EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 13 November 2008

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

(CON/2008/68)

Introduction and legal basis

On 31 October 2008 the European Central Bank (ECB) received a request from the Finnish Ministry of Finance for an opinion on draft government proposal for laws amending the Law on the Government Guarantee Fund and the Law on credit institutions (hereinafter the 'draft legislation').

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. Background and purpose of the draft legislation

1.1 The draft legislation concerns the Law on the Government Guarantee Fund[2], which was originally enacted in the context of the banking crisis of early 1990s, with a view to ensuring the stability of the Finnish banking system. At that time, the major part of the State's support and crisis management measures were implemented through the Government Guarantee Fund (hereinafter the 'Fund'), which was given authority to grant support loans and guarantees to deposit banks' own guarantee funds[3], to support banks directly by subscribing for their shares and to provide other forms of support. The Law on the Government Guarantee Fund therefore lays down a general framework for bank support, regulating, *inter alia*, applicable instruments, conditions, procedures, funding and management. The Fund is managed by the Ministry of Finance. The Parliament decides on the allocation of funds from the State Budget to the Fund, and the authority to decide on

1 OJ L 189, 3.7.1998, p. 42.

2 Law No 379/1992 as amended.

3 A bank's own guarantee funds are provided for in Section 113 of the Law on credit institutions. Membership of such fund is nowadays voluntary for deposit banks. The statutory deposit-guarantee scheme is distinct from these funds, which have become less important since the introduction of the deposit-guarantee scheme.

support measures is assigned to the Council of State. Suomen Pankki and the Financial Supervisory Authority are consulted on the Council of State's decisions concerning support measures.

1.2 The draft legislation is part of measures taken by the Finnish Government to preserve the stability of the financial markets in the context of the global financial crisis, with a view to implementing the Declaration on a concerted European action plan of the euro area countries of 12 October 2008[4] (hereinafter the 'Declaration'). In addition to the draft legislation, on 22 October 2008 the Finnish Government requested Parliament's consent to State guarantees on debt instruments issued by banks in accordance with the Government's plan for stabilisation of the financial markets in Finland[5].

1.3 The explanatory memorandum to the draft legislation states that the Law on the Government Guarantee Fund currently provides for a wide legal framework allowing for various kinds of support measures to be put in place and that the general conditions applicable to support measures are adequate. However, the Law on the Government Guarantee Fund does not allow the authorities to take the initiative at an early stage to solve solvency problems entailing a systemic risk or to intervene in certain situations where the conditions for stable operations are compromised due to external factors.

1.4 The draft legislation would give the Government the power to oblige distressed banks to apply for support if: (a) the solvency of a bank has decreased or is expected to decrease in such a way that the bank does not fulfil the conditions to continue its operations in accordance with its licence; (b) an acceptable level of solvency cannot be achieved without the State's financial support; and (c) the liquidation or insolvency of the bank could lead to serious disturbances in the financial markets. If the bank does not apply for support, the Council of State may decide to purchase its shares and capital loans or its business, depending on the corporate form of the bank concerned. Moreover, a bank's holding company could be subject to such support measures, but funds could no longer be channelled via the bank's own guarantee fund. In addition, the Government would be authorised to restrict, for a maximum period of six months, the operations of deposit banks and other financial market participants and to decide on restrictions of procedures to be followed in securities trading. The Council of State may decide on such restrictions provided that it is necessary due to disturbances in the international financial markets or due to measures taken by foreign authorities.

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

5 Government proposal HE 181/2008 vp. Under Section 82(2) of the Finnish Constitution, a State security and a State guarantee may be given on the basis of the consent of the Parliament. Such guarantees are further based on the Law on State lending and State guarantees (449/1988) and Section 3 of the Government Decree on fees payable for State guarantees (20/2003, as amended by Decree 109/2008). On the subject of stabilisation of the financial markets in Finland, see also the Press Releases 164/2008 and 168/2008 of the Ministry of Finance, available on the Ministry's website at www.vm.fi.

2. General observations

2.1 In the wake of the global financial crisis, the ECB has issued several opinions in the field of State rescue measures[6], emphasising the importance of a common approach aimed at restoring confidence in the financial markets and compliance with the Declaration. The ECB therefore draws the consulting authority's attention to its recent opinions issued at the request of other Member States in which it has commented on legislative proposals sharing some of the features of the draft legislation. It is the ECB's intention to facilitate 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.

