EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 27 November 2008

at the request of the Greek Ministry of Economy and Finance on a draft law on enhancing liquidity of the economy to address the impact of the international financial crisis and on a draft decision on its implementation

(CON/2008/79)

Introduction and legal basis

On 18 November 2008 the European Central Bank (ECB) received a request from the Greek Ministry of Economy and Finance for an opinion on a draft law on enhancing liquidity of the economy to address the impact of the international financial crisis (hereinafter the 'draft law') and on a draft decision of the Minister of Economy and Finance implementing the draft law (hereinafter the 'draft decision').

The ECB's competence to deliver an opinion is based on Article 105(4) of the Treaty establishing the European Community and the third and sixth indents 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 the draft decision relate to the Bank of Greece (BoG) 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 and the draft decision

1.1 *Objective and nature*

According to its explanatory memorandum, the draft law is aimed at strengthening the national economy against the implications of the international financial crisis by enhancing liquidity. In particular, the provision of additional capital should enable credit institutions to grant credit to households and businesses and contribute to reducing the pressure on lending interest rates. Finally, the draft law aims at safeguarding the proper implementation of the financial support measures (hereinafter the 'measures') by establishing a Supervisory Council (SC) and provides for sanctions in cases of non-compliance with the terms of use of such measures as laid down in the draft law. The draft decision implements the draft law, taking into account, *inter alia*, the capital adequacy

1 OJ L 189, 3.7.1998, p. 42.

and solvency of credit institutions, which are necessary factors to ensure financial stability[2]; in particular it lists the conditions for using the measures, such as the commission to be paid by beneficiary CIs and the rating requirements for eligible collateral.

1.2 *Main features*

The measures comprise the following: (i) State participation in the capital of credit institutions authorised by the BoG (hereinafter the 'beneficiary CIs') through the acquisition of preference shares with a value of up to EUR 5 billion to be issued by 1 February 2009 and subscribed for by the Greek State by 31 December 2009[3]; (ii) provision of State guarantees with a value of up to EUR 15 billion to beneficiary CIs for loans to be granted to them by 31 December 2009 with a maturity of three months to three years against payment of commission and/or provision of adequate collateral[4]; and (iii) issuance by 31 December 2009 of Government securities with a value of up to EUR 8 billion and a maturity of up to three years, to be lent to beneficiary CIs for enhancing liquidity against payment of commission and provision of adequate collateral[5]. In principle, the specific terms of implementation of the above measures will be determined by a decision of the Minister for Economy and Finance (hereinafter the 'MEF') on a proposal by the Governor of the Bank of Greece (hereinafter the 'BoG Governor').

Moreover, under Article 4 of the draft law, funds provided by the State for the purposes of implementing Articles 2 and 3 may, by an MEF Decision on a proposal by the BoG Governor, be allocated within a total cap on State guarantees and securities of EUR 23 billion, depending on the take-up and the overall needs that might arise. In addition, under Article 5, beneficiary CIs are obliged to use the proceeds of the liquidation of securities received under Article 3 to grant mortgage loans and loans to small and medium-sized enterprises (SMEs) on competitive terms, while the guarantee provided under Article 2 may apply to lending to businesses of vital importance for the growth of Greece. Article 6 provides for a simplified procedure for collateralising loans or credit granted to credit institutions using as collateral in favour of the State or the BoG claims of such credit institutions against third parties. Finally, Article 7 provides for the establishment of the SC to monitor implementation of the measures[6], as well as for sanctions.

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2 See recital 2 of the draft decision.

3 See Article 1 of the draft law. These shares give voting rights and a right to a fixed dividend on the capital contributed and shall allow for State representation at a general meeting of ordinary shareholders and on the Board entailing a right to veto any decision on dividend distribution and executive pay considered to jeopardise the interest of depositors or to substantially affect the solvency and smooth running of the bank; finally, these shares may not be transferred by the Greek State to third parties or listed on regulated markets; in case of liquidation, the claims of the Greek State as a shareholder shall be satisfied in priority to any other ordinary shareholder.

4 See Article 2 of the draft law. State representation on the Board has the same legal effects as under Article 1(3) for the period of the guarantee's validity.

5 See Article 3 of the draft law.

6 The SC will be chaired by the MEF; other participants will be the BoG Governor, the deputy MEF in charge of the State General Accounting Department and the State representative appointed to the Board of beneficiary CIs.

