EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 17 October 2008

at the request of the Spanish State Secretary for Economic Affairs

on a Royal Decree-Law creating a Fund for the acquisition of financial assets and on a Royal Decree-Law adopting urgent financial and economic measures in relation to the concerted European action plan of the euro area countries

(CON/2008/52)

Introduction and legal basis

On 13 October 2008 the European Central Bank (ECB) received a request from the Spanish State Secretary for Economic Affairs for an opinion on a Royal Decree-Law creating a Fund for the acquisition of financial assets (hereinafter 'Royal Decree-Law 1'). On 15 October 2008 the ECB received from the Spanish State Secretary for Economic Affairs a related request on a Royal Decree-Law adopting urgent financial and economic measures in relation to the concerted action plan of the euro area countries[1] (hereinafter 'Royal Decree-Law 2' and 'concerted European action plan' respectively). This opinion covers both Royal Decree-Laws. A Royal Decree modifying the guarantees provided for Spanish deposit and investment schemes was submitted only for information purposes.

The ECB's competence to deliver an opinion is based on Article 105(4) of the Treaty establishing the European Community and on 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 Royal Decree-Laws relate to Banco de España and 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 Royal Decree-Laws

Royal Decree-Law 1 is motivated by the current financial market crisis and by the Spanish authorities' concern to foster financing to companies and households[3]. For this purpose, Royal Decree-Law 1 establishes a fund that will be used to acquire from financial institutions top quality assets on a voluntary basis and subject to market criteria. The Fund will receive from the State budget an initial provision of

1 Declaration on a concerted European action plan of the euro area countries, available on the website of the French Presidency at www.eu2008.fr.

2 OJ L 189, 3.7.1998, p. 42.

3 See the first paragraph of the preamble to Royal Decree-Law 1.

EUR 30 billion extendable to up to EUR 50 billion[4]. The Fund will be managed by the Ministry for Economic Affairs and Finance, which will establish the Fund's Executive Council and its Executive Committee[5]. Moreover, Royal Decree-Law 2 seeks to implement the outcome of the Declaration on a concerted European action plan of the euro area countries in facilitating the funding of banks, while taking into account the situation of the Spanish financial system and the measures already adopted in Royal Decree-Law 1. To this end, Royal Decree-Law 2 authorises State guarantees of new financing operations by credit institutions with a maximum maturity of five years, 31 December 2009 as the time limit for granting such guarantees and EUR 100 billion as the maximum covered amount for 2008[6].

2. General observations

2.1 The Spanish Government has already adopted and published the Royal-Decree Laws on an urgent basis, thus having already normative effects. Therefore, this opinion relates to the parliamentary discussion in the validation phase of the Royal Decree-Laws, any further legislative amendments to them and to their subsequent implementation.

2.2 The ECB notes that the conclusions adopted at the Ecofin meeting on 7 October 2008 highlighted common principles to guide the States' action, namely 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 interest of competitors must be protected, in particular through the State aid rules, and (viii) negative spillover effects should be avoided[7]. Moreover, the ECB notes that in the concerted action plan of 12 October 2008 the Heads of State of the euro area agreed on common principles to be followed by the EU and euro area governments, central banks and supervisors to avoid national measures adversely affecting the functioning of the single market and the other Member States. The ECB highlights that all the initiatives put in place by national governments to restore confidence in financial markets should be aimed at implementing such common principles, in the spirit of close cooperation with other Member States and EU institutions.

2.3 Against this background, the ECB notes that Royal Decree-Law 1, to be in line with one of the conclusions of the Ecofin meeting on 7 October 2008, namely that the support should be temporary, should contain an expiry date. Although the references in the preamble of the Royal Decree-Law 1 to the temporary nature of the scheme and to the Budget Law of 2009 indicate that the scheme will

4 See Articles 1(1) and 2(1) of Royal Decree-Law 1 and the fourth paragraph of its preamble.

5 The Executive Council will consist of the Minister for Economic Affairs and Finance as Chair, the State Secretary for Economic Affairs, the State Secretary for Finance and the Budget, the President of the Instituto de Crédito Oficial, the Attorney General and the Auditor General. See Article 3(1) to (2) of Royal Decree-Law 1.

