investor Insurance Scheme, which transposed the EU Directives on depositor guarantee and investor-compensation schemes[4]. It also widens the scope of operation of the existing Private Contingency Association (PCA), an association set up and administered by the Danish financial sector, which may draw on guarantees given by its members for the purpose of winding up ailing credit institutions. Such guarantees currently amount to DKK 750 million per year. Under the Law, the new guarantee scheme applies to all credit institutions that apply for membership of the PCA before 13 October 2008, after which date such credit institutions will not be allowed to withdraw from the guarantee scheme during the two years for which it is scheduled to apply[5].

1.4 In addition to the above features, the Law obliges the Minister for Economic and Business Affairs to set up a Winding-Up Company (WUC), fully owned by the State, with the objective of covering the claims of creditors of credit institutions that are members of the PCA, and of contributing to a regulated winding-up of failing institutions[6]. The WUC will have powers to organise private-sector takeovers of credit institutions affected by financial difficulties, either by means of a directed transfer of the troubled credit institution's assets and liabilities to a purchaser nominated by the WUC, e.g. a subsidiary of the WUC, or of capital injections provided by the WUC to a selected private-sector purchaser acquiring the assets and liabilities of the troubled credit institution under a commercial contract[7]. Where insolvency procedures are initiated in relation to a credit institution, the WUC will enter into an agreement with the insolvency administrator on the sale of the insolvent credit institution's assets and liabilities[8].

1.5 The PCA will guarantee losses incurred by the WUC during the period of operation of the Law up to a maximum amount of DKK 35 billion[9]. The State will guarantee any losses exceeding the amount guaranteed by the PCA[10].

2. General observations

2.1 The ECB was consulted on the Law at the draft stage in the afternoon of 9 October 2008. Less than 24 hours later, the Danish Parliament adopted the Law. The ECB understands that the application

4 Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes, OJ L 135, 31.5.1994, p. 5 and Directive 97/9/EC of the European Parliament and of the Council of 3 March 1997 on investor-compensation schemes, OJ L 84, 26.3.1997, p. 22.

5 See Sections 2(1) and (5) of the Law.

6 See Sections 3-6 of the Law.

7 See Section 7 and Section 8(1) of the Law.

8 See Section 8(2) of the Law.

9 See Sections 9 and 10 of the Law

10 See Section 11 of the Law.

of an accelerated procedure during the preparation and adoption of the 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, and perhaps the ECB could have been consulted on a previous draft of the Law a few days earlier.

2.2 As already mentioned in a recent ECB opinion on another draft national law relating to emergency measures arising out of the current financial turmoil[11], the ECB is of the view that it is important for national authorities to seek to coordinate their responses to the current financial situation with their EU partners. In view of the similarities of the causes and consequences of the financial crisis across Member States and the potential interdependencies of policy responses, it would have been advisable to consult other EU authorities formally on the envisaged Law at the draft stage. At the same time, the ECB notes that there is an ongoing discussion at international and European level aimed at coordinating action to preserve confidence and financial stability. More specifically, the ECB would draw attention to the conclusions adopted at the Ecofin meeting on 7 October 2008, which highlighted common principles to guide the action of Member States as follows: (i) interventions should be timely and the support should in principle be temporary; (ii) the interests of taxpayers should be protected; (iii) existing shareholders should bear the due consequences of the intervention; (iv) the government should be in a position to bring about a change of management; (v) management should not retain undue benefits; (vi) governments may have, inter alia. the power to intervene in remuneration; (vii) legitimate interest of competitors must be protected, in particular through the State aid rules, and negative spill-over effects should be avoided[12]. Against this background, the ECB notes that a number of the elements contained in the Law are in line with the conclusions of the Ecofin meeting of 7 October 2008, inter alia on the temporary nature of the arrangement and the possibility, subject to certain conditions, to replace the board and management of institutions.

2.3 In line with the Declaration of 12 October 2008[13] made at the summit of the euro area Member States in Paris, the ECB notes that EU Member States have to act in a coordinated manner to avoid significant differences in national implementation having a counter-productive effect, creating distortions in global banking markets. In particular, the ECB notes that uncoordinated decisions to guarantee interbank deposits in some Member States should be avoided as they may involve a fragmentation of money markets.

