



OPINION OF THE EUROPEAN CENTRAL BANK
of 9 March 2009
at the request of the Polish Minister for Finance
on a draft law on recapitalisation of certain financial institutions
(CON/2009/19)

Introduction and legal basis

On 19 February 2009 the European Central Bank (ECB) received a request from the Polish Minister for Finance for an opinion on a draft law on the recapitalisation of certain financial institutions (hereinafter the 'draft law').

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 provisions¹, as the draft law contains 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

1.1 The draft law provides for public intervention instruments to address potential liquidity or solvency difficulties that may arise in the financial market by way of enabling public authorities to: (i) provide a State guarantee to market-initiated recapitalisation operations (hereinafter a 'State recapitalisation guarantee'); and (ii) initiate compulsory State takeovers of a distressed financial institution (hereinafter a 'compulsory State takeover')². The measures provided for in the draft law may be adopted until 31 December 2010³ in relation to two categories of financial institutions established in Poland: domestic banks⁴ and domestic insurance companies⁵, excluding mutual

¹ OJ L 189, 3.7.1998, p. 42.

² See Article 1 of the draft law. See explanatory memorandum to the draft law, p. 1.

³ See Article 25 of the draft law.

⁴ Article 2(1) of the draft law, referring to Article 4(1)(1) of the Law on banking of 29 August 1997 (consolidated text: *Dziennik Ustaw* (Dz.U.) of 12 June 2002 No 72, Item 665, as amended). The term 'bank' covers credit institutions registered in Poland, excluding Polish credit unions operating pursuant to the Law of 14 December 1995 on cooperative savings and loan associations (Dz. U. of 4 January 1996 No 1, Item 2). The term 'credit institutions' as used in Polish law only relates to European Economic Area (EEA) credit institutions from outside Poland. Non-EEA credit institutions are

insurance associations. They will complement other measures, which will be introduced on the basis of the Law on State Treasury support to financial institutions (hereinafter the ‘Law on State support’).

- 1.2 Specifically, the draft law will enable the Minister for Finance to provide State Treasury guarantees facilitating recapitalisation by market entities of distressed financial institutions in relation to which rehabilitation proceedings have been initiated⁶. Such State recapitalisation guarantees will result in the State Treasury acquiring shares, bonds or other debt instruments issued by the recapitalised financial institution in cases where such instruments are not acquired by market entities (existing shareholders or third persons)⁷. The Minister for Finance will issue State recapitalisation guarantees under the following cumulative conditions: (a) on application by the financial institution and by way of an agreement with the institution concluded after consultation with the Financial Supervision Commission (FSC) and the President of Narodowy Bank Polski (NBP); (b) on approval by the FSC of the relevant rehabilitation plan⁸; and (c) subject to certain statutory limitations as to the scope and amount of the guarantees⁹. The provision of a guarantee will be remunerated by way of commission charged to the recapitalised financial institution, the amount of which will be determined in accordance with the rules specified in the draft law and the implementing provisions to be adopted by the Minister for Finance¹⁰.
- 1.3 According to conditions linked to the provision of State recapitalisation guarantees, the guarantee agreement will also determine, *inter alia*, the power of the Minister for Finance to appoint members of the recapitalised financial institution’s bodies and the Minister’s influence on the financial policy of such institution, as well as limitations on the remuneration that the institution may offer to its management¹¹. Where a State recapitalisation guarantee is exercised, i.e. if the State Treasury acquires financial instruments issued by the recapitalised financial institution, the FSC may, acting on a request of the Minister for Finance, appoint a guardian to oversee the realisation of the rehabilitation plan¹². Furthermore, in the event of a breach of the conditions of a State recapitalisation guarantee, the State Treasury may demand the redemption of its holdings of financial instruments issued by the recapitalised financial institution and/or apply to the FSC to

referred to under Polish law as ‘foreign banks’ (Article 2, Article 4(1) and (3) and Article 4(17) to (20) of the Law on banking of 29 August 1997.

5 Article 2(1) of the draft law, referring to Article 2(1)(5) of the Law of 22 May 2003 on insurance activities (Dz. U. No 124, item 1151, as amended).

