EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 12 November 2009

on conditions and procedures for the application of the measures to strengthen financial stability

(CON/2009/93)

Introduction and legal basis

On 19 October 2009 the European Central Bank (ECB) received a request from the Lithuanian Ministry of Finance for an opinion on a draft Government resolution implementing the Law on financial sustainability (hereinafter the 'draft Government resolution').

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 Government resolution 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. Purpose of the draft Government resolution

1.1 The aim of the draft Government resolution is to specify conditions and procedures for the application of measures to strengthen financial stability provided for by the Law on financial sustainability, namely: (a) State guarantees; (b) subordinated loans; and (c) redemption of bank assets. The fourth category of measures to strengthen financial stability, provided for by the Law on financial sustainability, i.e. taking shares in a bank in the public interest, is not covered by the draft Government resolution.

1.2 The application of the draft Government resolution is limited in time – the Government may decide on the application of any of the three categories of measures to strengthen financial stability during a period of six months after the adoption of the draft Government resolution.

1 OJ L 189, 3.7.1998, p. 42.

2. General observations

2.1 On 2 April 2009 the ECB adopted Opinion CON/2009/32 at the request of the Lithuanian Ministry of Finance on a draft law on financial sustainability (hereinafter the 'April draft law'). The April draft law provided for a general legal framework of national measures to strengthen financial stability.

2.1.1 In Opinion CON/2009/32 the ECB drew the consulting authority's attention to the guidance provided by the Ecofin Council to the Member States in the Conclusions of its Meeting of 7 October 2008[2] and to the Declaration issued by the Heads of State of the euro area on 12 October 2008 (hereinafter the 'Declaration')[3]. In particular, the ECB stressed 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 question, in a spirit of close cooperation with other Member States and the Community institutions[4]. The principles contained in the Declaration and the Conclusions of the Ecofin Council were endorsed by the European Council of 15 to 16 October 2008[5].

2.1.2 In that opinion the ECB also made specific comments regarding, inter alia, the entities to which the new measures could be applied, the involvement of Lietuvos bankas, the circumstances under which the new measures could be applied, the relationship of the April draft law to monetary policy and the conditions for State capital investments.

The ECB welcomes that its comments were largely taken into account.

2.2 However, the ECB notes that its comments remain valid as regards the draft Government resolution. With these general observations in mind, and against the background of the abovementioned guidance the ECB has the following observations to make on the draft Government resolution.

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2 See 'Immediate Responses to Financial Turmoil', Ecofin Council Conclusions of 7 October 2008, available on the former French Presidency's website at www.ue2008.fr. The Ecofin Council recommended that: (i) interventions should be timely and the support should in principle be temporary; (ii) the interests of taxpayers should be protected; (iii) existing shareholders should bear the due consequences of the intervention; (iv) the Government should be in a position to bring about a change of management; (v) management should not retain undue benefits; (vi) governments may have, *inter alia*, the power to intervene in remuneration; (vii) legitimate interests of competitors must be protected, in particular through the State aid rules; and (viii) negative spill-over effects should be avoided.

3 The text of the Declaration is available on the former French Presidency's website at www.ue2008.fr. The Member States agreed to: (i) ensure appropriate liquidity conditions for financial institutions: (ii) facilitate the funding of banks; (iii) provide financial institutions with additional capital resources to continue to ensure the proper financing of the economy; (iv) allow for an efficient recapitalisation of distressed banks; (v) ensure sufficient flexibility in the implementation of accounting rules; and (vi) enhance cooperation procedures among European countries.

4 See ECB Opinions CON/2009/12, paragraph 2.2, and CON/2009/32, paragraph 2.2. All ECB opinions are published on the ECB's website at www.ecb.europa.eu.

5 Brussels European Council of 15 to 16 October 2008, paragraph 3 of the Presidency Conclusions, available at www.europa.eu.

