EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 9 November 2009

on the extension of the Irish State guarantee of certain liabilities of credit institutions

(CON/2009/92)

Introduction and legal basis

On 22 October 2009 the European Central Bank (ECB) received a request from the Irish Minister for Finance (hereinafter the 'Minister') for an opinion on a draft Credit Institutions (Eligible Liabilities Guarantee) Scheme 2009 (hereinafter the 'draft scheme').

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 scheme relates to the stability of Ireland's financial system and the Central Bank and Financial Services Authority of Ireland (CBFSAI). 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.

The ECB was consulted by the Minister on 18 June 2009 on a previous version of the draft scheme (hereinafter the 'original draft scheme'). The ECB provided an opinion on the original draft scheme on 25 June 2009 (Opinion CON/2009/56). The original draft scheme was not implemented and the draft scheme proposes to amend the original draft scheme in a number of respects as outlined below.

1. Purpose of the draft scheme

1.1 The draft scheme is made pursuant to the Credit Institutions (Financial Support) Act 2008 (hereinafter the '2008 Act'). Financial support may only be granted under the 2008 Act until 29 September 2010 or a later date as specified by the Minister, after consulting the Governor of the CBFSAI and the Irish Financial Services Regulatory Authority. The draft scheme will, *inter alia*, provide credit institutions with access to a stable funding stream and to longer term funding from the capital markets in order to maintain the stability of the Irish financial system[2].

1 OJ L 189, 3.7.1998, p. 42.

2 Paragraphs 1 and 2 of the schedule to the draft scheme.

1.2 Under the draft scheme, credit institutions and their subsidiaries which are systemically important and solvent may apply to the Minister to become participating institutions.[3] The eligible liabilities of the participating institutions will be guaranteed by the Minister under the draft scheme[4]. Eligible liabilities are deposits (to the extent not covered by deposit protection schemes in Ireland (other than the Credit Institutions (Financial Support) Scheme 2008 (hereinafter 'the existing scheme') or any other jurisdiction), senior unsecured certificates of deposit, senior unsecured commercial paper, other senior unsecured bonds and notes and other forms of senior unsecured debt which may be specified by the Minister, and which are consistent with EU State aid rules and with the European Commission's Banking Communication, subject to prior consultation with the Commission[5]. Eligible liabilities must also satisfy the specified eligibility criteria in that they must have a maximum maturity of five years and must be incurred during the period from the commencement date, being the date specified by the Minister as such (hereinafter the 'commencement date') and 29 September 2010 (hereinafter the 'issuance period')[6].

1.3 The Minister must review the draft scheme no less frequently than at six-month intervals, the results of which are to be provided to the European Commission[7]. The Minister will monitor the amount of eligible liabilities guaranteed under the draft scheme, and will also be able to vary its terms; however, any such variation will not affect any guarantee of a liability in issue at the date of that variation[8]. The draft scheme states that a fee shall be payable to the Minister or his nominee by each participating institution in respect of each guaranteed liability, which shall be consistent with the recommendations of the Governing Council of the ECB on government guarantees for bank debt of 20 October 2008 (hereinafter the 'ECB's recommendations on government guarantees'), as further discussed in paragraph 3.1 of this opinion. It also states that the basis for the calculation of the fee shall be advised by the Minister to the participating institutions from time to time[9].

1.4 The draft scheme allows a participating institution to incur eligible liabilities which are not guaranteed liabilities[10].

1.5 The draft scheme provides that eligible liability guarantees shall terminate five years after the end of the issuance period[11].

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3 Paragraph 3 of the schedule to the draft scheme.
4 Paragraph 10 of the schedule to the draft scheme.
5 Paragraph 11 of the schedule to the draft scheme.
6 Paragraph 12 of the schedule to the draft scheme.
7 Paragraph 5 of the schedule to the draft scheme.
8 Paragraphs 6 and 13 of the schedule to the draft scheme.
9 Paragraph 19 of the schedule to the draft scheme.
10 Paragraph 9 of the schedule to the draft scheme.
11 Paragraph 18 of the schedule to the draft scheme.

2. General observations

The ECB has issued opinions on the 2008 Act[12], the existing scheme[13] and the original draft scheme. It underlines that its recommendations in relation to the draft scheme should be taken together with the recommendations expressed in the abovementioned opinions.

3. Specific observations

3.1 *Fee arrangements*

The ECB notes that the fee arrangements in the draft scheme provide that a fee is to be paid by participating institutions to the Minister or his nominee in respect of each guaranteed liability. The draft scheme states that this fee shall be consistent with the ECB's recommendations on government guarantees and any Eurosystem guidelines and in accordance with EU State aid rules or such other rules as may be applicable. The ECB notes that the draft scheme provides that fees shall be consistent with the ECB's recommendations on government guarantees, and recommends that, in the interests of legal certainty, the reference to the ECB's recommendations on government guarantees and any Eurosystem guidelines should be deleted. Such recommendations and guidelines are not legal acts and may be subject to revision[14]. Furthermore, for the sake of transparency, a more precise indication should be given on the method to be used to calculate the fees.

