EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 22 March 2013

on the measures for strengthening bank stability

(CON/2013/21)

Introduction and legal basis

On 7 March 2013, the European Central Bank (ECB) received a request from the Slovenian Ministry of Finance for an opinion on a draft regulation on the implementation of measures to strengthen bank stability (hereinafter the 'draft regulation').

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 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 regulation relates to Banka Slovenije 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 regulation

1.1 *Criteria and conditions for the application of measures aimed at strengthening bank stability*

1.1.1 The draft regulation implements the Law on Slovenia's measures to strengthen bank stability[2] (hereinafter the 'Law on bank stability'). It lays down criteria and conditions for: (a) the transfer of a bank's[3] assets to the Bank Asset Management Company (BAMC) or to dedicated companies[4]; (b) the issuance of State guarantees for liabilities of the BAMC and of the dedicated companies; (c) the increase of a bank's share capital and of other capital instruments of banks which are taken into account in calculating a bank's capital pursuant to the Law on banking[5, 6].

1 OJ L 189, 3.7.1998, p. 42.

2 *Zakon o ukrepih Republike Slovenije za krepitev stabilnosti bank* (*Uradni list Republike Slovenije* No 105/2012).

3 Pursuant to Article 2 of the draft regulation in connection to Article 2 of the Law on bank stability, 'bank' here refers to a bank or a savings bank, as defined in the Law on Banking, with its head office in Slovenia.

4 Dedicated companies are companies that take over the risks of banks. They may be established by the banks or by the banks together with the BAMC, as joint-stock companies, pursuant to Articles 2 and 21 of the Law on bank stability.

5 Zakon o bančništvu (Uradni list Republike Slovenije, No 99/2010, official consolidated text, 9/2011 – ZPlaSS-B, 35/2011, 59/2011, 85/2011, 48/2012 and 105/2012).

6 See Article 3 of the draft regulation.

1.1.2 The measures may apply to a bank where the Government establishes that the bank does not have, or will not have within the following 12 months, sufficient capital to meet capital adequacy requirements and, as a result, the stability of the financial system is threatened[7].

1.1.3 In order to be eligible for the measures, a bank must be able to show in its business strategy that it: (a) will be able to conduct long-term sustainable and successful operations and have stable and adequate capital; (b) will implement measures for the suitable participation of its own assets and the assets of holders of the bank's capital instruments taken into account in calculating the bank's capital to attain these goals; (c) will implement measures to prevent or mitigate any possible distortion of competition[8]. On the basis of the Government's decision and after having received a positive opinion for State aid from the European Commission, the BAMC and the bank will conclude an agreement on implementing the approved measures in accordance with the business strategy[9].

1.2 *Purchase or takeover of bank assets or rights for consideration*

Pursuant to the draft regulation, the BAMC may acquire bank assets by transfer of all rights under certain risk items of the bank to the BAMC for consideration. The BAMC may take over risk items of a bank only if it also participates in increasing the bank's share capital or acquires other capital instruments of the bank. The following risk items may be transferred to the BAMC: (a) bank claims exceeding EUR 500 000 on the day of the valuation against non-payers[10] classified in group D or E which are in default for more than 90 days or otherwise unlikely to be repaid in full; (b) a bank's capital investments in shares or holdings in the share capital of companies with their head offices in Slovenia, which the bank acquired when realising its collateral rights over such capital investments or when increasing debtor share capital through non-cash contributions, the subject of which were the claims of the bank against the debtor; (c) real property, which the bank acquired when realising its collateral rights; (d) off-balance sheet items of the bank, if their acquisition will increase the BAMC's management efficiency or confidence in the bank[11]. The draft regulation requires that a bank's risk items be valued on the basis of the real long-term economic value of assets[12]. As a rule, the payment for transfers of assets will be provided to banks in the form of BAMC bonds guaranteed by the State and will be equal to the value of the assets, reduced by refinancing costs of the BAMC[13]. According to the draft regulation, the bank's assets may also be transferred to a dedicated company[14].

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7 See Article 4 of the draft regulation.

8 See Article 6 in connection to Article 2(2) of the draft regulation.

9 See Articles 8 and 9 of the draft regulation. See also Article 20(6) of the Law on bank stability.

10 According to Article 2(2)(4) of the draft regulation, the 'non-payer' is a legal entity with its head office in Slovenia and the characteristics of a debtor whose financial assets or assumed liabilities are classified in Group D or E in accordance with the Decision on estimating the credit risk losses of banks and savings banks.