3. Specific comments

3.1 *Involvement of Lietuvos bankas*

3.1.1 In its Opinion CON/2009/32 the ECB noted that the April draft law recognised Lietuvos bankas's expertise in the fields relevant to the stability of the financial market. However, the ECB expressed its understanding that Lietuvos bankas's role in relation to the new measures would only be a consultative one, i.e. advising the Government or an institution authorised by it in respect of specific measures and/or providing its findings on the situation of a particular bank.

3.1.2 The ECB understands from the consulting authority that the draft Government resolution envisages Lietuvos bankas's participation in the application of the measures to strengthen financial stability, including the submission of all relevant information to the Ministry of Finance that would allow it to adopt a decision on the application of a specific measure. It also gives Lietuvos bankas an important role in the supervision of the beneficiary financial institution during the period of its application and in monitoring how the beneficiary financial institution fulfils its obligations under the corresponding legal arrangement signed with and/or approved by the Government or the Ministry of Finance.

3.1.3 The ECB also understands from the consulting authority that Lietuvos bankas is to be assigned this role because it considers Lietuvos bankas best qualified for it considering its expert knowledge, and in view of the aim of safeguarding the taxpayers' interest and ensuring the efficient use of public funds.

3.1.4 The ECB reiterates that any involvement of Lietuvos bankas in the application of the measures to strengthen financial stability must be compatible with the Treaty[6], i.e. Lietuvos bankas's functions must be conducted in a manner that is fully compatible with Lietuvos bankas's institutional and financial independence[7] 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. In the same vein, it should also be borne in mind that the involvement of Lietuvos bankas in the application of the measures contained in the draft Government resolution must fully comply with the prohibition on monetary financing laid down in Article 101(1) of the Treaty, read in conjunction with Council Regulation (EC) No 3603/93 of 13 December 1993 specifying definitions for the application of the prohibitions referred to in Articles 104 and 104b(1) [now Articles 101 and 103(1)] of the Treaty[8].

6 ECB Opinions CON/2008/68, paragraph 3.7, and CON/2009/32, paragraph 3.2.2.

7 See ECB Opinion CON/2009/26, paragraphs 2.1-2.3, in relation to Lietuvos bankas's institutional and financial independence.

8 OJ L 332, 31.12.1993, p. 1. See also ECB Opinions CON/2008/52, paragraph 3.2, and CON/2008/68, paragraph 3.7.

3.1.5 The ECB notes that although according to the draft Government resolution Lietuvos bankas generally is being given an advisory role in the sense that final decisions on the application of the measures to strengthen financial stability will be made by the Government and/or the Ministry of Finance on the advice of Lietuvos bankas, certain provisions seem to go beyond such an advisory role and require Lietuvos bankas to assume tasks which appear to be more related to the administration of the measures to strengthen financial stability. The draft Government resolution should ensure that these functions will not affect Lietuvos bankas's ability to carry out its ESCB-related tasks from an operational and financial point of view. The ECB recalls that the principle of financial independence implies that an NCB must have sufficient means not only to perform ESCB-related tasks but also its own national tasks (e.g. financing its administration and own operations)[9].

3.1.6 The ECB considers that the draft Government resolution should also be consistent with Lietuvos bankas's overall tasks and functions under the Law on Lietuvos bankas and the Law on financial sustainability. In addition, with respect to the Agency Contract which is to be concluded between Lietuvos bankas and the Ministry of Finance, the ECB understands that the content of this Contract will not go beyond Lietuvos bankas's tasks and functions under those laws and will be consistent with institutional and financial independence.

3.2 *Solvency of the beneficiary financial institutions*

3.2.1 The ECB reiterates its remark made in Opinion CON/2009/32 that, according to the abovementioned guidance in this regard, the measures to strengthen financial stability (except for taking shares in a bank in the public interest, which is not covered in the draft Government resolution) should not be applied to insolvent banks. It is recalled in particular that any measures undertaken by Lietuvos bankas should only relate to liquidity support provided to solvent institutions in order to comply with the prohibition on monetary financing.