2. General observations

2.1 The Government submitted the draft law to the Greek Parliament on 23 October 2008 and a further amendment to the draft law was submitted on 6 November 2008. The Ministry of Economy and Finance consulted the ECB on 18 November 2008, requesting that the consultation be treated as a matter of urgency, and indicated that it was likely that Parliament would enact the draft law by 21 November 2008. The draft law provides for retroactive entry into force from the date of its submission to Parliament. The ECB understands that the legislative procedure is at an advanced stage and notes that a consultation should take place at a point which affords the ECB sufficient time to examine the draft legislative provisions and also enables the relevant national authorities to take the ECB's opinion into consideration before the provisions are adopted. It even follows from Article 3(4) of Decision 98/415/EC that Member States are obliged to suspend the adoption process of the draft legislative provision pending submission of the ECB's opinion, given that the adopting national authority should have the opportunity to deliberate the ECB's opinion in a meaningful way before taking its decision on the substance[7]. The ECB also wishes to draw the consulting authority's attention to the recent ECB opinions issued at the request of other Member States, in which the ECB has already commented on draft legislation sharing some of the features of the draft law[8]. Moreover, the ECB notes that harmonisation regarding the end of such schemes across euro

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7 See the Guide to consultation of the European Central Bank by national authorities regarding draft legislative provisions, Title IV, Section 1, available on the ECB's website at www.ecb.europa.eu.

8 See the following ECB Opinions: 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; CON/2008/46 of 8 October 2008 at the request of the Belgian Ministry of Finance on a preliminary draft law on measures promoting financial stability and in particular establishing a State guarantee for the provision of credit in the context of financial stability; CON/2008/48 of 15 October 2008 at the request of the Irish Minister for Finance on a draft Credit Institutions (Financial Support) Scheme 2008; CON/2008/50 of 17 October 2008 at the request of the Belgian Ministry of Finance on a draft royal decree adopted under Article 117bis of the Law of 2 August 2002 on the supervision of the financial sector and on financial services; CON/2008/51 of 17 October 2008 at the request of the Greek Ministry of Economy and Finance on a draft law on, inter alia, the establishment of the 'Depositors and Investors of Credit Institutions Compensation Fund'; CON/2008/52 of 17 October 2008 at the request of the Spanish State Secretary for Economic Affairs on a Royal Decree-Law creating a Fund for the acquisition of financial assets and on a Royal Decree-Law adopting urgent financial and economic measures in relation to the concerted European action plan of the euro area countries; CON/2008/54 of 17 October 2008 at the request of the Danish Ministry of Economic and Business Affairs on a proposed Law on financial stability; CON/2008/55 of 20 October 2008 at the request of the Austrian Ministry of Finance on draft legal measures to ensure the stability of the Austrian financial market; CON/2008/56 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/2008/57 of 21 October 2008 at the request of the German Ministry of Finance on a Law on the implementation of a package of measures to stabilise the financial market and an order on its implementation; CON/2008/58 of 23 October 2008 at the request of the Banca d'Italia on behalf of the Italian Ministry for Economic Affairs and Finance on two Decree-Laws containing urgent measures to guarantee the stability of the banking system and the continuity of the provision of credit; CON/2008/59 of 24 October 2008 at the request of the Swedish Ministry of Finance on a draft proposal on stabilising measures for the Swedish financial system; CON/2008/60 of 27 October 2008 at the request of the Spanish State Secretary for Economic Affairs on a draft Order implementing Royal Decree-Law 6/2008 creating the Fund for the acquisition of financial assets and on a draft Basic Agreement of the Fund's Executive Council; CON/2008/61 of 28 October 2008 at the request of the Belgian Minister for Finance on a draft royal decree implementing the Law of 15 October 2008 on measures promoting financial stability and in particular establishing a State guarantee for the provision of credit in the context of financial stability, in relation to the protection of deposits and life insurance and amending the Law of 2 August 2002 on the supervision of the financial sector and on financial services; CON/2008/62 of 29 October 2008 at the request of the Swedish Ministry of Finance on a draft ordinance on State guarantees for banks etc.; CON/2008/65 of 12 November 2008 at the request of the Banca d'Italia on behalf of the Italian Ministry for Economic Affairs and Finance on a draft ministerial decree containing provisions to implement Decree-Law No 157/2008 on further urgent measures to guarantee the stability of the credit system; CON/2008/67 of 13 November 2008 at the request of the Spanish Ministry for Economic Affairs and Finance on a draft order implementing Royal Decree-Law 7/2008 authorising State guarantees; and CON/2008/68 of 13 November 2008 at the request of the Finnish Ministry of Finance on a draft government proposal for laws amending the Law on the

area and EU Member States is also crucial. The ECB should be involved in such concertation and coordination and would welcome the explicit provision for this in subsequent legislation.

