EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 1 December 2008

at the request of the Hungarian Ministry of Finance

on a draft law on strengthening the financial intermediary system

(CON/2008/81)

Introduction and legal basis

On 17 November 2008 the European Central Bank (ECB) received a request from the Hungarian Ministry of Finance for an opinion on a draft law on the Law on strengthening the financial intermediary system (hereinafter the 'draft law').

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 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 intended to limit the effects of the global financial crisis in Hungary and maintain its financial system's stability. Subsequent to the International Monetary Fund (IMF) loan granted to Hungary, and in view of the financial intermediary system's role in its economy's operations, the Parliament intends to adopt the draft law to preserve this system's stability, maintain investor confidence and balance the interests of the owners of individual institutions within the system and the interests of the public.

1.2 Under the draft law, the Magyar Nemzeti Bank (MNB) and the Hungarian Financial Supervisory Authority (HFSA) will continuously assess the regulated financial institutions and will inform the Minister responsible for the regulation of the money, capital and insurance markets thereof on request. The Hungarian State will also deposit HUF 600 billion equivalent foreign currency from the IMF loan between 2008 and 2010 on a dedicated MNB account. The Minister responsible for general government will manage the funds via the MNB according to the funds' management rules

1 OJ L 189, 3.7.1998, p. 42.

to be laid down in a separate agreement by the Minister responsible for general government and the MNB's Governor.

1.3 Furthermore, the Hungarian State will be authorised to guarantee credit institutions' debts vis-à-vis their creditors subject to the cumulative fulfilment of the following conditions: (a) the Chair of the HFSA's Supervisory Council and the MNB's Governor jointly propose the guarantee; (b) the debt is based on a loan agreement or debt security; (c) the credit institution's debt maturity is between three months and five years; (d) the credit institution's debt arises between the entry into force of the draft law and 31 December 2009; (e) the debt is denominated in euro, Swiss francs or forint. The aggregated amount of the State guarantee may not exceed HUF 1 500 billion.

1.4 On a joint proposal by the Chair of the HFSA's Supervisory Council and the MNB's Governor, the Hungarian State may increase a credit institution's capital at the request or with the consent of the credit institution, or *ex officio* without the credit institution's consent, in exchange for preference shares in the credit institution.

1.5 The temporary provisions on measures introduced by the draft law will enter into force on the day after their publication and will apply until 31 December 2009.

2. General observations

2.1 The ECB would like to point out that, in cases of particular urgency which do not allow for a normal consultation period, the consulting authority may indicate such urgency in the consultation request and ask for a shorter deadline for the ECB's opinion to be adopted. This does not prejudice the national authorities' duty under Article 105(4) of the Treaty to appropriately consult the ECB on national draft legislative provisions falling within its fields of competence. It follows from Article 3(4) of Decision 98/415/EC that Member States are obliged to suspend the adoption process for a draft legislative provision pending receipt of the ECB's opinion. The adopting national authority should have the opportunity to deliberate the ECB's opinion meaningfully prior to taking its decision on the substance. If a time limit has been set for submission of the ECB opinion and this time limit has expired, the national authority may restart the adoption process[2].

2.2 The ECB has issued several recent opinions on State measures addressing the global financial crisis, which all emphasise the importance of a common approach aimed at restoring confidence in financial markets. Similarly, the ECB notes that the conclusions adopted at the Ecofin meeting on 7 October 2008 highlighted common principles to guide State actions[3]. Moreover, the ECB notes that on 12 October 2008 the Heads of State of the euro area issued a 'Declaration on a concerted

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

3 According to these principles, (a) interventions should be timely and the support should in principle be temporary; (b) the interests of taxpayers should be protected; (c) existing shareholders should bear the due consequences of the intervention; (d) the Government should be in a position to bring about a change of management; (e) management should not retain undue benefits; (f) governments may have, *inter alia*, the power to intervene in remuneration; (g) legitimate interest of competitors must be protected, in particular through the State aid rules; and (h) negative spillover effects should be avoided.

European action plan of the euro area countries'[4] (hereinafter the 'Declaration'), in which they confirmed their commitment to act together in a decisive and comprehensive way to restore confidence in and the proper functioning of the financial system, and appropriate and efficient financing conditions for the economy. They agreed on common principles to be followed by the European Union 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. This coordinated approach includes initiatives aimed at ensuring appropriate liquidity, facilitating the funding of banks by various means, providing additional capital resources to financial institutions and recapitalising distressed banks. The European Council also endorsed these principles for all Member States on 16 October 2008. As pointed out in recent ECB opinions[5], it is of the utmost importance that the operations conducted by national authorities do not interfere in any way with the single monetary policy and/or with the Eurosystem's refinancing operations.

