OPINION OF THE EUROPEAN CENTRAL BANK

of 12 May 2017

on judicial relief granted to holders of qualified bank credit

(CON/2017/16)

Introduction and legal basis

On 15 March 2017 the European Central Bank (ECB) received a request from the Slovenian Ministry of Finance for an opinion on a draft Act on judicial relief granted to holders of qualified bank credit (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 third indent of Article 2(1) of Council Decision 98/415/EC[1] as the draft law relates to a national central bank. 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 main objective of the draft law is to remedy the unconstitutionality, as declared by the Slovenian Constitutional Court, of certain provisions of the Slovenian Banking Act (hereinafter the 'ZBan-1')[2] governing Banka Slovenije's liability for damages with respect to extraordinary measures imposed by Banka Slovenije. ZBan-1 authorised Banka Slovenije to adopt extraordinary measures to write-down or convert qualified liabilities during the reorganisation of banks that failed, or were likely to fail, to meet the minimum requirements for capital and liquidity to an extent that would justify the withdrawal of their banking authorisation.

1.2 While the Constitutional Court confirmed that the legal basis for the extraordinary measures imposed in 2013 and 2014 by Banka Slovenije in respect of the write-down of subordinated instruments was in accordance with the Constitution of the Republic of Slovenia, it nevertheless declared the provisions of Article 350.a of the ZBan-1 to be unconstitutional. This conclusion was based on the Constitutional Court's finding that exercising judicial relief under Article 350.a of the ZBan-1 did not afford effective judicial protection to stakeholders affected by Banka Slovenije's extraordinary measures. The Constitutional Court decided that the legislator must remedy the unconstitutionality within six months of the publication of the Constitutional Court's decision, and

1 Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions (OJ L 189, 3.7.1998, p. 42).

2 Banking Act (Zakon o bančništvu), Official Gazette of the Republic of Slovenia no 131/06.

provided the legislator with further guidance on how best to ensure more effective judicial protection.

1.3 Shareholders and creditors affected by Banka Slovenije's extraordinary measures are eligible to seek compensation under the draft law, provided that the measures resulted in a less favourable treatment of their qualified liabilities compared to insolvency or regular liquidation proceedings[3] initiated on the day the extraordinary measures were imposed (the 'no creditor worse off principle')[4].

1.4 Compensation for damages incurred as a result of the extraordinary measures must be paid either by Banka Slovenije or the State. If no liability can be attributed to Banka Slovenije, compensation must be paid by the State. In particular, Banka Slovenije will be partially or wholly exempt from liability if it can demonstrate that it acted with due professional care when adopting the extraordinary measures and had, in the light of the facts and circumstances available at the time the extraordinary measures were adopted, reasonable grounds to believe that the statutory conditions for taking the extraordinary measures were fulfilled. If Banka Slovenije is only partially exempt from liability, then Banka Slovenije must pay damages to former holders of qualified liabilities, whereas financial resources for any compensation exceeding Banka Slovenije's liability must be provided by the State within three months of the publication of the court's decision in the Slovenian Official Journal.

1.5 Any claim for compensation must be filed against Banka Slovenije and the Republic of Slovenia within six months of the draft law entering into force. Such claims may be filed by applicants holding more than 10 % of the respective bank's share capital or having a claim of more than EUR 100 000 against the respective bank. The draft law codifies special procedural rules of judicial redress for the holders of qualified liabilities, which deviate from the general rules of civil proceedings and, *inter alia,* enable legal proceedings affecting similarly-placed litigants to be joined together to achieve a joint and uniform assessment of claims regarding a specific bank that was subject to Banka Slovenije's extraordinary measures.

1.6 When determining whether a claimant has a right to compensation, the court must establish whether extraordinary measures relating to qualified liabilities were adopted by Banka Slovenije in accordance with the conditions laid down in the ZBan-1. The court must, *inter alia,* verify whether the complex assessment of the conditions necessary for imposing extraordinary measures, as laid down in Article 253.a of the ZBan-1, including the respective bank's asset quality review (AQR), was correctly carried out or not. The main aspects that the court will verify are whether: (1) the methods and the assumptions underlying the methods used in the complex assessment of the

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3 Such proceedings may be applied if the bank's assets are sufficient to repay all its creditors.