6 See Article 1(1) and Articles 3 to 13 of the draft law.

7 In cases where a maximum of 50% of the total amount of issue has been acquired by other investors, the State Treasury will acquire the shares, bonds or debt instruments which were not acquired by other investors. Alternatively, in cases where other investors have acquired more than 50% of the total, the State Treasury will purchase additional bonds or debt securities issued by the financial institutions in the value of the difference between the guaranteed amount and the total value of shares acquired by other investors. See Article 5(1) and (2) of the draft law.

8 See Articles 3(1), 4(1) and 6(1) of the draft law.

9 An issue of bonds or bank debt securities may only be covered by a State recapitalisation guarantee if the issue fulfils the criteria for subordinated debt. The amount of the State recapitalisation guarantee may not exceed the amount of increase of the financial institution’s own funds, as provided for in the rehabilitation plan; see Article 4 of the draft law.

10 See Articles 11 and 12 of the draft law.

11 See Article 6(5) of the draft law.

12 See Article 8 of the draft law.

place the institution under compulsory administration, or carry out a compulsory State takeover of the institution¹³.

- 1.4 Finally, the draft law permits a compulsory takeover of a distressed financial institution by the State Treasury if there is a threat to the solvency of a financial institution and such takeover is justified on the grounds of financial system stability¹⁴. A compulsory State takeover requires the adoption of a decision by the Council of Ministers following consultation with the FSC and the President of the NBP¹⁵. The State Treasury has to dispose of the shares it has acquired as a result of a takeover once financial stability is restored, and in any event no later than within three years of their acquisition with up to two additional extensions of one year each being possible¹⁶.

2. General observations

- 2.1 The ECB notes that the draft law is the second Polish law providing for State intervention in the financial sector to mitigate the current financial turmoil alongside the Law on State support¹⁷, and therefore reminds the consulting authority of the statements expressed in ECB Opinion CON/2008/80¹⁸ on the Law on State support and in its other recent opinions on draft national laws in other Member States relating to emergency measures¹⁹. The ECB also notes that the common principles to guide State actions have been highlighted in the conclusions adopted at the Ecofin meeting on 7 October 2008²⁰. 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'²¹ (hereinafter the 'Declaration'), in which they 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 other Member States. This coordinated approach includes initiatives aimed at ensuring appropriate liquidity, facilitating the funding of banks by various means, providing additional capital resources to financial institutions and recapitalising distressed banks. The European Council endorsed these principles for all Member States on

13 See Article 9(1) of the draft law.

14 See Article 14(1) of the draft law.

15 See Article 14(1) of the draft law.

16 See Article 14(9) of the draft law.

17 This law, as adopted by the Parliament on 12 February 2009 and signed by the President on 25 February 2009, provides for the following measures: a State guarantee for repayment of a refinancing loan extended to a bank by NBP or of a credit facility or loan provided within a line of credit extended by a bank to another bank, loans of Treasury securities to financial institutions and preferential sales of Treasury securities to financial institutions.

18 ECB Opinion CON/2008/80 of 28 November 2008 at the request of the Polish Minister of Finance on a draft law on the provision of State Treasury support to financial institutions.

19 See in particular the ECB opinions listed in footnote 29 below.

20 According to these principles: (a) interventions should be timely and the support should in principle be temporary; (b) the interests of taxpayers should be protected; (c) existing shareholders should bear the due consequences of the intervention; (d) the Government should be in a position to bring about a change of management; (e) management should not retain undue benefits; (f) governments may have, *inter alia*, the power to intervene in remuneration; (g) legitimate interests of competitors must be protected, in particular through the State aid rules; and (h) negative spillover effects should be avoided.

21 Available on the website of the French Presidency at www.ue2008.fr.

16 October 2008²². The ECB notes that coordination of national measures is already taking place at European and international level²³.

