EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 23 July 2008

at the request of the Polish Minister for Finance

on a draft law amending the Law on the Bank Guarantee Fund

(CON/2008/32)

Introduction and legal basis

On 23 May 2008 the European Central Bank (ECB) received a request from the Polish Minister for Finance for an opinion on a draft law (hereinafter the 'draft law') amending the Law of 14 December 1994 on the Bank Guarantee Fund[1] (hereinafter the 'Law on the Bank Guarantee Fund').

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[2], as the draft law relates to Narodowy Bank Polski (NBP) and 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

1.1 The draft law proposes certain amendments to the regulation of the national deposit insurance scheme, managed by the Bank Guarantee Fund (hereinafter the 'Fund')[3]. The ECB has already been consulted on two earlier versions of the amendments, as described in detail in ECB Opinions CON/2007/26 and CON/2008/5[4].

1.2 The draft law introduces *inter alia* the following amendments to the Law on the Bank Guarantee Fund:

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1 Consolidated text: Dz.U. of 19 April 2007 No 70, Item 474.

2 OJ L 189, 3.7.1998, p. 42.

3 Participation in the deposit guarantee scheme operated by the Fund is mandatory for all banks established in Poland, including cooperative banks, but not for Polish credit unions operating on the basis of 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 scheme is compulsory for branches of non-EU banks and optional for branches of EU credit institutions to the extent that their home country schemes do not ensure the level of deposit guarantees provided by Polish law (Articles 2(3) and 2b of the Law on the Bank Guarantee Fund). For ease of reference, the entities covered by the mandatory deposit guarantee scheme operated by the Fund are referred to in this opinion as 'commercial banks'.

4 See ECB Opinion CON/2007/26 of 27 August 2007 at the request of the Polish Minister for Finance on a draft law amending the Law on the Bank Guarantee Fund and ECB Opinion CON/2008/5 of 17 January 2008 at the request of the Polish Minister for Finance on a draft law amending the Law on the Bank Guarantee Fund.

(i) it abolishes NBP's non-repayable annual subsidies for the Fund[5]. NBP's right to extend credit facilities to the Fund will be restricted to short-term credit facilities extended at NBP's discretion to enable the Fund to repay guaranteed deposits, only insofar as the Fund's own resources are insufficient and only where the stability of the banking system is threatened[6];

(ii) it introduces new rules for the Fund's management of its financial resources. In particular, any balance sheet surplus of the Fund should, as a rule, be allocated to its assistance fund supporting the Fund's operations to the benefit of distressed but still solvent commercial banks, rather than to the Fund's core resources securing the repayment of guaranteed deposits in the event of a bank insolvency[7];

(iii) it modifies the rules for the Fund's governance, regulation and supervision. Most of the NBP's governance and regulation powers over the Fund will be eliminated or limited, as further specified in paragraph 3.1[8].

2. Compatibility with the monetary financing prohibition

2.1 In line with its previous recommendations, the ECB welcomes the draft law insofar as it continues to propose abolishment of NBP's annual subsidies of the Fund[9].

2.2 As regards the possibility of NBP extending credit facilities to the Fund, the ECB repeats its stance on the prohibition on monetary financing, as most recently expressed in its 2008 Convergence Report. In the Convergence Report, the ECB states that national legislation which provides for the 'financing by NCBs [national central banks] of a public sector national deposit insurance scheme for credit institutions … would not be compatible with the monetary financing prohibition, if it is not short term, does not address urgent situations, systemic stability aspects are not at stake, and decisions do not remain at the NCB's discretion'[10]. The ECB further notes that Article 43 of the Law on Narodowy Bank Polski[11] and Articles 15(6) and 34(3) of the Law on the Bank Guarantee Fund, which empower NBP to grant credit to the Fund, are incompatible with the Treaty prohibition on monetary financing[12].

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5 At the same time, the method for calculating the commercial banks' financial contributions to the Fund is modified (see Article 13 of the Law on the Bank Guarantee Fund, as amended by Article 1(9) of the draft law).