4 According to the no creditor worse off (NCWO) principle no creditor or shareholder should incur greater losses than they would have incurred if the institution had been wound up under normal insolvency proceedings. The NCWO principle is defined under Article 34/1(g) of Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/.EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12.6.2014, p. 190).

conditions for imposing extraordinary measures and in the AQR were consistent with Union rules on State aid and the banking supervision standards adopted by the ECB, the European Commission and the European Banking Authority (EBA); (2) the method and the assumptions underlying such methods were applied improperly and whether this affected the outcome of the assessment; (3) there are reasonable grounds to suspect that either the original data was not used in the assessment or that the individual responsible for appraising the bank's assets did not act independently; and (4) there is reasonable doubt concerning the professional skills of the entity that performed the valuation of the bank's assets.

1.7 In the event of a dispute regarding the fulfilment of the conditions for the extraordinary measures, the burden of proof lies with Banka Slovenije. For complex questions requiring specialist knowledge the court may, either in addition to, or instead of, an expert appointed in accordance with the rules of civil proceedings, appoint a special committee of experts composed of three to five members selected through a public tender procedure, which will act as an advisory body to the court. The European Commission, the ECB and the EBA will be informed of the public tender procedure by the court.

1.8 The draft law lays down rules for a two-stage disclosure of documents and information in relation to any decision on extraordinary measures adopted by Banka Slovenije. These rules state that Banka Slovenije must publish on its website: (1) any decision imposing an extraordinary measure, (2) the valuation of assets for each bank in respect of which an extraordinary measure was taken, (3) the AQR report for each bank in respect of which an extraordinary measure was taken and (4) any documents revealing a contractual relationship between Banka Slovenije and the appraiser of the bank's assets. All personal and confidential information must be redacted in advance of any publication on Banka Slovenije's website. Furthermore, the applicants may file a motion to the court to oblige Banka Slovenije (and certain other entities, such the State, the Court of Audit, the Securities Market Agency and the bank affected by the extraordinary measure) to provide documents to the court without redacting personal or confidential information, whereby the court must limit any disclosure of evidence to that which is proportionate and must ensure the adoption of effective measures to protect such information[5], for example by excluding the public from the court's proceedings, limiting the review to certain entities, and similar measures.

1.9 If the court determines that former holders of qualified liabilities have a right to be compensated, its decision will be published in the Official Journal and will have an *erga omnes* effect, meaning that the decision will impact all former stakeholders affected by Banka Slovenije's extraordinary measures, regardless of whether they filed a claim to recover damages or not. The decision granting the right to compensation to former holders of qualified liabilities will be general in nature and will indicate how qualified liabilities should be treated and determine the extent of Banka

5 The draft law's provisions on access to information are derived from Article 5 of Directive 2014/104/EU of the European Parliament and of the Council of 26 November 2014 on certain rules governing actions for damages under national law for infringements of the competition law provisions of the Member States and of the European Union (OJ L 349, 5.12.2014, p.1).

Slovenije's liability. Thus, the court will not issue separate decisions awarding compensation to each individual stakeholder. Instead, the draft law provides a standardised formula for calculating compensation to be paid by Banka Slovenije based on a written request from former holders of qualified liabilities. The request may be submitted 15 days after the publication of the court's decision in the Slovenian Official Journal. The same applies if the Republic of Slovenia is liable to pay the compensation, in which case the compensation will be paid by the Ministry of Finance. The right to seek payment on the basis of the court's decision is limited in time and expires five years from the date of publication of the final court decision granting the right to compensation to former holders of qualified liabilities.

2. Observations

2.1 The draft law must comply with Article 123 of the Treaty, which prohibits overdraft facilities and any other type of credit facility with the national central banks of Member States in favour of the public sector, including central governments or other public authorities. Article 1(1)(b)(ii) of Council Regulation (EC) No 3603/93[6] defines 'other type of credit facility', *inter alia*, as 'any financing of the public sector's obligations vis-à-vis third parties'. Consequently, a requirement that Banka Slovenije must pay the compensation for damages, to the extent that it results in Banka Slovenije assuming the liability of the State[7], would not be in line with the monetary financing prohibition laid down in Article 123 of the Treaty.[8] Even if Banka Slovenije were to be reimbursed by the State within three months of the publication of the court's decision for any amounts paid as compensation, the financing of the State's obligation during this period would qualify as an 'other type of credit facility' granted by Banka Slovenije to the State, and as such would violate the monetary financing prohibition. Therefore, the draft law should be amended to ensure that Banka Slovenije does not assume any liability of the State, including, in particular, in cases where both Banka Slovenije and the State are severally liable. Banka Slovenije should only be liable in respect of its individual responsibility.