3.2.2 In this context, paragraph 3 of the draft rules on State guarantees contained in the draft Government resolution provides that 'The State guarantee for bank stability enhancement shall be issued if, according to the information received from the bank and Lietuvos bankas, it is possible to expect that the bank will have sufficient funds to fulfil the State guarantee liabilities', and in some other draft rules contained in the draft Government resolution such a condition is not present at all (for example, in the draft rules on redemption of bank assets). The ECB would welcome more explicit provisions in this regard in the draft Government resolution.

3.3 *Restrictions as regards undue use of the guaranteed status of beneficiary financial institutions to engage in a heightened level of activities*

3.3.1 In Opinion CON/2009/32 the ECB noted that it is important to ensure that beneficiary financial institutions may not profit from undue use of their guaranteed status to engage in a heightened level of activities which distort the market and facilitate abnormal balance sheet growth. In this regard,

9 See the ECB's Convergence Report, May 2008, p. 20.

the ECB reiterated the importance of establishing appropriate safeguards such as limits on the marketing of financial products or on expansion of activities on the basis of State guarantees.

3.3.2 In this context the draft rules for the application of the measures to strengthen financial stability contained in the draft Government resolution (for example, paragraph 12.3 of the draft rules on State guarantees and paragraph 12.4 of the draft rules on subordinated loans) provide for a similar prohibition on the use by the beneficiary financial institution of *the information of* the fact that the measure to strengthen financial stability has been granted for the marketing of financial activities or the expansion of such activities. The ECB notes that, not only information about the measure, but also the measure itself should not be used for the marketing or expansion of financial activities. Therefore, the ECB would welcome an amendment to this effect in the draft Government resolution.

3.4 *Temporary nature of the measures to strengthen financial stability*

3.4.1 In Opinion CON/2009/32 the ECB noted that the Declaration clearly draws attention to the need for any domestic support schemes, and for the framework that provides for them, to be temporary in nature, even if they can be extended or renewed[10]. Accordingly, the ECB recommended that more specific provisions on the time limits of the support measures be inserted in the April draft law, and provisions establishing means to redeem the new measures.

The ECB notes that this remark was taken into account: Article 4(2) of the Law on financial stability provides that the measures to strengthen financial stability 'shall be applied for a limited period established by the Government', and Article 5(2) provides for the maximum and minimum maturity (three years and three months respectively) of a bank's liabilities that are guaranteed by the State.

3.4.2 However, the ECB must reiterate its remarks as regards the other two categories of measures to strengthen financial stability, i.e. subordinated loans and redemption of bank assets. Even though the application of the draft Government resolution itself is limited in time – the Government can decide on the application of any of the three categories of measures for a period of six months after adoption of the draft Government resolution, the draft rules on subordinated loans provide for minimum maturity of subordinated loans only[11], while in the draft rules on redemption of bank assets there are no provisions on the temporary nature of this measure or on the exit strategy.

The ECB understands that the specific term/maturity of the measure could be set in the particular legal arrangement signed between the beneficiary financial institution and the Government or the Ministry of Finance, and/or approved by the Government or the Ministry of Finance. However, in order to ensure that a transparent and predictable legal framework is in place and to facilitate the

10 The Declaration states 'In all cases, these actions will be designed in order to avoid any distortion in the level playing field and possible abuse at the expense of non beneficiaries of these arrangements. As a consequence…the scheme will be limited in amount, *temporary* [italics added] and will be applied under close scrutiny of financial authorities'.

11 Two years, as laid down in paragraph 3.4 of the draft rules on subordinated loans.

adoption of individual decisions, the ECB would welcome specification in this regard in the draft Government resolution.

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

Done at Frankfurt am Main, 12 November 2009.

[signed]

The President of the ECB

Jean-Claude TRICHET