2.2 In line with its past opinions, the ECB notes that it should be ensured that beneficiary institution(s) are not unfairly advantaged by making undue use of their guaranteed status. In this respect, the ECB notes that financial support arrangements which may be considered as providing preferential treatment to specific credit institutions should be avoided. The ECB notes that in this case, the draft legislation extends the applicability of support measures beyond Finnish deposit banks to holding companies of deposit banks. Moreover, purchase measures can be applied irrespective of a bank's corporate form. This aspect should be further clarified in the draft legislation. Therefore, the ECB also underlines the importance of ensuring that the proposed arrangements under the draft legislation, including any implementation measures, should comply with the relevant Community law provisions and with 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

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6 See 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; 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; 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 117bis 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 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; ECB Opinion CON/2008/58 of 23 October 2008 at the request of the Banca d'Italia on behalf of the Italian Ministry for Economic Affairs and Finance on two Decree-Laws containing urgent measures to guarantee the stability of the banking system and the continuity of the provision of credit; ECB Opinion CON/2008/59 of 24 October 2008 at the request of the Swedish Ministry of Finance on a draft proposal on stabilising measures for the Swedish financial system; ECB Opinion CON/2008/60 of 27 October 2008 at the request of the Spanish State Secretary for Economic Affairs on a draft Order implementing Royal Decree-Law 6/2008 creating the Fund for the acquisition of financial assets and on a draft Basic Agreement of the Fund's Executive Council; ECB Opinion CON/2008/61 of 28 October 2008 at the request of the Belgian Minister for Finance on a draft royal decree implementing the Law of 15 October 2008 on measures promoting financial stability and in particular establishing a State guarantee for the provision of credit in the context of financial stability, in relation to the protection of deposits and life insurance and amending the Law of 2 August 2002 on the supervision of the financial sector and on financial services; 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/ecb/legal/opinions/html/index.en.html.

the current global financial crisis' (hereinafter the 'Commission Communication')[7]. For these reasons, the ECB expects to be consulted on any implementation measures relating to matters within its competence.

3. Specific observations

The draft legislation and euro area monetary policy

3.1 The ECB notes that, in line with the Declaration, Member States must act in a coordinated manner to avoid significant differences in national implementation of support measures from having a counter-productive effect and creating distortions in global banking markets. The Declaration acknowledges the need to work in cooperation with the ECB to ensure consistency with the Eurosystem's management of liquidity and compatibility with its operational framework. Against this background, the ECB notes that Member States should avoid taking decisions in an uncoordinated way, as this may lead to a fragmentation of the euro area money market. In this respect, the ECB makes the following observations, which are important from a monetary policy perspective, as regards the measures laid down in the draft legislation.

3.2 As regards the conditions applicable to support measures, the ECB notes that the draft legislation does not further specify the detailed terms or compensation payable by the supported entity. The ECB understands that under Section 14 of the Law on the Government Guarantee Fund, the terms for support measures may be laid down separately by the Parliament when deciding on allocation of funds and/or by the Council of State when deciding on support measures in each case. The ECB's specific observations are as follows.

3.3 First, the ECB notes that the draft legislation does not provide for a time limit as regards the implementation of the support measures. Such an 'open-ended' scheme does not appear to be in line with the Declaration which emphasises the temporary feature of such schemes.

3.4 Second, in case that the Fund would provide State guarantees as part of measures to implement the Declaration, the ECB understands that such guarantees would apply to all liabilities, without limit regarding the maturity. In this respect, the ECB would remind the Finnish authorities of Article 8 of the Declaration which states, *inter alia*, that the euro area governments will make available a Government guarantee of new medium term (up to five years) bank senior debt issuance. The ECB also considers that practically, arrangements for granting a State guarantee on bank debt should aim at: (a) addressing the funding problems of liquidity-constrained solvent banks by improving the functioning of the market for bank debt of longer term maturity; (b) preserving the level-playing field among financial institutions and avoiding market distortions; and (c) ensuring consistency with the management of liquidity by the Eurosystem. By contrast, it is the ECB's view that the extension of a State guarantee to cover interbank deposits should be avoided. It could entail a substantial distortion in the various national segments of the euro area money market by potentially increasing short-term debt issuance activity across Member States and thereby impairing the

7 2008/C 270/02.

implementation of the single monetary policy, which is an exclusive competence of the Eurosystem under Article 105(2) of the Treaty[8].