6 See Article 16(2) to (2b) of the Law on the Bank Guarantee Fund, as amended by Article 1(13) of the draft law.

7 See Article 1(13) of the draft law. The statutory application of the Fund's various resources is regulated in paragraphs 28 to 31 of the Bank Guarantee Fund Statute (see the Annex to the Regulation of the Council of Ministers of 28 February 1995 on the adoption of the Bank Guarantee Fund Statute, Dz.U. of 6 March 1995 No 21, Item 113, as amended (hereinafter the 'Fund Statute')).

8 See Article 1(4), (5), (8) and (17) of the draft law. Among other things these amendments increase the Minister for Finance's regulatory and supervisory powers over the Fund. Auditing powers exercised by the Supreme Chamber of Auditing are also strengthened (Article 3 of the draft law).

9 See the ECB Convergence Report, May 2008, p. 244 (Section 6.7.3 'Monetary financing and privileged access'). Available on the ECB's website at www.ecb.europa.eu. See also paragraph 2.2 of ECB Opinion CON/2007/26.

10 See the ECB Convergence Report, May 2008, p. 24 (under 'Financial support for deposit insurance and investor compensation schemes').

11 Law on Narodowy Bank Polski of 29 August 1997 (consolidated text: Dz.U. of 1 April 2005 No 1, Item 2, as amended (hereinafter the 'Law on NBP')).

12 See the ECB Convergence Report, May 2008, p. 244.

2.3 The draft law will amend the conditions under which NBP may grant credit facilities to the Fund. Under the amended Article 34(3) of the Law on the Bank Guarantee Fund, such credit facilities may only be given for a short term, and only if: (i) the total amount of claims submitted for the repayment of guaranteed deposits exceeds the Fund's accumulated resources; and (ii) the stability of the banking system is threatened[13]. Further, Article 15(6) of the Law on the Bank Guarantee Fund, establishing the sources of finance of the Fund, is amended to reflect the amendments to Article 34(3) of the same Law[14]. At the same time, the draft law amends Article 43 of the Law on NBP so that it will now provide: 'In the event referred to in Article 34(3) of the Law on the Bank Guarantee Fund, Narodowy Bank Polski may extend a short-term credit facility to the Bank Guarantee Fund'[15].

2.4 According to the consulting authority, the new regulation of conditions under which NBP's credit facilities may be extended to the Fund is intended to ensure full compliance of the Law on the Bank Guarantee Fund with the monetary financing prohibition under Article 101(1) of the Treaty[16]. The ECB welcomes this intention, but points to the remaining incompatibility. The Convergence Report states that central bank credit extended to a national deposit insurance scheme may only address urgent situations is not incorporated. To this effect, the amended Article 34(3) of the Law on the Bank Guarantee Fund needs to specify that credit facilities may only be granted for urgent needs of the Fund[17].

2.5 Other related comments in ECB Opinion CON/2008/5 remain valid, as in particular referring to the classification of the Fund as a 'body governed by public law', the priority of commercial banks' contributions over possible NBP credit facilities among the sources of Fund's funding and the possible enhancement of the regulation of the NBP's crediting of the Fund by way of including express references to adequate collateral and to compliance with Article 101 of the Treaty[18].

2.6 Moreover, the ECB notes the stronger emphasis by the draft law on the Fund's assistance activity constituting financial support for the reorganisation and consolidation of commercial banks threatened with insolvency[19], which is differentiated from the Fund's operations related to

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13 The proposed wording of Article 34(3) of the Law on the Bank Guarantee Fund, as amended by Article 1(17) of the draft law.

14 The proposed wording of Article 15(6) of the Law on the Bank Guarantee Fund, as amended by Article 1(12) of the draft law, specifies 'short-term credit facility extended by NBP pursuant to Article 34(3) [of the Law]' as one of the sources of finance of the Fund. The related provisions of the Law on the Bank Guarantee Fund specifying the mode of application and repayment of NBP's credits are not affected.

