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EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 24 November 2008

at the request of the Finnish Ministry of Finance

on a draft law on state capital investment in deposit banks

(CON/2008/75)

Introduction and legal basis

On 18 November 2008 the European Central Bank (ECB) received a request from the Finnish Ministry of Finance for an opinion on a draft proposal for a law on State capital investment in deposit banks (hereinafter the 'draft law'), including as an annex a draft decree on State capital investment in deposit banks (hereinafter the 'draft decree').

The ECB's competence to deliver an opinion is based on Article 105(4) of the Treaty establishing the European Community and 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

In consequence of the global financial crisis, the Finnish Government has announced measures that may be taken to stabilise the financial markets, including (i) State guarantees for new debt instruments issued by banks; (ii) State capital support for solvent financial institutions; and (iii) State recapitalisation of distressed banks[2]. The draft law relates to the second measure, which is aimed at providing capital support to solvent deposit banks to ensure the proper financing of the economy.

Capital support is proposed to be provided by subscribing a capital loan as referred to in Section 45 of the Law on credit institutions, i.e. an unsecured capital loan belonging to original own funds of the bank (Tier 1 capital). The terms of the loan must be approved by the Financial Supervision Authority (FSA). Support may be provided to sound and solvent Finnish deposit banks, including subsidiaries of foreign

1 OJ L 189, 3.7.1998, p. 42.

2 For further details, see press releases 164/2008 and 168/2008 of the Ministry of Finance, available on the Ministry's website at www.vm.fi. As regards Government guarantees, the Finnish Government requested on 22 October 2008 the Parliament's consent to State guarantees for debt instruments issued by banks (Government proposal HE 181/2008 vp). Recapitalisation of distressed banks would be, where necessary, conducted according to procedures laid down by the Law on the Government Guarantee Fund.

credit institutions. According to the draft law, capital loans could be subscribed up to a maximum of EUR 4 billion in total, and up to 20 % of each supported bank's original consolidated own funds. The State could subscribe capital loans until 30 April 2009 or, if the Government so decided, until 31 December 2009. The capital amount of a capital loan would only be repayable to the State after five years from the date of its issue, provided that certain solvency requirements were met and that the FSA gave its consent for the repayment. The Government would have no right to demand such repayment, but the capital of the loan would be gradually raised in the event of non-repayment. In the event of a deposit bank's bankruptcy, other debts would have priority over capital loans.

The interest rate of the capital loan would be the higher of the following: (i) 12-month Euribor plus a margin of seven percentage points; or (ii) a proportion of the issuer's net earnings after tax, corresponding to the proportion of the subscribed capital loan of the issuer's original consolidated own funds. Interest would be payable only if the deposit bank had distributable funds for the payment. If the deposit bank had not paid interest for two calendar years, the Government would be entitled to appoint two members to its board of directors.

The draft law and draft decree contain certain restrictions applicable to issuers of a capital loan, *inter alia* with regard to profit distribution, business restructuring (such as mergers), marketing, expansion of the business activity and remuneration and benefits of the management. Compliance with the terms and conditions of the capital loan would be supervised by the FSA.

2. General observations

2.1 The ECB has issued recently a number of opinions with regard to measures taken by Member States in the context of the financial crisis. It has emphasised the importance of a common approach aimed at restoring confidence in the financial markets and compliance with the Declaration on a concerted European action plan of the euro area countries[3] of 12 October 2008 (hereinafter the 'Declaration'). Such an approach should include 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 in respect of all Member States. In this context, the ECB delivered on 13 November 2008 its opinion CON/2008/68 on the Finnish draft legislation concerning the Government Guarantee Fund[4], making observations which also have a bearing in the context of the present opinion.

