EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 28 November 2008

at the request of the Polish Minister for Finance
on a draft law on the provision of State Treasury support to financial institutions

(CON/2008/80)

Introduction and legal basis

On 10 November 2008 the European Central Bank (ECB) received a request from the Polish Minister for Finance for an opinion on a draft law on the provision of State Treasury support to financial institutions (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 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 relates to a national central bank (Narodowy Bank Polski, (NBP)) and contains 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 aims at re-establishing appropriate liquidity conditions in the financial market by enabling the Minister for Finance to use, until 31 December 2009, a number of measures with the aim of providing State Treasury support to financial institutions[2] (hereinafter, the 'support measures'). The draft law specifies five categories of financial institutions established in Poland eligible to benefit from the support measures: banks[3], investment funds, investment fund associations[4], brokerage houses and insurance companies[5].

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1 OJ L 189, 3.7.1998, p. 42.

2 See Articles 1 and 18 of the draft law. See the explanatory memorandum to the draft law, p. 1.

3 Credit institutions registered in Poland are legally referred to as 'banks' (this definition does not cover the Polish version of credit unions, operating pursuant to the Law of 14 December 1995 on cooperative savings and loan associations (Dz. U. of 4 January 1996 No 1, Item 2, as amended)). The term 'credit institutions' as used in Polish law only relates to European Economic Area (EEA) credit institutions from outside Poland. Non-EEA credit institutions are referred to under Polish law as 'foreign banks' (Article 2, Article 4(1), Article 4(3) and Articles 4(17) to (20) of the Law on banking of 29 August 1997 (consolidated text: Dz.U. of 12 June 2002 No 72, Item 665, as amended).

4 An investment fund has a legal personality under Polish law but may only be represented through an investment fund association (which is a special type of joint stock company, normally administrating a number of investment funds with

1.2 The draft law provides for the following types of support measures, of which the first two are available to banks only[6]:

(i) a State guarantee for the repayment of the refinancing credit extended to a bank by NBP, under the conditions set out in Article 42(4) of the Law on Narodowy Bank Polski of 29 August 1997 (hereinafter the 'Law on NBP')[7]. Such a State guarantee may cover up to 50% of the amount of the NBP's refinancing credit remaining to be paid. It is to be granted at the request of NBP's President, by means of an agreement between the Finance Minister and the beneficiary bank[8];

(ii) a State guarantee for the repayment of the credit facility or loan provided within a line of credit extended by a bank to another bank, in which case the State guarantee is granted at the request of the banks concerned by means of an agreement between the Finance Minister and the beneficiary bank[9];

(iii) loans of Treasury securities to financial institutions, at the request of the financial institution concerned [10]; and

(iv) preferential sales of Treasury securities to financial institutions, involving deferred payment, payment in instalments or a sale directed to a specified institution, at the request of the financial institution concerned[11].

All support measures are granted by the Minister for Finance, following consultation with the Financial Supervision Commission and the NBP's President[12]. The Minister for Finance may require the beneficiary institution to provide collateral covering the obligation to repay the full amount of the support, including interest[13].

2. General observations

2.1 The ECB recalls that 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 European and

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various investment models); see Articles 3(1), 4(1) and 4(2) of the Law on investment funds (Dz.U. of 28 June 2004 No 146, Item 1546, as amended).

5 Article 2 of the draft law.

6 See Article 3(2) of the draft law.

7 Consolidated text: Dz.U. of 1 April 2005 No 1, item 2, as amended. See further description of the conditions specified in Article 42(4) of Law on NBP in paragraph 4.2(ii) of this opinion.