2.2 As already mentioned in recent ECB opinions on draft national laws in other Member States relating to emergency measures arising out of the current financial turmoil, it is important for national authorities to coordinate their responses to the current financial situation with their EU partners. Given the similarities of the causes and consequences of the financial crisis across Member States and the potential interdependencies of policy responses, the ECB notes that coordination is already taking place at the international and European level to preserve confidence and financial stability. More specifically, the ECB refers to the conclusions adopted at the Ecofin Council 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) the legitimate interest of competitors must be protected, in particular through the State aid rules; and (viii) negative spill-over effects should be avoided[9]. Against this background, the ECB is pleased to note that the draft law and draft decision closely follow these conclusions.

2.3 On 12 October 2008, the Heads of State of the euro area issued a 'Declaration on a concerted European action plan of the euro area countries' (hereinafter the 'Declaration')[10], in which they confirmed their commitment to act together in a decisive and comprehensive way to restore confidence and the proper functioning of the financial system, with the aim of 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 all of the following: (i) ensuring appropriate liquidity; (ii) facilitating the funding of banks through various means; (iii) providing additional capital resources to financial institutions; (iv) recapitalisation of distressed banks. The European Council also endorsed these principles for all Member States on 16 October 2008. Against this background, the ECB highlights that all initiatives put in place by national governments to restore confidence in the financial markets should be aimed at implementing such common principles, in the spirit of close cooperation with other Member States and EU institutions.

Government Guarantee Fund and the Law on credit institutions. All ECB opinions are available on the ECB's website at www.ecb.europa.eu.

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

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

3. Specific comments

3.1 *Eligibility for support*

The draft law states that beneficiary CIs are eligible for the measures. The ECB understands that subsidiaries of foreign credit institutions are included in the scope of beneficiary CIs, in line with the Commission's guidance on compliance by the financial sector support schemes with State aid rules[11], as also referred to in the preamble of the draft decision, in particular with the eligibility criteria that all institutions incorporated in the Member State concerned, including subsidiaries of foreign credit institutions, with significant activities in that Member State, should be covered by the support scheme concerned. In relation to this, the ECB notes that for reasons of legal certainty and clarity, terminological consistency should be ensured in the draft decision and the draft law when referring to such beneficiary CIs.

3.2 *Conditions for support and relationship with the single monetary policy of the euro area and financial stability*

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. Similarly, harmonisation regarding the expiry of such financial support schemes across the euro area would also be necessary. Against this background, the ECB recalls that uncoordinated decisions among Member States should be avoided as they may lead to a fragmentation of the euro area money market. In this respect, the ECB makes the following observations, which are important from a monetary policy perspective, as regards the measures.

First, the ECB notes that Article 1 of the draft law provides for State participation in the capital of beneficiary CIs through the acquisition of preference shares. In this respect, in line with previous opinions, the ECB recalls that harmonisation and coordination of government measures intended to alleviate tensions in the financial markets is of crucial importance. The recapitalisation measures considered in Member States are aimed at strengthening the capital position of fundamentally sound financial institutions in order to improve the functioning and stability of the banking system and to ensure the proper financing of the economy. In particular, a consistent approach should be used when defining the conditions for recapitalisations including the pricing of the instruments to provide Tier 1 capital to financial institutions, in order to support the implementation of the

11 See the 'Communication from the Commission – The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis' of 13 October 2008, available on the Commission's website at www.ec.europa.eu. Paragraph 18 specifies that 'The eligibility criteria of financial institutions … must be objective, taking due account of their role in the relevant banking system and the overall economy, and non-discriminatory so as to avoid undue distortive effects on neighbouring markets and the internal market as a whole. In application of the principle of non discrimination on the grounds of nationality, all institutions incorporated in the Member State concerned, including subsidiaries, and with significant activities in that Member State should be covered by the scheme'.

Declaration of 12 October 2008. Against this background, the ECB notes that in general the conditions for capital support should aim at protecting the interests of taxpayers and respecting the level playing field among institutions. Moreover, the ECB highlights that the pricing conditions for capital support should be risk-based and market-oriented, determined by taking into consideration the specific risk of both the specific instrument chosen for injecting capital and the institution concerned. Specific features of the instruments for capital injections (such as preferred shares and other hybrid instruments) should be appropriately chosen so that, while encouraging an early end to the State's capital support of banks, they should not result in an excessive increase in the cost of capital. Finally, the temporary nature of the State's intervention should be ensured by providing financial institutions with incentives to redeem such instruments as soon as possible.