2.2 In line with its previous opinions, the ECB notes that it should be ensured that beneficiary institutions are not unfairly advantaged and that financial support arrangements which may be considered as providing preferential treatment to specific credit institutions should be avoided. It also notes that, in line with the Declaration, Member States must act in a coordinated manner to

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

4 ECB Opinion CON/2008/68 at the request of the Finnish Ministry of Finance on a draft government proposal for laws amending the Law on the Government Guarantee Fund and the Law on credit institutions.

avoid significant differences in national implementation of support measures from having a counterproductive effect and creating distortions in global banking markets. The ECB would also like to emphasise the importance of ensuring that such measures are in accordance with the requirements of EC competition law, in particular State aid rules, and that the State's provision of capital to banks is limited in time. In this regard, reference should also be made to the criteria set out in the Commission's Communication entitled 'The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis' (hereinafter the 'Commission Communication')[5] and, in particular, to Section 4 concerning recapitalisation schemes[6].

3. Specific observations

Eligibility criteria

3.1 In line with the Commission Communication, the ECB notes that eligibility criteria should be objective and non-discriminatory. According to the draft law, capital support may be provided 'to a deposit bank that is authorised to carry on credit institution activity in Finland'. The explanatory memorandum further clarifies the scope of this provision, referring to Finnish deposit banks including subsidiaries, but excluding branches of foreign credit institutions[7]. The ECB welcomes this provision, as it avoids the preferential treatment of specific financial institutions and distortion of the level playing field. Moreover, only institutions fulfilling the solvency requirements laid down in Section 2(2) of the draft law would be eligible for capital support. The ECB understands that this condition differentiates the draft law from the special rescue provisions which were the subject of Opinion CON/2008/68 and which were aimed *inter alia* at credit institutions whose solvency had decreased or was expected to decrease in such a way that they no longer fulfilled the conditions required to continue their operations[8]. The ECB understands that the clear differentiation between two types of support is intended to be maintained (preventive support to sound credit institutions under the present draft law and reactive support to troubled institutions under the law commented on in Opinion CON/2008/68). In this context, the ECB also welcomes the FSA's involvement in the evaluation of the need for support of solvent institutions.

Conditions applicable

3.2 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

5 2008/C 270/02.

6 Section 4 concerns recapitalisation measures to be used to support financial institutions that are fundamentally sound but may experience distress because of extreme conditions in financial markets. In this context, the Commission laid down the following general principles: (i) objective and non-discriminatory criteria for eligibility; (ii) the temporal scope of the scheme; (iii) limitation of the aid to the strict necessary; (iv) the need for safeguards against possible abuses and undue distortions of competition; and (v) the requirement for recapitalisation as an emergency measure to support the financial institution through the crisis.

7 See Section 4, 'Impacts of the proposal'.

8 See the Section 11a which it was proposed to add to the Law on the Government Guarantee Fund (379/1992) of 30 April 1992 by the draft law commented on in Opinion CON/2008/68.

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 ensure the proper financing of the economy. In particular, a consistent approach should be employed in defining the conditions for recapitalisations and the pricing of the instruments to provide Tier 1 capital to financial institutions, in order 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 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 of 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 early as possible after a certain period of time.

3.3 The ECB notes that, according to the draft law, in the event that a deposit bank did not pay interest for two calendar years, the Government would be entitled to appoint two members to the bank's board of directors. It also notes that the influence of such board members may vary depending on the management structure of the bank in question. In principle, such a provision should allow the involvement of the State to the extent necessary in the decision-making of the defaulting bank. Further, the ECB would like to reiterate that, as stated in the Commission Communication, the capital injection must be limited to the minimum necessary and should not allow the beneficiary to engage in aggressive commercial strategies or expansion of its activities or other purposes that would imply undue distortions in competition.

3.4 As regards the temporal scope of the scheme, as mentioned above the ECB notes that under the draft law capital loans could only be subscribed until 30 April 2009, or 31 December 2009 if the Government so decided.

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

Done at Frankfurt am Main, 24 November 2008.

[signed]

The President of the ECB

Jean-Claude TRICHET