8 See Article 3(1)(1) and Article 4 of the draft law.

9 See Article 3(1)(1) and Article 5 of the draft law.

10 See Article 3(1)(2)and Article 10 of the draft law.

11 See Article 3(1)(3) to (5) and Articles 11 to 13 of the draft law.

12 See Article 16(4) of the draft law.

13 See Article 3(3) and (4) of the draft law.

international level to restore confidence and preserve financial stability. More specifically, the ECB refers to:

(i) 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; and (vii) legitimate interest of competitors must be protected, in particular through the State aid rules, and negative spill-over effects should be avoided[14];

(ii) the 'Declaration on a concerted European action plan of the euro area countries', adopted on 12 October 2008 by the Heads of States of the euro area, as subsequently endorsed by the European Council on 16 October 2008 for all Member States (hereinafter 'the Paris Declaration')[15]. In the Paris Declaration, the Member States confirmed their commitment to act together in a decisive and comprehensive way in order 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 governments, central banks and supervisors to avoid national measures adversely affecting the functioning of the single market and the other Member States. The Paris Declaration further states that 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 this context, the need to work in cooperation with the ECB was also emphasised. Against this background, the ECB has repeatedly highlighted that all the initiatives put in place by national governments to restore confidence in financial markets should be aimed at implementing such common principles, in a spirit of close cooperation with other Member States and EU institutions[16].

2.2 The ECB wishes to draw the consulting authority's attention to the recent ECB opinions issued at the request of other Member States, whereby the ECB has commented on legislative proposals sharing some of the features of the Polish scheme[17]. It is the ECB's intention to facilitate

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

15 See the Declaration of 12 October 2008, available on the French Presidency's website at www.ue2008.fr.

16 Cf., for example, paragraph 2.4 of 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; paragraph 2.2 of ECB Opinion 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.

17 See, for example, 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; 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; ECB Opinion CON/2008/52 of 17 October 2008 at the

coordination of the various national efforts addressing the current financial situation, *inter alia*, through the timely adoption and publication of ECB opinions on such draft national legislation[18].

3. Specific observations

3.1 *Eligibility for support*

Article 2 of the draft law provides that support measures will be available to financial institutions established in Poland and falling within one of the covered categories, which, *inter alia*, implies that Polish subsidiaries of financial institutions established in other Member States are covered by the draft law. The ECB welcomes the above provision, as it avoids the preferential treatment of specific financial institutions and a possible distortion of the level playing field[19].

3.2 *Scope and remuneration of State guarantees*

As regards the support measures in the form of State guarantees under Articles 4 to 8 of the draft law, the ECB considers that the proposed arrangements in their practical implementation should 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 NBP's liquidity management[20]. The ECB makes the following specific comments in this regard:

(i) The ECB considers that further clarification is needed in the draft law as regards the type of liabilities that the State guarantees may cover. In particular, the ECB notes that the draft law does not explicitly exclude interbank deposits from among the obligations that may be secured with a State guarantee. In this respect, the ECB recalls that State guarantees to cover interbank deposits should be avoided as they have the potential to interfere with the conduct of the central bank's liquidity-providing operations, and thus on the transmission of NBP's monetary policy decisions[21]. The ECB considers that State guarantees to be provided under the draft law may have an economic character of guarantees for the repayment of the interbank deposits if the guarantee is provided for the repayment of an unsecured loan drawn

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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; ECB Opinion 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; 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; ECB Opinion 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, ECB Opinion 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 and ECB Opinion 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. All ECB opinions are available on the ECB website at www.ecb.europa.eu.

18 All ECB opinions are available on the ECB's website at: www.ecb.europa.eu.

19 Cf., for example, paragraph 3.2 of Opinion CON/2008/57.

20 Cf., for example, paragraph 2.1.2 of Opinion CON/2008/62.

21 Cf., for example, paragraph 3.2 of Opinion CON/2008/50 and paragraph 2.3 of Opinion CON/2008/54.

by the borrower bank. This may be the case, in particular, for guarantees provided (i) under Article 4(1) of the draft law together with Article 42(4) (1) of the Law on NBP for the repayment of NBP's refinancing credit in the form of an unsecured line of credit; and (ii) under Article 5(1) of the draft law for the repayment of unsecured interbank loans arising from the lines of credit. The ECB recommends that provision of State guarantees which have the economic characteristics of guarantees for deposits be avoided.