15 Article 43 of the Law on NBP, as amended by Article 4 of the draft law.

16 See the third paragraph of the general part of the explanatory memorandum accompanying the draft law (p. 12 of the joint document containing the draft law and the explanatory memorandum) as well as specific remarks in point 15 of the explanatory memorandum (p. 17 of the joint document).

17 See paragraph 2.5(ii) of ECB Opinion CON/2008/5.

18 See paragraphs 2.4 and 2.6 to 2.7 of ECB Opinion CON/2008/5.

19 See Article 1(13) of the draft law amending Article 16 of the Law on the Bank Guarantee Fund, as commented in point 19 of the specific remarks in the explanatory memorandum (p. 16 of the joint document containing the draft law and the explanatory memorandum). The assistance activity constitutes providing repayable financial assistance, under statutorily defined conditions, to commercial banks threatened with insolvency by, among other things, issuing credit facilities, guarantees and endorsements to such commercial banks, acquiring specified types of their loan portfolios and other receivables, or crediting the acquisition of bank shares or stocks. See also Article 4(2) of the Law on the Bank Guarantee Fund, as partly amended by Article 1(5) of the draft law. See also paragraph 4 of the Regulation of the Council of

repayment of guaranteed deposits held by insolvent banks. In this respect, the ECB notes that the Law on the Bank Guarantee Fund stipulates that NBP's credit facilities may only be used to fulfil the Fund's task of protecting guaranteed deposits, hence excluding the use of NBP's credits to finance any of the Fund's other operations[20]. From a Community law perspective, as consistently held by the ECB, any financing by the central bank of the tasks of a deposit guarantee fund which is a public sector body will be compatible with the monetary financing prohibition only subject to the introduction of the necessary safeguards related to solvency of the recipient institution, as most recently stated in the ECB Convergence Report of May 2008[21].

3. Governance of the Fund and coordination with the central bank's financial stability role

3.1 The draft law will make certain changes to the current institutional and regulatory regime for the Fund which, as regards the powers of NBP's President exercised in relation to the Fund: (i) reduces the number of Fund Council members appointed by NBP's President from four to two, and limits the role of NBP's President in selecting the Fund Council's Chair[22]; (ii) NBP's President will only submit a non-binding opinion on draft regulations proposed by the Minister for Finance relating to the Fund, instead of being a co-regulator of the Fund operations[23]; (iii) NBP's President will lose his current powers related to the selection of the Fund's auditors[24]; and, on the other hand, (iv) NBP's President will obtain a new right to receive, together with the Minister for Finance, quarterly reports on the activities and finances of the Fund[25].

3.2 The ECB repeats its earlier observation that deposit insurance schemes are a key element of the financial safety net and that effective coordination of their important functions with the overall role of central banks in safeguarding financial stability should be ensured. This aim may be achieved

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Ministers of 22 September 1999 on the trade by the Bank Guarantee Fund in the receivables acquired from banks threatened with insolvency (Dz.U. of 8 October 1999 No 80, Item 904).

20 Article 16(1)(2) in conjunction with Article 15(6) of the Law on the Bank Guarantee Fund.

21 See the ECB Convergence Report, May 2008, p. 244 (Section 6.7.3 'Monetary financing and privileged access') and paragraph 2.2 of ECB Opinion CON/2007/26.

22 Currently the Prime Minister appoints the Fund Council's Chair on a joint recommendation by the Minister for Finance and NBP's President; the draft law provides for appointment by the Minister for Finance after consulting NBP's President, the Chair of the Financial Supervision Commission and the Polish Banking Association (Article 1(6) of the draft law, amending Article 6(3) and (4) of the Law on the Bank Guarantee Fund).

