EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 25 February 2009

at the request of the Irish Minister for Finance

on a draft National Pensions Reserve Fund (Amendment) and Miscellaneous Provisions Bill 2009

(CON/2009/16)

Introduction and legal basis

On 23 February 2009 the European Central Bank (ECB) received a request from the Irish Minister for Finance (hereinafter the 'Minister') for an opinion on a draft National Pensions Reserve Fund (Amendment) and Miscellaneous Provisions Bill 2009 (hereinafter the 'draft law').

The ECB's competence to deliver an opinion is based on Articles 105(4) and 105(5) 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 law contains provisions relating to the stability of Ireland's financial system and the Central Bank and Financial Services Authority of Ireland (hereinafter the '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 draft law proposes amendments to the National Pensions Reserve Fund Act 2000 (hereinafter the '2000 Act'), and provides that the Minister may give a direction to the Commission of the National Pensions Reserve Fund (hereinafter the 'Fund') to: (i) invest in specified securities of a credit institution whose shares are admitted to trading on a regulated market; and (ii) underwrite or otherwise support the issue of any kind of securities of a credit institution whose shares are admitted to trading on a regulated market, where the Minister is of the opinion, after consulting the Governor of the Central Bank and the Irish Financial Services Regulatory Authority, that this is necessary to remedy a serious disturbance in the economy or to prevent potential serious damage to the financial system in Ireland[2]. The draft law authorises the Minister to direct the Commission in relation to the holding, management, exercise of voting rights attaching to and disposal of such investments. Under the draft law, a 'credit institution' is defined broadly to include an undertaking,

1 OJ L 189, 3.7.1998, p. 42.

2 Section 8 of the draft law.

other than a credit union or friendly society, whose business it is to receive deposits or other repayable funds from the public and to grant credit on its own account[3].

1.2 Under the draft law, the value of a shareholding or other interest held by the Minister that is transferred to the Fund shall be taken to be in satisfaction or part-satisfaction of the Minister's obligation to make payments into the Fund[4]. Commencing in 2001 and continuing until 2055, the 2000 Act requires the Minister to pay into the Fund a sum equivalent to 1 % of Ireland's Gross National Product. Under the 2000 Act, the Fund is established under the ownership of the Minister and the management and control of the Commission for the purpose of meeting as much as possible of the Exchequer's cost of social welfare and public service pensions to be paid from 2025 until 2055 or later[5].

1.3 The draft law also provides for consequential amendments to other provisions of Irish legislation in order to facilitate the making of directed investments in credit institutions by the Commission or an investment vehicle established by the Commission[6].

1.4 The background to the draft law is the Irish Government's announcement on 11 February 2009 of the recapitalisation terms to be offered to two leading Irish credit institutions, Allied Irish Bank and Bank of Ireland. Under the terms of the recapitalisation, the Government would provide EUR 3.5 billion in core Tier 1 capital to each credit institution, in return for which the Minister would receive preference shares with a fixed dividend of 8 % payable in cash or ordinary shares. These preference shares can be repurchased at par up to the fifth anniversary of the issue and at 125 % of the face value thereafter. The Minister can appoint, in total, 25 % of the directors to both credit institutions and would also receive 25 % of total ordinary voting rights in respect of change of control and board appointments. The State would have an option in five years to buy ordinary shares at a predetermined strike price, which according to the Government provides the State with the potential for a significant return. Of the total EUR 7 billion to be invested in the two credit institutions, EUR 4 billion would be funded from the Fund's current resources while EUR 3 billion would be provided by means of a frontloading of the Exchequer contributions to the Fund for 2009 and 2010. According to the Irish Government's announcement, the Government does not intend to take control of these credit institutions.

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3 Section 2 of the draft law, which cross-refers to the definition of 'credit institution' contained in the Central Bank Act 1997, which in turn cross-refers to the definition of credit institution contained in the European Communities (Licensing and Supervision of Credit Institutions) Regulations, S.I. No 395/1992.

4 Section 6 of the draft law.

5 Section 18(1), (2), (6) and (7) of the 2000 Act

6 Sections 5 and 9 of the draft law. These include the disapplication of certain requirements of Irish competition and takeover law in respect of an acquisition or proposed acquisition by the Commission or a Commission investment vehicle of an interest in a credit institution, clarification that the Commission and any Commission investment vehicle are not subject to the Irish regulations implementing the Markets in Financial Instruments (MiFID) Directive and that nothing done by the Minister or the Commission for the purposes of a directed investment in credit institutions constitutes a re-organisation measure for the purposes of the Irish regulations implementing the Directives on the reorganisation and winding-up of credit institutions and insurance undertakings.

2. General observations

2.1 As stated in several ECB opinions on draft national laws relating to emergency measures arising out of the current financial turmoil, including the recent opinions regarding such measures in Ireland[7], it is important for national authorities to coordinate their responses to the current financial situation with their EU partners. Given the similarities of the causes and consequences of the financial crisis across Member States and the potential interdependencies of policy responses, the ECB refers to the conclusions adopted at the Ecofin Council meeting on 7 October 2008, which highlighted common principles to guide the action of Member States as follows: (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) the legitimate interest of competitors must be protected, in particular through the State aid rules; and (viii) negative spill-over effects should be avoided[8].