(ii) The ECB also notes that the Paris Declaration states that the Member State governments would make available a State guarantee with regard to new medium term (up to 5 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[22]. The ECB recommends that the draft law be amended to ensure full compliance with the Paris Declaration's criteria in this respect[23].

(iii) Article 8 of the draft law provides for a fee that may be charged on a beneficiary bank in connection with the provision of the State guarantee, the level of which is to be set in the relevant agreement. In this respect, the ECB points out that the fee charged in respect of the provision of the State guarantee should be risk-based and determined on the basis of the costs of a corresponding guarantee under normal market conditions. For the sake of transparency, a further more precise indication should be given on the method to be used to calculate the fees. The ECB recalls in this respect that it is of crucial importance to ensure harmonisation of the price for such guarantees within the EU, to ensure a level playing field[24]. Moreover, the ECB understands that the fees under Article 8(1) of the draft law are to be imposed on the beneficiaries of the support measures, and that no such fee will be charged to NBP, even though it is the party which formally requests the State guarantee to be provided in respect of the repayment of the NBP's own refinancing credit[25]. Similarly, the ECB understands that NBP will not be requested to establish collateral in connection with the provision of a State guarantee under Article 3(3) of the draft law. For the sake of clarity and legal certainty, the ECB recommends that the draft law should expressly refer to the beneficiary institution as the party which is obliged to pay the fee under Article 8(1) of the draft law, and which may be required to provide collateral under Article 3(3) of the draft law.

22 See Article 18 of the draft law and comment to this Article in the explanatory memorandum to the draft law.

23 See, for example, paragraphs 3.4-3.5 of Opinion CON/2008/55.

24 See, for example, paragraph 2.1.3 of Opinion CON/2008/62.

25 See, however, Article 16(1) and the introductory part of the explanatory memorandum to the draft law which both suggest that a request for provision of the support measures is in all cases submitted by the applicant institution.

3.3 *Conditions of support*

According to the provisions of the Paris Declaration, and as noted in past ECB opinions[26], the support provided under the draft law should be designed in order to avoid any distortion in the level playing field and possible abuse at the expense of non-beneficiaries. The ECB notes that the draft law provides that the specific conditions for granting the support in relation to beneficiary institutions will be decided by the Minister for Finance and set out in an agreement to be entered into with such institutions (potentially on the basis of the pre-defined framework agreement)[27]. The explanatory memorandum to the draft law clarifies that such contractual conditions may include rules regarding: (i) the manner of application of the received support, whereby it is envisaged, in particular, that the beneficiary institution will be obliged to only use the funds obtained for covering funding needs directly related to its ongoing business; and (ii) the beneficiary institution's necessary financial discipline, whereby, in particular, limitations are envisaged as regards executive remuneration and dividend payouts. The ECB recommends inclusion in the draft law of the main principles according to which contractual conditions for the use of support measures will be set, in accordance with the abovementioned Paris Declaration criteria. In the same vein, the ECB would welcome the inclusion in the draft law of more specific conditions which would have to be satisfied before the Minister for Finance could partially waive the repayment of support under Article 14 of the draft law.

3.4 As a general remark, in line with its previous opinions[28], the ECB reiterates the importance of ensuring that the regulatory practice under the proposed arrangements will be conducted in full compliance with the relevant Community law provisions, including EU single market principles and financial services legislation, as well as competition and State aid rules. In the latter respect, the ECB draws the consulting authority's attention to the Commission's recently adopted guidance on compliance by the financial sector support schemes with EU State aid rules[29], which includes in the specific context of the provision of State guarantees, detailed rules on the setting of eligibility criteria for the beneficiary institutions[30].

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26 See, for example, paragraph 3.5 of Opinion CON/2008/57.

27 See Articles 8(2) and 16(4) of the draft law.

28 See, for example, paragraph 3.3 of Opinion CON/2008/57.

29 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 (hereinafter the 'Commission's guidance').

