EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 26 April 2010

on additional financial stability measures in Estonia

(CON/2010/35)

Introduction and legal basis

On 23 March 2010 the European Central Bank (ECB) received a request from the Ministry of Finance for an opinion on the draft law amending the Law on the financial supervision authority, the Law on credit institutions and the Law on the guarantee fund (hereinafter the 'draft law').

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union 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 the 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

The draft law is aimed at fostering the necessary tools for handling a financial crisis and mainly regulates issues within the competence of the Financial Supervisory Authority (FSA) and the State. Estonia adopted the first measures to secure the stability and functioning of the Estonian financial system in March 2009[2]. The draft law further increases the efficiency and effectiveness of financial supervision, also in the event of a financial crisis. The draft law allows for a faster exchange of information and makes it possible for the State to acquire shares of a credit institution in the public interest for fair compensation (expropriation), if this is necessary to safeguard financial stability. Under the current law, a credit institution may not be divided and the legal form may not be changed; however, the draft law establishes a regime for the division of a credit institution, i.e. the transfer of assets and liabilities to one or more existing or newly created companies, if this is necessary to guarantee its financial soundness. Under the draft law, the FSA will be responsible for supervising the division of credit institutions, adopting proposals to impose structural changes to a credit institution's organisational structure, requesting specific rehabilitation measures for a credit institution and granting temporary exemptions from prudential requirements. The draft law also introduces changes to the guarantee fund, resulting mainly from the

1 OJ L 189, 3.7.1998, p. 42.

2 See Opinion CON/2009/18. All ECB opinions are published on the ECB's website at www.ecb.europa.eu.

enhanced requirements under Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes[3].

2. General observations

2.1 The ECB welcomes measures that strengthen the powers of competent authorities to intervene when the stability of either individual credit institutions or the financial system as a whole is jeopardised[4]. The financial crisis has shown the importance of an efficient resolution regime and has triggered reflections both at international and European level on how to enhance the instruments at the disposal of competent authorities in a crisis situation. In this context, the ECB welcomes the draft law's measures to enhance the capability of a competent authority to respond in a timely and effective manner in the case of a solvent credit institution in distress[5]. Another important aspect is enhanced information sharing and cooperation between competent authorities[6].

2.2 The ECB has assessed measures related to the creation of 'bad banks', 'good banks' and 'bridge banks' and pointed out that such measures are welcome and are in line with current policies both at European and international levels for establishing a sound crisis resolution framework to intervene when financial institutions have a systemic impact on the financial system[7]. Such resolution framework is important in order to achieve the objective of ensuring the continuity of systemically important operations; this has been highlighted by the Eurosystem when replying to the initial ideas expressed by the Commission on a Union framework for crisis management and resolution[8]. The possibility to use a bridge bank is recognised as part of the trend towards enhanced convergence of national legal schemes for crisis management and resolution developing at both international and European level. In this context, the Estonian legal framework for crisis management and resolution may need to be further adapted taking into account future regulatory initiatives at Union level that aim to enhance the coordination of resolution and insolvency proceedings involving cross-border credit institutions.

2.3 Additional supervisory tools may be needed to handle a crisis involving cross-border credit institutions. The greater interdependencies among financial systems require appropriate action to address the possible systemic impact of failing cross-border credit institutions[9]. Therefore, supervisory tools should be effective in order to manage problems arising from such a crisis. The ECB emphasises the need for the mutual recognition of crisis management and resolution proceedings and measures. National supervisory authorities should work closely with relevant home and host resolution authorities to resolve cross-border situations effectively.

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3 OJ L 135, 31.5.1994, p. 5.

4 See for example paragraph 2 of Opinion CON/2009/65 and paragraph 3.2 of Opinion CON/2009/10.

5 See also paragraph 2.3.2 of Opinion CON/2010/12.

6 Paragraph 2.17 of Opinion CON/2010/10.

7 Paragraph 3.1.1 of Opinion CON/2010/7.

8 See the Eurosystem's reply to the public consultation of the Commission Communication on 'An EU framework for cross-border crisis management in the banking sector' of 4 February 2010.

9 *Idem.*

2.4 The draft law allows a credit institution to be divided. The FSA will have the right to carry out on-site inspections of the acquiring company and may refuse to authorise the transfer of assets and liabilities if the acquiring company is not subject to financial supervision. In this context, the option to divide credit institutions may be mainly useful under normal market conditions; it may take too much time to implement this solution in a crisis situation. However, these provisions are of general application and are not limited to financial crises.

2.5 The draft law provides for the expropriation of credit institutions' shares as a new measure to safeguard the stability of the financial system. The ECB welcomes the involvement of Eesti Pank and the FSA in this procedure. The proceedings leading to expropriation must be in line with the European Convention for the Protection of Human Rights and Fundamental Freedoms[10] and decisions of the European Court of Human Rights[11], and so comply with the principle that nobody may be deprived of their property except in the public interest and in accordance with the law. The ECB assumes that expropriation measures will only be taken in exceptional circumstances where, in compliance with the principle of proportionality, the seriousness of the measure is commensurate with the threat to financial stability[12].

2.6 Finally, the ECB reiterates that the financial support measures should not be applied to insolvent credit institutions and the pricing conditions should be risk-based and market-oriented[13]. As a general remark and in line with previous opinions[14], the ECB reiterates the importance of ensuring that the regulatory practice under the proposed arrangements will be conducted in full compliance with the relevant Union law provisions, including single market principles and financial services legislation, as well as competition and State aid rules[15]. Moreover, remedies to handle financial crises should be temporary in nature[16].

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10 European Convention for the Protection of Human Rights and Fundamental Freedoms, as amended by Proctocol No 11, Rome, 4 November 1950.

11 7 November 2002, *Olczak* v *Poland*, No 30417/96 and 1 April 2004, *Camberrow MMS AD* v *Bulgaria*, No 50357/99.

12 Paragraph 3.1.3 of Opinion CON/2010/7.

13 Paragraph 3.2.1 of Opinion CON/2009/93 and paragraph 3.4.2 of Opinion CON/2009/18. See also the Recommendations of the Governing Council of the European Central Bank on the pricing of recapitalisations, 20 November 2008, available on the ECB's website at www.ecb.europa.eu.

14 See, for example, paragraph 3.4 of Opinion CON/2008/80.

15 See the 'Communication from the Commission – The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis' of 13 October 2008, available on the Commission's website at www.ec.europa.eu.

16 Declaration of 12 October 2008 on a concerted European action plan of the euro area countries, available on the French Presidency's website at www.ue2008.fr. See also point 3.1.1 of Opinion CON/2009/18.

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

Done at Frankfurt am Main, 26 April 2010.

[signed]

The President of the ECB

Jean-Claude TRICHET