2.2 On 12 October 2008, the Heads of State of the euro area issued a 'Declaration on a concerted European action plan of the euro area countries' (hereinafter the 'Declaration')[9], in which they confirmed their commitment to act together in a decisive and comprehensive way to restore confidence and the proper functioning of the financial system, with the aim of restoring appropriate and efficient financing conditions for the economy. They agreed on common principles to be followed by governments, central banks and supervisors to avoid national measures adversely affecting the functioning of the single market and the other Member States. Such coordinated approach includes initiatives aimed at providing additional capital resources to financial institutions and recapitalisation of distressed banks. The European Council endorsed these principles for all Member States on 16 October 2008. Against this background, the ECB highlights that all initiatives put in place by national governments to restore confidence in the financial markets should be aimed at implementing such common principles, in the spirit of close cooperation with other Member States and EU institutions.

3. Specific observations

3.1 *Recapitalisation proposals*

3.1.1 In line with the Declaration, Member States must act in a coordinated manner to avoid significant differences in national implementation having a counter-productive effect and creating distortions

7 ECB Opinion CON/2008/69 of 17 November 2008 at the request of the Irish Minister for Finance on a draft Financial Services (Deposit Guarantee Scheme) Bill 2008, 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, and ECB Opinion CON/2008/44 of 3 October 2008 at the request of the Irish Minister for Finance on a draft Credit Institutions (Financial Support) Bill 2008.

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

9 The Declaration is available on the French Presidency's website at www.ue2008.fr.

in global banking markets. The Declaration 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 reiterates that uncoordinated decisions among Member States should be avoided as they may lead to a fragmentation of the euro area money market. In this respect, the ECB makes the following observations, which are important from a monetary policy perspective, as regards the proposed recapitalisation measures.

3.1.2 The ECB notes that the recapitalisation measures considered in Member States are aimed at strengthening the capital position of fundamentally sound financial institutions, in order to improve the functioning and stability of the banking system and to ensure the proper financing of the economy. In particular, a consistent approach should be used in defining the conditions for recapitalisations and the pricing of the instruments intended to provide Tier 1 capital to financial institutions. The ECB underlines the importance of appropriate pricing for recapitalisations to reflect the goals of enhancing the stability of the financial system, facilitating a return to normal market conditions and ensuring the proper financing of the economy. Against this background, the ECB has published recommendations on the pricing of recapitalisations (hereinafter the 'Recommendations')[10]. The ECB highlights that the pricing conditions for capital support should be risk-based and market-oriented, determined by taking into consideration the specific risks related to both the specific instrument chosen for injecting capital and the institution concerned. Specific features of the instruments for capital injections (such as preference shares) should be appropriately chosen so that, while encouraging an early end to the State's capital support of banks, they should not result in an excessive increase in the cost of capital.

3.1.3 In line with the Declaration, the ECB emphasises that harmonisation regarding the expiry of national financial support schemes across the EU and in particular within the euro area is of crucial importance. Furthermore, in line with previous ECB opinions[11], it should be ensured that such measures are in accordance with the requirements of Community competition law, in particular State aid rules, and that the State's role as shareholder is limited in time. In this respect, the announcement by the Irish Government on 11 February 2009 states that the Government's recapitalisation proposals have been designed having regard to the European Commission's Communication entitled 'The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition'[12] and are subject to EU State aid approval. The announcement sets out certain terms for the repurchase of the preference shares at par in the two credit institutions concerned up to the fifth anniversary of the issue and at 125 % of the face value thereafter. While the Government has

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10 See the Recommendations of the Governing Council of the European Central Bank on the pricing of recapitalisations issued on 20 November 2008, available on the ECB's website at www.ecb.europa.eu.

11 See, e.g., paragraph 3.1.3 of ECB Opinion CON/2009/3 of 8 January 2009 at the request of the Slovenian Ministry of Finance on a draft decree laying down criteria and conditions for the implementation of State capital investments and for the conversion of State claims into capital shares under Article 81.a of the Law on public finance and ECB Opinion CON/2009/6 of 26 January 2009 at the request of the Danish Ministry of Economic and Business Affairs on a proposal for a Law on State investments in credit institutions and a proposal for a Law amending the Law on financial stability.

12 OJ C 10, 15.1.2009, p. 2.

made clear that it does not intend to take control of these two credit institutions, the State would have an option to buy ordinary shares in five years at a predetermined strike price that would provide the State with the potential for a significant return. In accordance with the Recommendations, the ECB considers that, while the pricing and other conditions of capital injections should protect the interests of taxpayers by ensuring an equitable return on public investment, terms should be set on the redemption of the instruments so as to retain the temporary nature of the State's involvement and to discourage financial institutions from maintaining such involvement for an extensive period of time.

3.2 *Role of the Central Bank Governor*

The Central Bank's role in relation to the Fund will be limited to providing advice through consultation with the Governor on the directed investments of the Fund. The ECB considers that this advisory role of the Governor is consistent with the Governor's overall powers and functions with respect to the stability of Ireland's financial system under the Central Bank Act 1942.

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

Done at Frankfurt am Main, 25 February 2009.

[signed]

The President of the ECB

Jean-Claude TRICHET