30 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'.

4. Role of NBP and the monetary financing prohibition

4.1 NBP's role under the draft law is as follows: (i) pursuant to Article 4(2) of the draft law, NBP's President makes a formal request to the Minister for Finance for a State guarantee covering the repayment of an NBP's refinancing credit[31]; and (ii) pursuant to Article 16(4) of the draft law, NBP is consulted, along with the Financial Supervision Commission (FSC), on the Minister for Finance's decision to use supporting measures in relation to a given institution. The ECB notes that the precise scope of advice to be provided by the FSC and by NBP is not specified and recommends that more specific provisions are included in the draft law in this respect, in particular as regards the body assessing the compliance of the beneficiary institution with the conditions linked to the support measures provided. As a general point, the ECB expects that all the abovementioned functions to be performed by NBP will be conducted in a manner fully compatible with NBP's 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 involvement of NBP will not go beyond an advisory and procedural role and, in particular, that it will fully comply with the monetary financing prohibition laid down in Article 101(1) of the Treaty[32], 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[33].

4.2 In this context, specifically as regards the support measure provided for under Article 4 of the draft law, i.e. State guarantees for the repayment of NBP's refinancing credit extended under Article 42(4) of the Law on NBP, the ECB notes that NBP's refinancing credit may be extended under this provision: (i) as a line of credit open for the specified amount, or (ii) as a 'lombard facility', i.e. against pledges of securities, up to an amount corresponding to a specified proportion of the face value of such securities; or (iii) in other forms, as specified by the NBP Management Board. The ECB further notes that a refinancing credit in the form of a lombard facility may be used by NBP in the function of providing emergency liquidity assistance (ELA)[34]. The ECB recalls that ELA as a central bank task consists of liquidity assistance provided by central banks in exceptional circumstances and on a case-by-case basis to temporarily illiquid but solvent institutions[35]. It is also noted that, under Article 237(d) of the Treaty, the ECB is entrusted with the

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31 See, however, a restriction in footnote 25 of this opinion.

32 See paragraph 3.2 of Opinion CON/2008/52.

33 Now Article 101 and Article 103(1) of the Treaty, respectively, OJ L 332, 31.12.1993, p. 1.

34 See NBP Management Board Resolution No 44/2008 of 13 October 2008 (Dz. Urz. NBP of 15 October 2008 No 16 Item 19) amending the NBP Management Board Resolution resolution No 4/2008 of 1 February 2008 introducing 'Rules of refinancing with the lombard credit granted by Narodowy Bank Polski' (Dz. Urz. NBP of 12 February 2008 No 3 Item 3, hereinafter the 'Lombard credit rules'). Paragraph 2 of the amending resolution introduces a new paragraph 2a to Lombard credit rules, envisaging a possibility of provision 'in justified cases' of the lombard facility against types of collateral other than bonds and bills issued by the State Treasury or NBP. The lombard credit is normally to be repaid on the operational day following the day of issuance of the lombard credit, but NBP may agree on a longer repayment period (see paragraph 7(1) to (2) of Lombard credit rules).

35 See the ECB Financial Stability Review, December 2006, p. 171 and the ECB's Annual Report 1999, p. 98. It is also the ECB's view that 'national legislation foreseeing the financing by NCBs [national central banks] of credit institutions other than in connection with central banking tasks (such as monetary policy, payment systems or temporary liquidity

task of monitoring the compliance of all ESCB central banks with the prohibition on monetary financing[36].