3.5 Third, as regards the price of the State guarantees to be applied, the ECB notes that the draft legislation does not specify detailed conditions, which could be determined on a case-by-case basis[9]. In this context, the ECB would remind the Finnish authorities that it is of crucial importance to ensure harmonisation of the price determination of such guarantee within the euro area and within the EU, as a level-playing-field is also of essence in this respect. It is also important that the price for the guarantee should be risk-based and market-oriented, determined on the basis of the costs of a corresponding guarantee in the market.

3.6 Fourth, under Section 1 of the draft legislation, the Fund may acquire shares and holdings from financial institutions. Although such measures should restore confidence in the Finnish banking system, it is also important for the price applied by the Fund to its transactions to be determined in a coordinated manner within the euro area and the EU and for the pricing of the purchased assets to be determined by the market. The ECB notes the importance of price determination of transactions conducted by the Fund and their potential implications for the transmission of the single monetary policy decisions within the euro area. In this respect, the ECB emphasises that uncoordinated price determination between all euro area Member States could lead to segmentation of the euro area money market. Moreover, the transactions conducted by the Fund should not interfere with the transmission of the single monetary policy. The ECB should be involved in such concertation and coordination, and would welcome explicit provision to this effect in subsequent legislation.

Suomen Pankki's role

3.7 The ECB understands that the Government Guarantee Fund will be managed by the Ministry of Finance, and that Suomen Pankki's role in relation to the Fund will be only be limited to providing advice through consultation on support measures. The ECB appreciates that these provisions recognise Suomen Pankki's expertise in the fields relevant to the Fund's operation. In this respect, the ECB notes that any involvement of Suomen Pankki with the Fund must be compatible with the Treaty provisions. The ECB expects that functions to be performed by Suomen Pankki for the benefit of the Fund will be conducted in manner that is fully compatible with Suomen Pankki's institutional and financial independence to safeguard the proper performance of its existing tasks under the Treaty and the Statute of the European System of Central Banks and of the European Central Bank. Second, the ECB also understands that the Fund's resources will be exclusively financed from budgetary resources[10]. It is therefore expected that the involvement of Suomen Pankki will not go beyond an advisory function and, in particular, that it will fully comply with the

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8 See ECB Opinion CON/2008/52.

9 With regard to the support measures provided for in the Law on the Government Guarantee Fund, the Council of State determines, under authorisations granted in the State budget, the consideration payable, determined according to the liability incurred by the State from the principal of various guarantees, securities and commitments and its contractual obligation. Guarantee payments as referred to in the Law on State lending and State guarantees (449/1988), will not be collected for these guarantees or obligations.

10 See Section 2 of the Law on the Government Guarantee Fund.

prohibition on monetary financing laid down in the Treaty[11]. If Suomen Pankki were to perform certain activities for the Fund at the request of the State, such activities would also need to comply with the abovementioned prohibition as regards their remuneration.

Community rules on State aid and financial services

3.8 Finally, it should be ensured that any beneficiary institution(s) will not be unfairly advantaged by making undue use of their guaranteed status[12]. In this context, the ECB notes that the explanatory memorandum to the draft legislation[13] refers to the recently adopted Commission Communication regarding compliance with EU State aid rules by financial sector support schemes which include in the specific context of the provision of State guarantees detailed rules on setting eligibility criteria for the beneficiary institutions[14]. In line with its previous opinions[15], the ECB reiterates the importance of ensuring that the proposed arrangements under the draft legislation are implemented in full compliance with the relevant Community law provisions, including EU financial services legislation and the single market principles. It should also be ensured that such measures are in accordance with the requirements of EC competition law, in particular State aid rules, and that State's role as shareholder is limited in time.

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

Done at Frankfurt am Main, 13 November 2008.

[signed]

The President of the ECB

Jean-Claude TRICHET

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11 Cf. Paragraph 3.2 of ECB Opinion CON/2008/52.

12 See e.g. paragraph 3.4 of ECB Opinion CON/2008/48, paragraph 3.1 of ECB Opinion CON/2008/50 and paragraph 3.4 of ECB Opinion CON/2008/57.

13 See point 2.2 of the explanatory memorandum to the draft legislation.

14 See paragraph 18 of the Commission Communication, 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'.

15 See paragraph 2.3 of ECB Opinion CON/2008/44 and paragraph 3.5 of ECB Opinion CON/2008/48.