2.4 At this stage, the ECB wishes to underline the importance it attaches to ensuring that the Law, and any subsequent executive orders, fully comply with the relevant provisions of Community law, including State aid rules, especially in view of the fact that interbank deposits from foreign credit

11 See ECB Opinion CON/2008/44 of 3 October 2008 at the request of the Irish Minister for Finance on a draft Credit Institutions (Financial Support) Bill 2008.

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

13 See the Declaration of 12 October 2008, available on the website of the French Presidency, www.ue2008.fr.

institutions are covered by the guarantee scheme. This feature could be seen to give some Danish credit institutions a competitive advantage both in a European context and domestically, as certain national competing financial institutions, such as mortgage credit institutions, are excluded from the guarantee scheme[14]. In this respect, the ECB notes that the Danish authorities notified the Commission of the State guarantee on 8 October 2008. According to the Commission's press release the guarantee scheme has been approved under the State aid rules laid down in the Treaty, because it was the most appropriate means of addressing the risk of a severe disturbance in the Danish economy, while keeping potential distortions of competition to a minimum through effective safeguard mechanisms[15].

3. State guarantee and the prohibition on monetary financing

3.1 The ECB welcomes the new guarantee scheme, which is structured in such a way that it should encourage the Danish financial sector to take an active and responsible role in the measures necessary to ensure financial stability and the regulated winding-up of failing institutions. At the same time, it is noted that Section 3 of the Law states that the Minister for Economic and Business Affairs will set up a company, the WUC, with share capital provided by the State. The State will be the sole owner of the WUC[16], which will be able to borrow to cover its financing needs[17]. However, neither the Law nor the explanatory memorandum to the Law specifies or clarifies from whom such borrowing will take place.

3.2 In this specific context, the ECB would remind the Danish authorities that a number of elements must be observed in order to comply with the monetary financing prohibition laid down in the Treaty. First, it should be noted that the WUC will qualify as a 'public undertaking' within the meaning of Article 101(1) of the Treaty, since the State will exercise dominant influence over the WUC by controlling its entire subscribed capital and will have the majority vote in a general meeting, while also being able to appoint members of the WUC's governing body[18]. The WUC will also qualify as a 'body governed by public law' of Denmark within the meaning of Article 101(1) of the Treaty, since it will be established by the Law as a legal person financed and closely dependent on the Danish State, with the specific purpose of meeting needs in the general interest, while its organisation and the exercise of its public functions and powers in relation to commercial banks will be based on the provisions of the Law[19]. The ECB notes therefore that the

14 See paragraph 2.3 of ECB Opinion CON/2008/44.

15 See Commission press release IP/08/1483 of 10 October 2008. The non-confidential version of the Commission's decision will be made available under Case NN 58/2008.

16 See Section 3 of the Law.

17 See Section 3(2) of the Law.

18 Such being the three options for classification as a 'public undertaking', as specified in Article 8(1) of Council Regulation 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.

19 Cf. paragraph 2.4 of ECB Opinion CON/2008/5 of 17 January 2008 at the request of the Polish Minister for Finance on a draft law amending the Law on the Bank Guarantee Fund.

WUC should not be allowed to benefit from any type of lending or overdraft facilities from Danmarks Nationalbank to ensure compliance with the prohibition on monetary financing, and Danmarks Nationalbank has confirmed that it does not intend to lend or provide any financing to the WUC. Second, it should also be remembered that the provision of emergency liquidity assistance is a central bank function, which consists in giving support in exceptional circumstances and on a case-by-case basis to temporarily illiquid but solvent credit institutions[20].

3.3 It is the ECB's view that national legislation providing for the financing by NCBs of credit institutions other than in connection with central banking tasks, such as monetary policy, payment systems or temporary liquidity support operations, in particular to support insolvent credit and/or other financial institutions, is incompatible with the monetary financing prohibition.

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

Done at Frankfurt am Main, 17 October 2008.

[signed]

The President of the ECB

Jean-Claude TRICHET

20 See ECB Opinion CON/2008/42 of 10 September 2008 at the request of the Banque centrale du Luxembourg on amendments to the draft law improving the legislative framework for Luxembourg as a financial centre and amending the Law of 23 December 1998 on monetary status and on the Banque centrale du Luxembourg, footnote 16.