4.3 In the above context, the ECB understands that Article 4(1) of the draft law introduces an explicit legal basis for the provision of State guarantees securing the repayment of NBP's refinancing credit, including in cases where such credit is provided as ELA. As stated by the ECB in another opinion[37], the following criteria need to be met to ensure that the extension by the ESCB central banks of ELA secured by a State guarantee comply with the monetary financing prohibition. *First*, the central bank needs to independently exercise full discretion regarding the decision whether to extend ELA in exceptional circumstances. The ECB understands that such decision would be the sole responsibility of NBP's Management Board[38]. The ECB is of the view that the same degree of independence should be exercised by NBP in this respect as in the performance of its ESCB-related tasks. Explicit provisions to this effect could be considered, by analogy with other draft national provisions directly addressing the extension of ELA by ESCB central banks[39]. *Second,* it should be ensured that the credit provided by the NBP is as short term as possible. The ECB would welcome any clarification in this regard, at least in the explanatory memorandum to the draft law. *Third*, there must be systemic stability aspects at stake. In the present case, the ECB understands that the granting of the above credit would be part of the NBP's contribution to the stability of the financial system. The ECB reiterates its earlier recommendation that NBP's financial stability function should be expressly recognised in the Law on NBP[40]. *Fourth*, there must be no doubts as to the legal validity and enforceability of the State guarantee under Polish law. In this respect, the ECB welcomes the fact that the establishment of the State guarantee is enshrined in the draft law and expects that set-off mechanism foreseen by Article 6(2) of the draft law will not impede effective enforcement of the NBP's claims[41]. *Fifth*, there must be no doubts as to the economic adequacy of the State guarantee, which should cover both principal and interest on the loans, thus fully preserving NBP's financial independence. Any lack of clarity in the draft law, e.g. as regards the party obliged to pay fees, needs to be eliminated. Further, where the State guarantee would constitute the sole form of collateral for the ELA operation, it is essential that the State

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support operations), in particular to support insolvent credit and/or other financial institutions, is incompatible with the monetary financing prohibition' (see the ECB's May 2006 Convergence Report, p. 68; the December 2006 Convergence Report, p. 30; the May 2007 Convergence Report, p. 22 and the May 2008 Convergence Report, p. 24, which are available on the ECB's website at www.ecb.europa.eu).

36 See paragraph 4.1 of Opinion CON/2008/46.

37 See Paragraph 4.3 of Opinion CON/2008/46.

38 See Article 17(3)(2) of the Law on NBP stipulating that NBP's Management Board performs such functions as are not restricted for other NBP governing bodies.

39 See paragraph 4.11 of the 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; see paragraph 3.3 of Opinion CON/2008/46.

40 See paragraph 2.2 of the ECB Opinion CON/2008/39 of 1 September 2008 at the request of the Polish Minister for Finance on a draft law on the Financial Stability Committee.

41 Article 6(2) of the draft law foresees that collateral provided by the debtor and realised by NBP is to be deducted from the scope of the State guarantee.

guarantee covers 100% of the amount of the credit, and not only up to 50% of the amount remaining for repayment, as stated in the draft law.

4.4 Finally, for the sake of completeness, the ECB recalls its stance as expressed in the ECB's Convergence Report[42] with respect to Article 42(3) of the Law on NBP, which is outside the scope of the present draft law and which allows NBP's refinancing credit to be granted for the purposes of implementing bank rehabilitation proceedings. The ECB noted in this regard that 'safeguards … aiming at ensuring timely repayment of the credit do not fully exclude an interpretation of legal provisions that would allow an extension of refinancing credit to a bank undergoing rehabilitation proceedings which then becomes insolvent. More explicit safeguards are needed to avoid incompatibility with the monetary financing prohibition under Article 101 of the Treaty'. In the present opinion, the ECB reiterates that compliance with Article 101 of the Treaty is a necessary element of the regulation of the refinancing credit. The obligation of ensuring such compliance is binding on the Polish authorities as of the date of Poland's EU accession, i.e. 1 May 2004[43].

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

Done at Frankfurt am Main, 28 November 2008.

[signed]

The President of the ECB

Jean-Claude TRICHET

42 See the ECB's Convergence Report of December 2006, p. 228 and the ECB's Convergence Report of May 2008, p. 244.

43 See the ECB's Convergence Report of May 2008, p. 22.