23 Currently, proposals for regulations in the following areas must be agreed between the Minister for Finance and NBP's President: (1) the adoption of the Fund's Statute; (2) setting the conditions for the Fund's trading in the loans acquired from commercial banks threatened with insolvency; and (3) any additional Fund tasks concerning the provision of assistance to commercial banks. Further, NBP's President adopts the regulation regarding remuneration of the Fund Council's members in consultation with the Minister for Finance. These powers of NBP's President will be replaced with the right to issue a non-binding opinion on the proposals submitted by the Minster for Finance (see Articles 3(4), 4(2a), 4(3) and 6(6) of the Law on the Bank Guarantee Fund, as amended by Article 1(4)(a), (5)(d) and (6) of the draft law). Additionally, NBP's President will also obtain the right to issue a non-binding opinion on draft regulations by the Minister for Finance relating to special accounting rules for the Bank Guarantee Fund (see Article 81(2)(11) of the Law of 29 September 1994 on accounting (consolidated text: Dz.U. 2002 No 76, Item 694, as amended) as added by Article 2 of the draft law).

24 See Article 17(2) of the Law on the Bank Guarantee Fund, as amended by Article 1(14) of the draft law, which provides that auditors are selected through a tender announced by the Fund Council (and no longer by NBP's President).

25 See Article 7(2)(3a) of the Law on the Bank Guarantee Fund, as added by Article 1(7) of the draft law.

through, among other things, maintaining an adequate level of central bank involvement in the governance and regulation of the national deposit insurance scheme[26].

3.3 Moreover, the ECB notes that as a result of the supervisory reform completed on 1 January 2008, banking supervision responsibilities have been transferred from the defunct Banking Supervision Commission, a body closely associated with NBP, to the newly created Financial Supervision Commission, which is largely disconnected from NBP[27]. In this new institutional setting, it is important to maintain channels for timely central bank access to information concerning financial market participants, relating in particular to crisis situations. Such meaningful access to prudential information, as possessed *inter alia* by the Fund, will allow NBP to properly perform its financial stability role. The ECB further notes that the financial stability role, as expressly introduced by the draft law in relation to the Fund[28], should also be expressed more explicitly in relation to NBP. Specifically, the ECB refers to paragraph 4.2 of ECB Opinion CON/2006/39: 'Assuming the implementation of a supervisory reform weakening the existing institutional relationship between NBP and the banking supervisory authority, the ECB recommends amending the Law on NBP, so as to specify that NBP has a formal responsibility for contributing to financial stability by monitoring and assessing the financial system as a whole, as a separate function from hands-on supervision and financial regulation'[29].

3.4 Finally, the ECB notes the introduction by the draft law of a procedure under which the members of the Fund's governing bodies will be automatically dismissed if the Council of Ministers does not endorse the Fund's financial report[30]. This procedure is described by the explanatory memorandum to the draft law as 'similar' to the procedure for endorsement of the NBP's financial report by the Council of Ministers[31]. For clarification purposes, the ECB understands that in the context of submission of NBP's financial report for endorsement by the Council of Ministers no dismissal sanction of any kind may be applied to members of the NBP's governing bodies.

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

Done at Frankfurt am Main, 23 July 2008.

[signed]

The President of the ECB

Jean-Claude TRICHET

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26 See paragraph 3.3 of ECB Opinion CON/2007/26.

27 As described in paragraph 1.1 of ECB Opinion CON/2007/31 of 9 October 2007 at the request of the Polish Minister for Finance on a draft law amending the Law on the supervision of financial markets.

28 See Article 1(5)(e) of the draft law, adding Article 4(4) in the Law on the Bank Guarantee Fund, as commented in point 10 of the specific remarks in the explanatory memorandum (p. 15 of the joint document containing the draft law and the explanatory memorandum).

29 ECB Opinion CON/2006/39 of 2 August 2006 at the request of Poland's Sejm Marshall on a draft law amending the Law on Narodowy Bank Polski.

30 See Article 1(14) of the draft law amending Article 17(5) of the Law on the Bank Guarantee Fund, as commented in point 12 of the specific remarks in the explanatory memorandum (p. 16 of the joint document containing the draft law and the explanatory memorandum).

31 Article 69(3) of the Law on NBP.