Second, the ECB notes that under Article 2 of the draft law, the MEF may issue a State guarantee for loans to be concluded by beneficiary CIs by 31 December 2009 with a maturity of up to three years. The ECB also notes that, under Article 2(1) of the draft law, as implemented by Section 2A of the draft decision, the deadline for such guarantees will expire on 31 December 2012 at the latest. The ECB recalls that such arrangements for the granting of government guarantees on bank debt should, in their practical implementation, aim at: (i) addressing the funding problems of liquidity-constrained solvent banks by improving the functioning of the market for bank debt of longer term maturity; (ii) preserving the level-playing field among financial institutions and avoiding market distortions and (iii) ensuring consistency with the management of liquidity by the Bank of Greece. In this context, the ECB understands that the above provision seeks to implement Article 8 of the Declaration which states, *inter alia*, that the euro area governments would make available a Government guarantee of new medium term (up to five years) bank senior debt issuance and meets the principles stated in the Declaration indicating the temporary feature of such schemes.

Third, the ECB notes that the draft decision, in line with paragraph 3.4 of CON/2008/52, recognises the ECB's contribution[12] to the harmonisation and coordination across the EU of the exercise of determining the price of State guarantees. In particular, the ECB recalls that it is important to ensure that the price of the State guarantee is risk-based and market-oriented and determined on the basis of the costs of a corresponding guarantee in the market. However, it has to be highlighted that the abovementioned contribution by the ECB is not formally incorporated in any ECB legal act.

Fourth, the ECB welcomes the provision of Section 9 of the draft decision which aims to ensure that the beneficiary CIs do not profit from undue use of their guaranteed status[13] to engage in a heightened level of activities which could distort the market and facilitate abnormal balance sheet

12 Under Section 2A(c) of the draft decision the pricing of State guarantees will be determined in accordance with the procedure established by the ECB. Under Section 3(d) thereof, such pricing also applies to Government securities.

13 See, e.g. paragraph 3.4 of ECB Opinion CON/2008/48, paragraph 3.1 of ECB Opinion CON/2008/50 and paragraph 3.4 of ECB Opinion CON/2008/57.

growth[14]. In this regard, the ECB reiterates the importance of establishing appropriate safeguards such as limits on the marketing of financial products or on expansion of activities on the basis of State guarantees.

Fifth, as stated in previous opinions, the ECB considers that extending State guarantees to interbank deposits should be avoided, as 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 therefore impairing the implementation of the single monetary policy. Therefore, the ECB welcomes Section 2A (a) of the draft decision, which states that interbank deposits may not be covered by State guarantees.

3.3 *Role of the central bank*

The ECB notes the participation of the BoG in the measures, as provided for in the draft law and further specified and supplemented in the draft decision. In particular, Articles 1 to 4 of the draft law require a proposal of the BoG Governor prior to the adoption of ministerial decisions determining the terms of implementation of the draft law. Moreover, Article 7(1) provides for the participation of the BoG Governor in the newly established SC with the task of coordinating the proper and efficient implementation of the draft law and ensuring that the liquidity provided will benefit depositors, borrowers and the Greek economy in general. In this respect the ECB notes that the draft law expressly clarifies that the establishment and operation of the SC will be without prejudice to the supervisory competences of the BoG. In addition, Article 7(2) provides for sanctions to be imposed under Article 55A of the Statute of the Bank of Greece in cases of non-compliance by beneficiary CIs with the terms of use of the scheme, including revocation of the measures by an MEF decision on a proposal by the BoG Governor[15]. The ECB appreciates that the draft law recognises the BoG's expertise as it will facilitate the BoG's effective performance of its financial stability role. The ECB understands that such advisory function will be performed without prejudice to the BoG's independence and in full compliance with the Treaty provisions on the prohibition of monetary financing.

14 Section 9 states, *inter alia*, that in implementing the draft law beneficiary CIs must abstain from aggressive market strategies, including advertising by invoking their guaranteed status especially against non-beneficiary CIs. They must also abstain from expanding their activities or from pursuing other purposes in manners unduly distorting competition. To this end, beneficiary CIs must ensure that during the implementation the average increase of total assets does not exceed a determined limit. The SC will monitor compliance with such obligations on the basis of reports provided for in Section 8.

15 In this context, Section 8 of the draft decision stipulates, *inter alia*, that beneficiary CIs must regularly inform the BoG on the precise use of the funds received. The BoG Governor then informs the SC accordingly. On the basis of quarterly reports from beneficiary CIs, the BoG prepares a biannual report on the use of funds, outlining the implementation of the business plans of each beneficiary CI as well as any restructuring plans. Such report will be submitted to the SC and the Commission of the European Communities.

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

Done at Frankfurt am Main, 27 November 2008.

[signed]

The President of the ECB

Jean-Claude TRICHET