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EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 13 April 2010

on the amendment to the Law on credit institutions and financial undertakings introducing further financial market stabilisation measures

(CON/2010/31)

Introduction and legal basis

On 11 March 2010, the European Central Bank (ECB) received a request from the Hungarian Ministry of Finance for an opinion on a draft law amending the Law on credit institutions and financial enterprises[1] (CIFE) and the Law on the Financial Supervisory Authority (FSA)[2] (hereinafter referred to as the 'draft law').

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 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[3], as the draft law relates to the Magyar Nemzeti Bank (MNB) and rules applicable to financial institutions in so far 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 motivated by the financial market crisis and, in particular, the need to avoid potential systemic risks, thus maintaining confidence in the national financial system and enhancing its stability and solvency. Ensuring the uninterrupted operation of key banking services is important to maintain investor confidence, while the interests of the individual institutions and that of the public need to be balanced. The Hungarian Government has already taken steps to stabilise the financial markets[4]. The provisions of the draft law aim at strengthening the supervisory framework by providing the FSA with enhanced powers in crisis prevention and resolution.

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1 Law CXII of 1996, *Magyar Közlöny*, 1996/109 XII. 12.

2 Law CXXXV of 2007, *Magyar Közlöny*, 2007/162 XI. 28.

3 OJ L 189, 3.7.1998, p. 42.

4 For previous stabilisation measures taken by the Hungarian Government see ECB Opinions CON/2009/28 and CON/2008/81. All ECB opinions are available on the ECB's website at www.ecb.europa.eu.

1.2 Against this background, the draft law enhances the supervisory and resolution powers of the FSA by providing, *inter alia*, for: (i) a recovery plan for the financial institutions; (ii) the possibility of appointing a supervisory commissioner and his/her tasks; (iii) specific procedures aimed at financially distressed financial institutions, including, *inter alia*, the transfer of assets and liabilities from a credit institution and the possible establishment of a 'bridge bank' based on a Government decision; (iv) basic valuation principles and procedures to determine the acquisition value of assets and liabilities; (v) the rules and conditions for compensating a credit institution; (vi) the possible legal remedies against certain FSA decisions; (vii) specific administrative deadlines.

1.3 The draft law specifies qualitative and quantitative thresholds triggering FSA specific powers that would increase in intensity, depending on the seriousness of the situation of the ailing financial institution. Under the new proposed Article 151(4) of the CIFE to maintain the stability of the financial intermediary system and to protect the interest of depositors and account holders, and to minimise public expenditure, the FSA will be liable to take the exceptional and necessary measures subject to the fulfilment of each of the following conditions: (i) the owners of a credit institution refuse to cooperate with the FSA or the supervisory commissioner; (ii) the credit institution is likely to fail to fulfil its obligations; (iii) the credit institution's insolvency would potentially jeopardise the stability of the financial system; and (iv) other measures taken by the FSA have failed to achieve their purpose.

1.4 Moreover, the draft law establishes a legal framework which would enable the FSA to transfer assets and liabilities from the balance sheet of a systemically important credit institution to either another credit institution or to a wholly State-owned special purpose bank, i.e. a 'bridge bank' to be established as explained in paragraph 2.2 below.

2. General observations

2.1 The ECB has issued a number of opinions at the request of the Member States on national measures adopted in response to the global financial crisis. The ECB invites the Ministry of Finance to take into account the relevant observations made in its recent opinions[5] on similar draft legislative provisions in other Member States, some of which are repeated below. The ECB also refers to the importance of the guidance provided by the Ecofin Council[6], as well as the Declaration issued by the Heads of State of the euro area[7]. In particular, the ECB emphasises that any initiatives put in place by the competent national authorities to restore confidence in the financial markets should be coordinated and should aim to implement the common principles, in a spirit of close cooperation with other Member States and the Union institutions. As a general remark in this

5 See Opinions CON/2009/34, CON/2010/7 and CON/2010/12.

6 For guidance to the Member States in the conclusions of the Ecofin meeting see 'Immediate responses to financial turmoil', Ecofin Council Conclusions of 7 October 2008, available on the Council's website at www.consilium.europa.eu.

7 The text of the Declaration of 12 October 2008 is available on the former French Presidency's website at www.ue2008.fr.

context, the ECB, in line with its previous opinions[8], notes the importance of a transparent and predictable framework as regards the parameters of and limitations to the exercise by the authorities of their powers.

2.2 Under the new legal framework proposed by the draft law, the FSA will have the right to transfer assets and liabilities from the balance sheet of a systemically important credit institution to a sound institution, that is to another operational credit institution or to a newly established and organisationally and financially independent bridge bank, wholly owned by the State and separately established for this specific purpose. The establishment of a bridge bank may be necessary if, at the relevant time, no credit institution is available on the market to take over the assets and liabilities of an ailing credit institution. The ECB welcomes the introduction in the draft law of the option of addressing a possible crisis situation through the transfer of a distressed bank's assets and liabilities to a bridge bank. The Eurosystem highlighted the importance of such a resolution tool in ensuring the continuity of essential business operations of systemically important credit institutions when replying to the Commission's initial analysis of the possible orientation of a future Union framework for crisis management and resolution[9]. The availability of a bridge bank is recognised as part of the trend towards enhanced convergence of national legal schemes for crisis management and resolution developing at both international and European level[10]. Taking the growing inter-dependencies between financial systems into account and the need for appropriate action to address the possible systemic impact of failing cross-border institutions, the ECB highlights that the domestic legal framework for crisis management and resolution may need to be further adapted to future regulatory initiatives at Union level addressing existing problems in the coordination of resolution and insolvency proceedings concerning cross-border banks.

2.3 With these general observations in mind, and against the background of the guidance previously given by the ECB and the Union institutions in this regard, the ECB has the following specific observations on the draft law.