- 2.2 Concerning the issue of the application of State aid rules to measures taken by the Member States in connection with financial institutions in the context of the ongoing financial crisis, the ECB also draws the consulting authority's attention to the importance of ensuring that the proposed arrangements comply with the relevant Community law provisions, in particular that they avoid undue distortions of competition, and with the criteria recently laid down by the Commission in its guidance on compliance by financial sector support schemes with EU State aid rules²⁴, as well as the subsequent Commission's guidance specifically targeting recapitalisation measures²⁵.
- 2.3 The ECB notes that under the draft law the Ministry of Finance proposes to consult the President of NBP prior to deciding to support a domestic financial institution. While appreciating the draft law's recognition of NBP's expertise in this field, the ECB also expects that NBP's involvement in the procedure provided for in the draft law should not extend beyond the provision of advice and that it will otherwise comply fully 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) of the Treaty²⁶. In addition, it is also expected that NBP will perform these advisory tasks in connection with State support measures in a manner fully compatible with its institutional and financial independence, thereby safeguarding the proper performance of its tasks under the Treaty and the Statute of the European System of Central Banks and of the European Central Bank²⁷.

22 See also paragraph 2.2 of ECB Opinion CON/2008/81 of 1 December 2008 at the request of the Hungarian Ministry of Finance on a draft law on strengthening the financial intermediary system.

23 See paragraph 2.1 of ECB Opinion CON/2008/80.

24 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, OJ C 270, 25.10.2008, p. 8 (hereinafter the 'Commission's communication on rescue measures'), in particular its Section 4 (Recapitalisation of financial institutions). See also the following: (a) paragraph 3.8 of ECB Opinion CON/2008/68 of 13 November 2008 at the request of the Finnish Ministry of Finance on a draft government proposal for laws amending the Law on the Government Guarantee Fund and the Law on credit institutions; (b) 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 (c) paragraph 3.3 of 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.

25 'Communication from the Commission – The recapitalisation of financial institutions in the current financial crisis: limitations of aid to the minimum necessary and safeguards against undue distortions of competition', OJ C 10, 15.1.2009, p. 2 (hereinafter the 'Commission's communication on recapitalisation measures').

26 OJ L 332, 31.12.1993, p. 1.

27 See paragraph 3.3 of ECB Opinion CON/2008/79 of 27 November 2008 at the request of the Greek Ministry of Economy and Finance on a draft law on enhancing liquidity of the economy to address the impact of the international financial crisis and on a draft decision on its implementation. Also paragraph 3.10 of ECB Opinion CON/2008/81 and paragraphs 3.2.2 and 3.2.3 of paragraph 3.1.3 of ECB Opinion CON/2009/3.

3. Specific observations

3.1 *Eligibility for support and takeover measures*

The ECB understands that subsidiaries of foreign financial institutions are included in the scope of ‘financial institutions’ as defined in Article 2(1) of the draft law and that they are eligible to benefit from the measures provided for by the draft law. This is in line with the Commission’s guidance on compliance by the financial sector support schemes with State aid rules²⁸. The ECB welcomes the above provision, as it avoids distortion of the level playing-field for domestic financial institutions and subsidiaries of foreign institutions.

3.2 *The draft law and coordination of the policy of the Member States*

In line with the Declaration, Member States have to act in a coordinated manner to avoid the risk of significant differences in national implementation creating distortions in global banking markets. The euro area Heads of State also acknowledged the need to work in cooperation with the ECB so as to ensure consistency with the management of liquidity by the Eurosystem and compatibility with the operational framework of the Eurosystem. In this respect, the ECB emphasises that uncoordinated decisions among Member States should be avoided as they may lead to significant differences in the treatment of financial institutions between Member States. This remark also applies to measures relating to state capital investments.

3.3 *Conditions for State capital investments*

The ECB takes the opportunity to reiterate the points made in its previous opinions regarding recapitalisations²⁹, as also subsequently published in a separate document³⁰. In this respect the ECB notes that the recapitalisation measures considered in Member States should be 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

²⁸ See the Commission’s communication on rescue measures, paragraph 18 of which specifies 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’. See also paragraph 3.1 of ECB Opinion CON/2008/79 and paragraph 3.1 of ECB Opinion CON/2008/81.

²⁹ See 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; ECB Opinion CON/2008/54 of 17 October 2008 at the request of the Danish Ministry of Economic and Business Affairs on a proposed Law on financial stability; ECB Opinion CON/2008/55 of 20 October 2008 at the request of the Austrian Ministry of Finance on draft legal measures to ensure the stability of the Austrian financial market; ECB Opinion CON/2008/58 of 23 October 2008 at the request of the Banca d’Italia on behalf of the Italian Ministry for Economic Affairs and Finance on two Decree-Laws containing urgent measures to guarantee the stability of the banking system and the continuity of the provision of credit; ECB Opinion CON/2008/75 of 24 November 2008 at the request of the Finnish Ministry of Finance on a draft law on state capital investment in deposit banks; ECB Opinion CON/2008/79; ECB Opinion CON/2008/81; ECB Opinion CON/2009/3; ECB Opinion CON/2009/6; ECB Opinion CON/2009/11 of 9 February 2009 at the request of the Latvian Ministry of Finance on a draft regulation on fair compensation granted to a bank or its shareholders; and ECB Opinion CON/2009/16 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.