11 See Articles 13 and 14 of the draft regulation.

12 See Article 16 of the draft regulation.

13 See Articles 21(3) and 22(1) in conjunction with Article 23 of the draft regulation.

14 See Article 30 of the draft regulation.

1.3 *Issuance of State guarantees for liabilities of the BAMC and dedicated companies*

State guarantees may be issued for BAMC liabilities meeting the ECB's eligibility criteria for collateral in monetary policy operations[15]. State guarantees may be issued also for liabilities of a dedicated company[16].

1.4 *Increase of bank share capital and other capital instruments*

A bank's share capital may be increased with cash contributions for new ordinary shares of the bank or other capital instruments that are taken into account when calculating a bank's capital.[17].

2. Duty to consult the ECB

The ECB was consulted on the draft provisions of the Law on bank stability, which the draft regulation now implements, and adopted Opinion CON/2012/71[18]. Some of the amendments to the draft provisions of the Law on bank stability, following adoption of that ECB Opinion, were substantial. The national authorities did not consult the ECB on those amendments. Furthermore, the draft regulation subject to this consultation was adopted four business days after the ECB received the request for an opinion. The ECB would like to draw the Ministry's attention to the proper procedure for its consultations. The national authorities must consult the ECB on substantive new provisions introduced in draft legislative acts after the adoption of an ECB opinion on such draft legislative act. The ECB must also be consulted at an appropriate stage of the legislative procedure affording the ECB sufficient time to prepare its opinion and enabling the relevant national authorities to take the ECB's opinion into consideration before the draft provisions are adopted[19].

3. General observations

The ECB welcomes the efforts of the Slovenian authorities to address its banking sector's difficulties. The implementation of the measures envisaged under the draft regulation would however be most effective in promoting financial intermediation if they were embedded in a comprehensive financial sector strategy aimed at creating a more resilient and profitable banking system. In this context, an independent system-wide asset quality review and a fresh stress test using appropriately severe assumptions should be conducted, also with a view to ensuring that the fiscal envelope remains realistic and the selection of tools is appropriate.

15 See Articles 25 and 26 of the draft regulation.

16 See Articles 30 to 34 of the draft regulation.

17 See Chapter 2 of the draft regulation.

18 All ECB Opinions are published on the ECB's website at www.ecb.europa.eu.

19 See Article 127(4) of the Treaty on the Functioning of the European Union and Council Decision 98/415/EC. See also the Guide to consultation of the European central bank by national authorities regarding draft legislative provisions.

4. Role of Banka Slovenije

In Opinion CON/2012/71, the ECB noted that Banka Slovenije should be more actively involved in the BAMC, in particular in any procedure identifying the banks that would be eligible to draw on the measures. Against this background, it should not be the Government or the Committee, but rather Banka Slovenije assessing and deciding whether the stability of the financial system is threatened[20]. Banka Slovenije should also be given a role in the valuation of assets to be transferred to the BAMC or any dedicated company[21]. Article 16(2) provides that the long-term real economic value of assets is assessed by the bank and the assessment confirmed by an authorised independent auditor. While the ECB welcomes the involvement of an independent auditor, Banka Slovenije should be given a prominent, if not leading, role in determining the long-term real economic value, with the valuation to be confirmed by such auditor.

5. Eligibility of bonds, credit claims and other financial instruments as collateral in Eurosystem credit operations

As payment for the transferred assets, the participating banks will receive bonds issued by the BAMC or dedicated companies and guaranteed by the State. Potentially the banks could also have credit claims against the BAMC and dedicated companies arising from loans granted to them for the purposes of asset transfer payment. It follows from Articles 25 and 26 of the draft regulation that these instruments and credit claims will be structured to meet the conditions set out in Guideline ECB/2011/14 of 20 September 2011 on monetary policy instruments and procedures of the Eurosystem[22]. In this context the ECB emphasises that it is the prerogative of the Eurosystem to decide, on the basis of any information it may consider relevant within the legal framework laid down in and according to Article 18.1 of the Statute of the European System of Central Banks and of the European Central Bank, whether such instruments and credit claims fulfil the criteria of its collateral framework. In addition, the consideration provided for the transferred banks assets by the BAMC or a dedicated company must comply with the Union state aid framework.