6 See Article 1 of Royal Decree-Law 2.

7 See the press release of the 2894th Council meeting (13784/08), available on the Council's website at www.consilium.europa.eu.

not go beyond 2009[8], a clear time limit would dissipate any expectation that the scheme is permanent.

2.4 The ECB draws the consulting authority's attention to the Declaration of Paris where it says in point (8) that Member States' actions' taken to facilitate the funding of banks 'will be designed in order to avoid any distortion in the level playing field', which is a crucial element for the integration of the financial markets in Europe. And further, that 'all the financial institutions incorporated and operating in [euro area countries] and subsidiaries of foreign institutions with substantial operations will be eligible' to benefit from States' actions. The ECB welcomes the fact that Royal Decree-Law 1 does not discriminate between credit institutions established in Spain. However, the ECB notes that Royal Decree-Law 2, namely in Article 1(1), could be considered as allowing for different treatment of some EU credit institutions established in Spain, with a potential disruption of the level playing field within the internal market. The ECB has stated in other opinions that 'arrangements that may be seen as providing preferential treatment to specified institutions should be avoided'[9].

2.5 The ECB understands that implementing rules will complete the details of the Royal Decree-Laws[10]. Consequently, the ECB expects to be consulted on any proposed implementing legislation to be adopted under the Royal Decree-Laws that materially influences the stability of financial institutions and markets[11].

3. Specific comments

3.1 *Eligibility for support*

The ECB notes that: (i) the Fund will use competitive procedures to select assets and make acquisitions in accordance with the usual financial market mechanisms to perform its operations[12]; and (ii) the financial instruments in which the Fund will invest will be of the highest quality and determined by the Fund's Executive Committee in accordance with the criteria established by the Fund's Executive Council and in all cases respecting the principles of objectivity, security, transparency, efficiency, profitability and diversification[13]. The ECB welcomes the above provisions, as financial support arrangements which may be considered as providing preferential treatment of specified credit institutions should be avoided[14]. The ECB further draws the consulting

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8 See also the third and sixth paragraphs of the preamble to Royal Decree-Law 1.

9 ECB Opinion CON/2008/48 of 15 October 2008 at the request of the Irish Minister for Finance on a draft Credit Institutions (Financial Support) Scheme 2008. All ECB opinions are available on the ECB's website at www.ecb.europa.eu.

10 See, e.g. 'investment guidelines' to be adopted by the Fund's Executive Council under Article 3(3)(1) of Royal Decree-Law 1. See also Article 1(4) of Royal Decree-Law 2.

11 See definition of 'draft legislative provisions' under Article 1(1) and also the sixth indent of Article 2(1) of Decision 98/415/EC.

12 See 4(2) of Royal Decree-Law 1.

13 See 4(3) of Royal Decree-Law 1.

14 See ECB Opinion CON/2008/48.

authority's attention to the recently adopted Commission's guidance on compliance by the financial sector support schemes with EU State aid rules[15], which includes in the specific context of provision of State guarantees detailed rules on setting the eligibility criteria for the beneficiary institutions[16]. In this context, the ECB recommends clarifying in Royal Decree-Law 2 that it ensures compliance with the requirements of EU State aid and competition law and that regulatory and supervisory measures will be undertaken to ensure that the beneficiary institutions will not be unfairly advantaged by making undue use of their guaranteed status to engage in a heightened level of activities which create market distortions and facilitate abnormal balance sheet growth[17]. In this regard, the ECB underlines the importance of establishing appropriate safeguards such as for example limits to marketing of financial products or limits to expansion of activities on the basis of the State guarantees.

3.2 *Role of the central bank*

The ECB understands that the Fund will be managed by the Ministry for Economic Affairs and Finance, and that the role of Banco de España in relation to the Fund will be limited to: (i) acting as an instrument for the Fund's financial operations of the Fund in its capacity as agent to the Government and deposit bank[18]; and (ii) providing expert advice to the Fund's Executive Committee[19]. The ECB appreciates that the above provisions recognise the Banco de España's expertise relevant to the operation of the Fund. Moreover, the ECB notes that the Banco de España's involvement with the Fund must be compatible with the Treaty. First, the ECB understands from Royal Decree-Law 1 that Banco de España will only play the role of fiscal agent. Therefore, the ECB expects that functions to be performed by Banco de España for the benefit of the Fund will be conducted in a manner fully compatible with Banco de España's institutional and financial independence, as a safeguard for the proper performance of the Banco de España's tasks under the Treaty and the Statute of the European System of Central Banks and of the European Central Bank. Second, the ECB also understands that the Fund's resources will be financed through public debt issuance and that the Fund will finance its own management costs[20]. It is therefore expected that the involvement of Banco de España will not go beyond the agent function and, in particular, that it will fully comply with the prohibition on monetary financing laid down in the Treaty.