2.3 The ECB also underlines the importance of ensuring that the proposed arrangements comply with the relevant Community law provisions, in particular as regards competition, including in the area of cross-border bank mergers and acquisitions, as well as financial services legislation and the single market principles. In addition, they need to comply with the criteria set out in the recently adopted Commission's guidance on compliance by financial sector support schemes with State aid rules[6] (hereinafter the 'Commission's guidance'). Hence, the State's role as shareholder as a consequence of recapitalisation under the draft law must be limited in time.

2.4 The ECB understands that Article 24 of the draft law authorises the Hungarian Government to adopt decrees to regulate the procedure for activating a State guarantee under the draft law. The ECB expects to be consulted on any new draft legislative provisions if they materially influence the stability of financial markets.

3. Specific observations

Eligibility for support

3.1 Pursuant to Articles 1 and 2 of the draft law, all banks and specialised credit institutions as defined in Law CXII of 1996 on credit institutions[7] having their registered office in Hungary are entitled to benefit from the measures under the draft law. The ECB understands, therefore, that subsidiaries of foreign banks are also included, but branches of foreign banks are not. The ECB welcomes the

4 Available on the website of the French Presidency at www.ue2008.fr.

5 See, in particular, ECB Opinion 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 and financial and economic measures in relation to the concerted European action plan of the euro area countries. See also ECB Opinion 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. All ECB opinions are available on the ECB's website at www.ecb.europa.eu.

6 See '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' (OJ C 270, 25.10.2008, p. 8).

7 *Magyar Közlöny*, 1996.12.12.

above provisions, as they avoid preferential treatment of specified credit institutions, and distortion of the level playing field as regards the treatment of domestic financial institutions and subsidiaries of foreign institutions[8]. The ECB notes that, in the specific context of provision of State guarantees, the Commission's guidance includes detailed rules on the eligibility criteria for the beneficiary institutions[9].

Conditions for support and interaction with monetary policy

3.2 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. Similarly, support measures by EU Member States should be temporary in nature and their expiry across the EU should be harmonised. In this respect, the ECB makes the following observations.

3.3 First, as regards the support measures in the form of State guarantees under Articles 6 and 7 of the draft law, the ECB considers that the implementation of the proposed arrangements should aim at: (a) addressing the funding problems of liquidity-constrained solvent banks by improving the functioning of the market for bank debt of longer term maturity; (b) preserving the level-playing field among financial institutions and avoiding market distortions; and (c) ensuring consistency with the management of liquidity by the MNB[10].

3.4 Second, according to Article 7 of the draft law, the Parliament authorises the Minister responsible for general government to provide a guarantee in the name of the Hungarian State to increase a credit institution's financial resources, subject to the fulfilment of the conditions listed in paragraph 1.3 of this Opinion. The ECB finds that the eligibility criteria are unclear concerning the State guarantees for credit institutions that increase their financial resources under Article 7 and need further consideration by the legislator[11].

3.5 Third, the ECB considers that further clarification is needed in the draft law of the type of liabilities that the State guarantees may cover. In particular, it is not clear whether the guarantees provided by the Hungarian State cover interbank deposits. In this respect, the ECB notes that State guarantees to cover interbank deposits should be avoided as they have the potential to interfere with the conduct of a central bank's liquidity-providing operations, and thus with the transmission of monetary policy decisions. In particular, the ECB considers that State guarantees to be provided under the

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8 On these aspects see, in particular, 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. See also ECB Opinion 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. See also ECB Opinion CON/2008/52 and ECB Opinion 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.

9 See paragraph 18 of the Commission's guidance, specifying 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.'

10 See, e.g. paragraph 2.1.2 of ECB Opinion CON/2008/62 of 29 October 2008 at the request of the Swedish Ministry of Finance on a draft ordinance for State guarantees for banks etc.

11 See *inter alia* paragraph 3.3(a) of this Opinion.

draft law may be economic in nature as guarantees for the repayment of the interbank deposits if the guarantee is provided for the repayment of an unsecured loan drawn by the borrower bank. The ECB thus recommends avoiding the provision of State guarantees which are economic in nature as guarantees for deposits[12].