2.2 In order to provide effective judicial protection to the holders of qualified liabilities by allowing them to examine any relevant facts before bringing a claim to court, it is appreciated that there is a requirement to disclose documents that formed the basis for Banka Slovenije's decision on extraordinary measures.

2.3 Article 14(4), point 5 of the ZBan-2[9], stipulates that if it is specifically required by law, Banka Slovenije must disclose confidential information to the public. However, such national legislation should fully respect the provisions of Directive 2013/36/EU of the European Parliament and of the

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6 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) of the Treaty (OJ L 332, 31.12.1993, p. 1).

7 See Article 4 of the draft law.

8 See for example paragraph 3.2.3 of Opinion CON/2010/33 and paragraph 4.2(d) of Opinion CON/2008/16, all ECB opinions are available on the ECB's website at www.ecb.europa.eu .

9 Banking Act (*Zakon o bančništvu*), Official Gazette of the Republic of Slovenia, no. 25/15, 44/16 and 77/16.

Council[10] as regards professional secrecy. In this context the ECB notes that, notwithstanding the requirement under the draft law to redact personal and confidential information prior to any disclosure of information on Banka Slovenije's website, the asset valuations and AQR reports relating to individual supervised entities (banks) are to be regarded as confidential information. In addition, these documents may contain confidential information pertaining to each bank's customers or other counterparties, which have been obtained by Banka Slovenije from the banks and external service providers through the exercise of its supervisory powers[11]. Public disclosure of such documents would thus inevitably contravene the principle set out in Article 53 of Directive 2013/36/EU[12], according to which all persons working for competent supervisory authorities must be bound by the obligation of professional secrecy. Confidential information which such persons receive in the course of their duties may be disclosed only in summary or aggregate form, thus individual credit institutions may not be identified, without prejudice to cases covered by criminal law.

2.4 In order to establish a framework which safeguards both confidential information and the legitimate interest of investors affected by Banka Slovenije's extraordinary measures, the ECB recommends that an alternative approach should be considered, which would comply with the principles set out in Article 53 and Article 54 of Directive 2013/36/EU. In order to ensure the adequate protection of confidential supervisory information and to safeguard the principles set out in Article 53 of Directive 2013/36/EU, the disclosure of the asset valuations and AQR reports should be limited only to the shareholders or creditors who were directly affected by the extraordinary measures taken by Banka Slovenije and therefore have a legitimate legal interest as defined by the Constitutional Court of the Republic of Slovenia.

2.5 Regarding the draft law's requirement to verify that the methods and assumptions used to assess whether the extraordinary measures and the results of the AQR were consistent with the standards of banking supervision adopted by the ECB, the European Commission and the EBA, it is noted that in order to provide legal certainty the draft law should specify in more detail the relevant legal sources (e.g. legal acts and best supervisory practices) relevant in this context.

2.6 The ECB takes note that, pursuant to the draft law, the European Commission, the ECB and the EBA will be informed by the court of the public tender procedure for the appointment of a special committee of experts to act as an advisory body to the court for complex questions requiring specialist knowledge. On the understanding that the scope of the judicial review, and therefore the review by the special committee of experts, would be limited to explain facts, and taking account of the above-mentioned suggestion that the draft law should specify in more detail the relevant legal sources to be considered when assessing whether the extraordinary measures and the results of

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10 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

11 On the basis of Articles 53 of Directive 2013/36/EU and Article 14 of ZBan-2, Banka Slovenije is obliged to treat all information regarding supervised entities that was acquired in the course of its supervisory duties as confidential.

12 See footnote 11.

the AQR were consistent with the banking supervision standards of the ECB, European Commission and EBA, the ECB stands ready, at its discretion, to cooperate with the court, taking account of the principle of sincere cooperation between the Union and the Member States pursuant to Article 4(3) of the Treaty on European Union and the co-operation between the institutions of the Union and the responsible authorities of the Member States pursuant to Article 18 of Protocol (No 7) on the privileges and immunities of the European Union.

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

Done at Frankfurt am Main, 12 May 2017.

[signed]

The President of the ECB

Mario DRAGHI