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EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 28 October 2009

on measures to improve liquidity and increase the competitiveness of credit institutions

(CON/2009/86)

Introduction and legal basis

On 14 October 2009, the European Central Bank (ECB) received a request from the Austrian Ministry of Finance for an opinion on a draft Federal law amending the Austrian Banking Act and the Securities Supervision Act (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 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.

The consulting authority has informed the ECB that the draft law will enter into force on 1 January 2010 and that, due to the legislative schedule of the Austrian Parliament, the ECB has been asked to deliver its opinion by 23 October 2009. This implies that the consulting authority is invoking the exemption under Article 3(2) of Council Decision 98/415/EC, which allows for a reduction of the minimum time limit for consultation of one month only in case of extreme urgency.

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 According to the explanatory note of the consulting authority, the main purpose of the draft law is to introduce measures aimed at improving liquidity and to increase the competitiveness of credit institutions.

1.2 The measures contained in the draft law are expected to have anti-cyclical effects to be achieved as follows.

- Interest on supplementary capital is only to be paid out in so far as it is covered by the distributable profits (whereas currently it may be paid out if it is covered by the profit for the year after tax, i.e. before the allocation of reserves).

1 OJ L 189, 3.7.1998, p. 42.

- In order to strengthen their liquidity, Austrian credit institutions are to be entitled to include (reverse) repurchase agreements with an option to resell (*unechte Pensionsgeschäfte*) as second class liquidities.
- The draft law will also allow credit institutions to redeem individual tranches of participation capital, provided they were identified at the time of issuance[2]. This provision is intended to facilitate the redemption of participation capital provided to credit institutions by the Federal Government in accordance with the recapitalization scheme of the Financial Stability Act (FinStaG).
- Based on the agreement of the Member States in the Council's Working Group on Financial Services in October 2009, the transitional floors for credit institutions or groups of credit institutions that apply the internal ratings based approach (hereinafter the 'IRB approach'), as referred to in Article 152 of the Capital Requirements Directive (CRD)[3], are to be extended until 31 December 2011.

1.3 The draft law also amends the supervisory procedure for the IRB approach and the models for groups of credit institutions, provided that parent and subsidiary banks consistently and jointly fulfil the approval requirements. In such cases, the Austrian Financial Market Authority may restrict its assessment to the parent credit institution provided such an approach is appropriate.

1.4 In addition, a minor amendment to the Securities Supervision Act 2007 is proposed. In future, only investment companies, but not credit institutions, will be required to disclose their fixed overheads in their annual accounts.

2. General observations

2.1 The ECB understands that the draft law is intended to enhance the liquidity framework of credit institutions, extend the provisions for transitional floors, and mitigate procyclical effects.

2.2 The ECB notes that work is under way at international and European levels with a view to strengthening the global capital framework by building stronger buffers into the financial system, covering capital, liquidity and provisioning, that will constrain the procyclical build-up of leverage in the system. The ECB takes the view that the initiatives of national governments to mitigate procyclicality should be aligned with the outcome of this work.

2.3 The ECB also notes that the CRD is currently being reviewed and amended at European level. It may therefore be necessary to align the draft law with the amended CRD.

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2 Equity capital may also be redeemed if substituted with capital of equivalent or higher quality.

3 Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast) (OJ L 177, 30.6.2006, p. 1).

3. Specific observations

3.1 The ECB acknowledges that allowing the redemption of individual tranches of participation capital, provided they are identified at the time of issuance, could contribute to limiting the duration and scope of recapitalisation schemes, and thus retain the temporary nature of the government's involvement in financial support schemes.

3.2 The ECB acknowledges the need to ensure international fair competition for the treatment of dividends paid on supplementary capital. However, as far as the stated objective of mitigating procyclicality is concerned, the amendment to Article 23(7) No 2[4] would only have the intended counter-cyclical effects if credit institutions set aside annual profits in good times to be drawn on in times of economic stress, when annual profits may easily turn into losses and capital buffers are needed to absorb these losses. Yet, given that credit institutions often follow stable dividend policies, the proposed amendment may provide an incentive to credit institutions to distribute dividends on supplementary capital in excess of the 'profit or loss for the year after tax', simply by drawing on profits brought forward or on reserves built up in previous periods. Therefore, the ECB sees the risk that, in practice, the proposed amendment could lead to results contrary to those intended if credit institutions were allowed to reduce their capital base by paying out stable dividends. Mitigating procyclicality by introducing prudential requirements should rather aim to give credit institutions incentives to maintain their lending activity also in times of stress.

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

Done at Frankfurt am Main, 28 October 2009.

[signed]

The President of the ECB

Jean-Claude TRICHET

4 The amendment would allow the payment of dividends from 'distributable profits', i.e. net profits or losses for the year, rather than 'profits or loss for the year after tax', i.e. profits or losses before 'changes in reserves' and 'profits or losses brought forward'.