3.6 Fourth, the ECB also notes that the Declaration states that the Member State governments would make available a State guarantee of new medium-term, i.e. up to five years, bank senior debt issuance. The ECB understands that the draft law empowers the Minister for Finance to provide State guarantees on the basis of the agreements to be entered into until the end of 2009, while the maximum time limit for guaranteed obligations remains undefined. The ECB recommends amending the draft law to ensure full compliance with the Declaration's criteria in this respect[13].

3.7 Fifth, Article 7(7) of the draft law provides that a beneficiary bank may be charged a fee in connection with the provision of the State guarantee, the level of which is to be set in the relevant agreement 'taking into account the relevant recommendations and communications issued by the European Commission'. In this respect, the ECB notes 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. For the sake of transparency, a further more precise indication should be given on the method to be used to calculate the fee. The ECB also notes in this respect that it is of crucial importance to ensure harmonisation of the price for such guarantees within the EU, as a level playing field is essential[14].

3.8 Sixth, as regards the provision of capital to the credit institutions under Article 8, the ECB makes the following observations. On the one hand, the eligibility criteria are unclear and should be clarified in the draft law. Furthermore, in line with its previous opinions, the ECB notes that harmonisation and coordination of government measures intended to alleviate tensions in the financial markets are of crucial importance. The recapitalisation measures considered in Member States are aimed at strengthening the capital position of fundamentally sound financial institutions to improve the functioning and stability of the banking system and ensure the proper financing of the economy. In particular, the conditions for recapitalisations, including the pricing of the instruments to provide Tier 1 capital to financial institutions, should be defined consistently to support the implementation of the Declaration. Against this background, the ECB notes that in general the conditions for capital support should aim at protecting the interest of taxpayers and respecting the level playing field for institutions. On the other hand, 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

12 See, e.g. paragraph 3.2 of ECB Opinion CON/2008/50 of 17 October 2008 at the request of the Belgian Ministry of Finance on a draft royal decree adopted under Article 117*bis* of the Law of 2 August 2002 on the supervision of the financial sector and on financial services.

13 See, e.g. paragraphs 3.4 and 3.5 of ECB Opinion CON/2008/55.

14 See, e.g. paragraph 2.1.3 of ECB Opinion CON/2008/62.

encouraging an early end to the State's capital support for 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 early as possible after a certain period of time.

Role of the central bank

3.9 The ECB understands that the MNB in its supervisory role will under Article 3 of the draft law assess the regulated institutions under the Law of 2007 CXXXV on the Hungarian Financial Supervisory Authority[15]. The ECB appreciates that the draft law recognises the MNB's expertise in strengthening the financial intermediary system.

3.10 The ECB expects that the functions to be performed by the MNB under the draft law[16] will be conducted in a manner fully compatible with its institutional and financial independence, as a safeguard for the proper performance of its tasks under the Treaty and the Statute of the European System of Central Banks and of the European Central Bank. It is therefore expected that the MNB's involvement will not go beyond an advisory and procedural role and, in particular, that it will fully comply with the prohibition of monetary financing laid down in the Article 101(1) of the Treaty[17], interpreted in line with 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[18].

3.11 Finally, the ECB notes that the amendment to Law CXII of 1996 proposed under Article 28 of the draft law provides that sharing of information on individual credit institutions by the HFSA or the MNB with the Minister responsible for general government and the Minister responsible for the regulation of money, capital and insurance markets will not constitute a breach of business secrets if (a) the data is provided for the purpose of analysing trends in the national economy and planning the central budget; or (b) the stability of the financial intermediary system is potentially endangered. The ECB notes that limits imposed by Community law on sharing information on individual credit institutions are currently subject to discussion in the context of the Commission's proposed amendments to Directive 2006/48/EC of the European Parliament and of the Council of 14 July 2006 relating to the taking up and pursuit of the business of credit institutions[19], according to which authorities may disclose information to governments in emergency situations. The draft law will need to fully comply with Community law.

15 *Magyar Közlöny*, 2007.11.12.

16 In particular the function under Article 4 of the draft law. See paragraph 1.2 of this Opinion.

17 See paragraph 3.2 of ECB Opinion CON/2008/52.

18 OJ L 332, 31.12.1993, p. 1.

19 OJ L 177, 30.6.2006, p. 1.

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

Done at Frankfurt am Main, 1 December 2008.

[signed]

The President of the ECB

Jean-Claude TRICHET