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15 See '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 See paragraph 18 of the Commission's guidance, specifying that 'The eligibility criteria of financial institutions … must be objective, taking due account of their role in the relevant banking system and the overall economy, and non-discriminatory so as to avoid undue distortive effects on neighbouring markets and the internal market as a whole. In application of the principle of non discrimination on the grounds of nationality, all institutions incorporated in the Member State concerned, including subsidiaries, and with significant activities in that Member State should be covered by the scheme'.

17 See for instance ECB Opinion CON/2008/48.

18 Article 4(5) of Royal Decree-Law 1.

19 Article 3(6) of Royal Decree-Law 1; seventh paragraph of the preamble to Royal Decree-Law 1.

20 Article 2(3) and (4) of Royal Decree-Law 1.

3.3 *State guarantees and the prohibition on monetary financing*

In addition, the ECB reminds the Spanish authorities that compliance of the State guarantee arrangements with the monetary financing prohibition laid down in the Treaty needs to be ensured. It should be noted in this context that the Fund will qualify as a 'public undertaking' within the meaning of Article 101(1) of the Treaty, since the State will exercise dominant influence over the Fund by controlling its financial resources and governing bodies[21]. As a result, the ECB notes that, to ensure compliance with the monetary financing prohibition, the Fund may not benefit from overdraft facilities or any type of credit facility with the Banco des España in accordance with Regulation (EC) No 3603/93.

3.4 *The scheme's relationship with the single monetary policy of the euro area*

The ECB notes that, in line with the concerted action plan, Member States must act in a coordinated manner to avoid significant differences in national implementation from having a counter-productive effect and creating distortions in global banking markets. The concerted action plan also acknowledges the need to work in cooperation with the ECB to ensure consistency with the Eurosystem's management of liquidity and compatibility with its operational framework. Against this background, the ECB notes that uncoordinated decisions among Member States should be avoided as they may involve a fragmentation of the euro area money market.

First, the ECB notes that, under Royal Decree-Law 1, the Fund will acquire top quality assets from financial institutions, giving priority to assets backed by new credit that could be granted later than 7 October 2008. In this respect, the ECB makes the following observations which are important from the monetary policy perspective. Although such measures should restore confidence in the Spanish banking system, it is important that they are taken in a coordinated manner, that the pricing of assets is determined by market conditions (e.g. through auction procedures) and that the transactions conducted by the Fund do not interfere with the transmission of the monetary policy of the Eurosystem.

Second, the ECB considers that extending the State guarantees to cover interbank deposits should be avoided. It 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 therefore impairing the implementation of the single monetary policy, which is an exclusive Eurosystem competence under Article 105(2) of the Treaty. In this context, the ECB attaches the utmost importance to Article 1(2) of Royal Decree Law 2 that provides that any State guarantee for interbank deposits will only be issued 'within a concerted and coordinated framework of euro area Governments'. It also appears crucial to ensure the harmonisation of the pricing of such guarantee within the euro area and the EU, as a level playing field is of essence. The ECB should be involved in such concertation and coordination, and would welcome an explicit provision for this in any subsequent legislation.

21 See the classifications of 'public undertaking' in Article 8(1) of 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).

3.5 *Recapitalisation of credit institutions*

The ECB notes that Royal Decree-Law 2 provides the Minister for Economic Affairs and Finance with the temporary power until 31 December 2009 to acquire securities issued by credit institutions to reinforce their own resources, including preference shares and participations[22]. The ECB again draws attention to the common principles adopted at the Ecofin meeting on 7 October 2008 and in particular to the need to ensure that shareholders and management bear the due consequences of intervention. Against this background, the ECB would suggest that the Minister consider setting specific terms to maximise the potential benefits for taxpayers along those common principles.

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

Done at Frankfurt am Main, 17 October 2008.

[signed]

The President of the ECB

Jean-Claude TRICHET

22 Article 2 of Royal Decree-Law 2.