6. Dividend payments and use of excess cash holdings by the BAMC

The draft regulation should provide for the necessary legal arrangements to ensure, in a transparent manner, the timely redemption of State-guaranteed BAMC bonds, other financial instruments and credit claims of transferring banks[23]. This may be accomplished by additional provisions which limit dividend payments by the BAMC and by ensuring that cash held by the BAMC is, as a priority, applied to the timely or early repayment of the State-guaranteed bonds or other potentially issued financial instruments

20 See Article 4(1)(2) of the draft regulation.

21 See Articles 3 and 30 of the draft regulation.

22 OJ L 331, 14.12.2011, p. 1.

23 While the compensation for the assets transferred to the BAMC will be primarily provided in the form of BAMC State-guaranteed bonds, according to Article 22(2) of the draft regulation the BAMC may also take a State-guaranteed loan from the transferring bank or ensure other sources of financing for the takeover of risk items.

or credit claims of the transferring banks[24]. In addition, if the BAMC's liabilities towards banks arising from bonds, credit claims or other potential financial instruments are transferred to another entity after the expiry of the BAMC's term in 2017, as follows from the Law on bank stability[25], the cash protocol arrangements should apply to such entity as well. The same requirements should also apply to dedicated companies.

7. Asset valuation and management

The valuation of assets to be transferred should correspond to their real economic value. The definition of 'real long-term economic value' used in Article 16(3) of the draft regulation should be thus brought in line with the Communication from the Commission on the Treatment of Impaired Assets in the Community Banking Sector. The valuation to be performed by Banka Slovenije or the BAMC should be confirmed by an internationally renowned audit firm that has not had any business dealings with the participating bank for more than three years.

The BAMC will likely receive a large set of heterogeneous assets, such as diverse credit claims, equity participations and real estate property. Therefore, a comprehensive and transparent asset management and divestiture strategy should be developed to promote efficient BAMC operations and minimise costs borne by the public. To this effect the ECB expects that the BAMC will additionally abide by internationally recognised best practice as regards corporate governance.

8. Other issues

Article 5(3)(16) of the draft regulation provides that the bank must include as part of its business strategy a plan of measures to enhance the scope of loans, primarily of loans to small and medium-sized companies, and measures to implement the sustainable business model. The ECB notes that the eligibility of banks for the measures envisaged should not be contingent on a commitment to increase lending to small and medium-sized companies, since extension of credit should always rely on a sound assessment of borrowers' creditworthiness.

Given the fixed financial envelope of the BAMC and the need to restore the soundness of participating banks, assets that represent the greatest burden for such banks should be transferred to the BAMC first. The corresponding wording in Article 15(2) should be brought into line with Article 21(2) of the draft regulation.

9. Dedicated companies

The ECB notes that the draft regulation allows the banks to also apply to transfer risky assets to a dedicated company as an alternative to the BAMC. It does not however stipulate any further specific

24 See also Opinion CON/2012/108, paragraph 9.

25 Article 36(3) of the Law on bank stability provides that the assets, rights and obligations of the BAMC will be transferred to the Slovenian Compensation Company (or its legal successor, i.e. Slovenia Sovereign Holding), whereas the legal succession of the BAMC will be specified by the Government in an executive act on preliminary reporting to the Parliament.

conditions that dedicated companies have to meet to be able to take over bank assets, apart from those mentioned in Article 32 of the draft regulation. It would be advisable to include in the draft regulation minimum conditions on key matters, such as corporate governance standards and conflict of interest rules, which would have to be part of the bye-laws of dedicated companies.

10. Monitoring the BAMC and dedicated companies

For asset management companies established in other euro area countries to which bank assets have been transferred, the ECB has welcomed arrangements where an independent body, not involved in the activities of the company, monitors the operations of the company and has access to relevant information. The ECB notes that no such mechanism is envisaged for the BAMC and dedicated companies that may be established. The ECB suggests that such arrangements may nevertheless prove useful, to enhance the acceptance of the scheme and its work, and therefore could still be considered by the authorities in the implementing regulations or any other relevant legal act.

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

Done at Frankfurt am Main, 22 March 2013.

[signed]

The Vice-President of the ECB

Vítor CONSTÂNCIO