3.2 *Scope of the guarantees and implementation of Eurosystem monetary policy*

The ECB takes the opportunity of this opinion to reiterate the points made in its previous opinions and to reemphasise the key elements of the Declaration issued by the Heads of State of the euro area on a concerted European action plan of the euro area countries (hereinafter the 'Declaration')[15]. In addition, the ECB reminds the consulting authority of the ECB's recommendations on government guarantees. Concerning the Declaration, the Heads of State acknowledged the need to cooperate with the ECB to ensure consistency in liquidity management by the Eurosystem and compatibility with the Eurosystem's operational framework and pointed out that, with a view to ensuring a sufficiently level playing field, uncoordinated decisions among Member States should be avoided as they may involve a fragmentation of the euro area money market. Against this background, the ECB has the following observations.

3.3 The extension of a guarantee to cover interbank deposits should be avoided as this 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 impairing the implementation of the single monetary policy, which is a unique competence of the Eurosystem

12 ECB Opinion CON/2008/44.

13 ECB Opinion CON/2008/48.

14 See paragraph 3.2 of ECB Opinion CON/2008/67.

15 The text of the Declaration is available on the former French Presidency's website at www.ue2008.fr.

under Article 105(2) of the Treaty. The ECB has expressed this particular concern in a number of opinions delivered to the authorities of Member States, including Ireland[16].

Furthermore, in line with the Declaration, the ECB reminds the consulting authority that the euro area governments committed themselves to making available for an interim period a Government guarantee of new medium-term (up to five years) bank senior debt issuance. In the same vein, the ECB's recommendations on government guarantees state that 'Government guarantees on short-term bank debt with maturity of three to 12 months could be provided so as to help revitalise the short-term bank debt market.' Moreover, it is noticeable that under the draft scheme there is no stated minimum maturity for any guaranteed liabilities which means that liabilities with a maturity of less than three months may be guaranteed in practice.

3.4 The ECB notes that the guarantee provided for in the draft scheme is to cover all deposits and short-term debt. In this regard, the ECB notes the points made by the consulting authority on why it considers it necessary that short-term funding with a maturity of up to three months can continue to benefit from a State guarantee. In summary, it advanced the following points: (i) notwithstanding the improvement in liquidity conditions overall over recent months, credit institutions in Ireland remain subject to liquidity pressures; (ii) because the existing scheme covers interbank deposits and obligations of less than three months duration, a transitional phase is necessary so that the guarantees in respect of such funding can be phased out in an orderly fashion; and (iii) it will be possible for participating institutions to issue unguaranteed deposits, a strategy which is encouraged by way of the fee arrangements provided for under the draft scheme.

3.5 The ECB acknowledges the significant challenges currently faced by the banking sector in Ireland and notes the points made by the consulting authority referred to above. However, granting government guarantees for bank debt with a maturity of less than three months should be avoided to the extent possible. The ECB reiterates that it is essential that the scheme will not impair the implementation of the single monetary policy throughout the euro area.

3.6 Finally, the ECB notes that the draft scheme provides that the Minister shall review the scheme and its rules no less frequently than at six-month intervals from the commencement date to ensure that it is achieving the purposes of the Act. The results of such reviews are to be provided to the European Commission which must approve the continued operation of the draft scheme on a six-monthly basis. The ECB welcomes the fact that the draft scheme is specifically stated to terminate five years after the end of the issuance period. As previously stated, the ECB emphasises that, in

16 See paragraph 3.7 of ECB Opinion CON/2008/48; paragraph 3.2 of ECB Opinion CON/2008/50; paragraph 3.3 of ECB Opinion CON/2008/50; paragraph 3.4 of ECB Opinion CON/2008/52; paragraphs 2.3 and 2.4 of ECB Opinion CON/2008/54; paragraph 3.5 of ECB Opinion CON/2008/55; paragraph 3.2 of ECB Opinion CON/2008/56; paragraph 3.4 of ECB Opinion CON/2008/57; paragraph 3.2 of ECB Opinion CON/2008/58; paragraph 3.3 of ECB Opinion CON/2008/59; paragraph 2.1.2 of ECB Opinion CON/2008/62; paragraph 2.1 of ECB Opinion CON/2008/65; paragraph 3.3 of ECB Opinion CON/2008/67; paragraph 3.4 of ECB Opinion CON/2008/68; paragraph 3.3 of ECB Opinion CON/2008/76, paragraph 3.2 of ECB Opinion CON/2008/79; paragraph 3.2 of ECB Opinion CON/2008/80; paragraph 3.5 of ECB Opinion CON/2008/81; paragraph 3.1 of ECB Opinion CON/2008/88; paragraph 3.3 of ECB Opinion CON/2009/2; paragraph 2.3 of ECB Opinion CON/2009/6; paragraph 3.2.2 of ECB Opinion CON/2009/12; paragraph 3.3.2 of ECB Opinion CON/2009/18; paragraph 2.4 of ECB Opinion CON/2009/28; paragraph 3.4.3 of ECB Opinion CON/2009/32; paragraph 3.9 of ECB Opinion CON/2009/49.

accordance with the Declaration, harmonisation regarding the expiry of the various financial support measures within a particular country and the national financial support schemes across the EU is of crucial importance in order to ensure a level playing field[17].

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

Done at Frankfurt am Main, 9 November 2009.

[signed]

The President of the ECB

Jean-Claude TRICHET

17 See ECB Opinion CON/2009/6.