3. Specific observations

3.1 *Role of the MNB*

Under the new proposed Article 168A(2) of the CIFE, the draft law provides for the conditions for the MNB's involvement, which is limited only to the process of issuing an assessment at the request of the FSA of whether a credit institution's insolvency would potentially jeopardise the stability of the financial system in Hungary under the new proposed Article 151(4)(c). The ECB welcomes the recognition of the MNB's expertise in assessing financial stability. Moreover, to

8 See CON/2009/62 and CON/2009/93.

9 See Eurosystem's reply of 8 February 2010 to the public consultation by the Commission launched in its Communication on an EU Framework for Cross-Border Crisis Management in the Banking Sector on 20 October 2009.

10 See in particular 'Report and Recommendations of the Cross-border Bank Resolution Group', March 2010, available at www.bis.org and 'Practical Guide on Cross-Border Insolvency Cooperation' adopted by UNCITRAL on 1 July 2009, available at www.uncitral.org.

make such assessment, a smooth exchange of information on the situation of individual credit institutions must be in place. The ECB emphasises that functions to be performed by the MNB in this regard for the benefit of the resolution regime must be conducted in a manner that will fully comply with the Treaty obligations. In particular, it is expected that the MNB's new task laid down in the draft law will neither affect the MNB's institutional, functional and financial independence, nor the performance of its tasks under the Treaty and the Statute of the European System of Central Banks and of the European Central Bank.

3.2 *Transfer of assets*

According to the new proposed Article 168A of the CIFE, the establishment of a bridge bank will be restricted to cases where no other resolution to the financial difficulties of a credit institution was effective and it is necessary to ensure the stability of the financial system. This Article furthermore broadly formulates rules for the terms and conditions for bidding on the transfer of assets and liabilities to another operational credit institution, as it specifically leaves the FSA to determine the detailed rules for the bidding process in an ad hoc decision. For reasons of legal clarity, the basic rules for bidding could also be reflected in the draft law. Additionally, the draft law does not specify the criteria for an operating credit institution to qualify as eligible to take over these assets based on the bidding process. The ECB would welcome further clarifications of the conditions for transferring assets to operating credit institutions.

The ECB also advises considering the possibility of including further provisions in the draft law to provide for a smooth and swift continuation of the legal relationship with clients relating to the debts taken over and the new credit institution taking over the debts.

3.3 *Valuation of the transferred assets and the pricing of compensation*

Under the new proposed Article 168A(7) to (9) of the CIFE, the draft law provides that transferred assets will be valued at a rate applicable on the day before transfer. The same article sets out further requirements concerning the valuation. In particular, the valuation will also have to be regarded as a revaluation affecting the book value of assets and liabilities which will also be reflected in the income of the transferring credit institution.

Under the new proposed Article 168C of the CIFE, the draft law regulates the pricing rules and the conditions for compensation. The transparency of criteria for valuation is of the essence in pricing. In this respect, it may be advisable to further specify how a valuation is obtained when no valid market prices are available for the assets in question. Furthermore, the ECB suggests including in the draft law the possibility of bringing a judicial appeal against the pricing of compensation. Such court procedure should be expedited to avoid jeopardising the aim of the transfer of the assets.

3.4 *Property rights*

According to the new proposed Article 168B(3) of the CIFE, the cost of purchasing assets by the bridge bank will be covered by the central budget and, as detailed in the new proposed Article 168C(3), compensation will only be due if the equity capital of the transferring credit institution (i)

has been decreased as a result of the FSA's decision to transfer the assets, and (ii) was positive on the day before the time of transfer. The compensation also has to be in accordance with the provisions of the Hungarian Constitution on property rights. The ECB notes that any such compensation must be 'fair' according to law.

3.5 *The possible winding up of affected credit institutions and going concerns*

The draft law is silent on whether after removing certain assets and liabilities from the portfolio of a credit institution, the transferring institution will continue as a going concern, or be wound up after the transfer takes place. Therefore, the ECB suggests including further provisions on these matters in the draft law, ensuring that if the transferring credit institution continues its operations, it will base its transactions on a sound business policy and a solid business model.

3.6 *The future role, operation and temporary nature of the bridge bank*

The ECB reiterates the importance of ensuring that the State's involvement is limited in time to the extent deemed necessary for the success of the reorganisation measure. Transferring assets from credit institutions in distress should remain a measure for use in clearly defined and exceptional circumstances. The ECB stresses that it should be ensured that such a measure is only used as a last resort, that disruption of the level playing-field is minimised and that the State's role is limited in time. Against this background, the ECB notes that in the new proposed Article 168A of the CIFE, the draft law provides for the possibility for the FSA to propose the establishment of a bridge bank as a general measure if any other measures have proved inefficient, but the draft law does not specify a possible end-date for the operations of a bridge bank. Since the duration of the operation of the bridge bank has to reflect the amount and the nature of the assets and, in particular, their maturity structure, the ECB would welcome a generally defined exit strategy in the draft law for the operations of a bridge bank based on, for example, the basis of a period of time or the development of market conditions, to ensure the temporary nature of the State's involvement and at the same time preserve the value of the transferred assets and liabilities.

3.7 *Procedural issues*

The ECB is aware that the draft law was submitted to the Hungarian Parliament at a time when it was no longer possible for the legislators to discuss the draft law in detail as the Parliament has been dissolved due to the general elections in Hungary. The ECB would like to remind the consulting authority of the guidance given on Council Decision 98/415/EC and, in particular, that the duty to consult the ECB also applies to additional substantial amendments to draft legislative provisions that have already been submitted to the ECB for an opinion.

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

Done at Frankfurt am Main, 13 April 2010.

[signed]

The President of the ECB

Jean-Claude TRICHET