³⁰ See Recommendations of the Governing Council of the European Central Bank on the pricing of recapitalisations of 20 November 2008, as published on 19 December 2008 on the ECB’s website at www.ecb.europa.eu (section ‘Publications’) (hereinafter the ‘Recommendations’).

economy. In particular, a consistent approach should be adopted 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 in terms of 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. The ECB also highlights that the pricing conditions for capital support should be risk-based and market-oriented, determined by taking into consideration the specific risk of 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.

- 3.4 Against this background, the ECB has the following remarks. First, the ECB notes that pursuant to the draft law the State may issue guarantees in order to facilitate recapitalisation by market entities of distressed financial institutions in relation to which rehabilitation proceedings have been initiated. The ECB therefore understands that these guarantees, if activated, would lead to capital injections by the State into distressed financial institutions. In this respect, the ECB underlines that, according to the Recommendations and in line with paragraph 9 of the Declaration, the recapitalisation measures considered by Member States should be aimed at strengthening the capital position of distressed but fundamentally sound financial institutions.
- 3.5 Second, as regards the pricing of State recapitalisation guarantees, the ECB reminds the consulting authority that it is crucial to ensure a level playing-field for the harmonisation of the price determination of such guarantees within the euro area and the EU; moreover, that the price of a State recapitalisation guarantee is risk-based and market-oriented and determined on the basis of the costs of a corresponding guarantee in the market. In this context, the ECB welcomes Articles 11 and 12 of the draft law and the implementing provisions to be adopted by the Minister for Finance, which make the applicable commission dependent, *inter alia*, on the beneficiary's risk rating.
- 3.6 Third, the ECB also reminds the Polish authorities that beneficiary financial institutions may not profit from undue use of their guaranteed status to engage in a heightened level of activities that distort the market. In this regard, the ECB reiterates the importance of establishing appropriate safeguards such as limits on the marketing of financial products or on the expansion of activities on the basis of State guarantees.
- 3.7 Fourth, in line with the Declaration, the ECB also emphasises that harmonisation regarding the expiry of national financial support schemes across the EU is crucial, as application of such schemes is aimed at restoring normal market conditions. In this context, reiterating its position taken in previous opinions³¹, the ECB welcomes the fact that the draft law expressly provides that

³¹ See e.g. paragraph 3.1.3 of ECB Opinion CON/2009/3, paragraph 3.3 of ECB Opinion CON/2009/6 and paragraph 3.1.3 of ECB Opinion CON/2009/16 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.

the State's participation in financial institutions resulting from a compulsory State takeover is temporary and that the State's role as a shareholder is limited both on the basis of a period of time and the development of market conditions³². The ECB also welcomes the introduction of a precise deadline, 31 December 2010, for the issuance of State recapitalisation guarantees and carrying out compulsory State takeovers³³. In this context, the ECB suggests introducing a more precise reference to issuance of State recapitalisation guarantees in Article 25 of the draft law by extending the reference to Article 3(1) in conjunction with Article 4(1).

In contrast, it appears from the draft law that once State recapitalisation guarantees are exercised, the related capital injection by the State into the financial institutions is not intended to be a temporary measure that would only remain in force for the duration of the present crisis or until a given point in time in the future. In this respect, the ECB suggests introducing limitations on State ownership of shares acquired as a result of exercising the recapitalisation guarantee pursuant to Article 5(1) of the draft law, which are similar to those applicable to shares acquired by the State in result of a compulsory State takeover pursuant to Article 14 of the draft law. In this context, the ECB notes that the step-up clause in Article 7(3) of the draft law regarding dividends paid on preferred shares of the State Treasury provides an incentive for the issuer to redeem the shares acquired by the State Treasury as soon as possible³⁴. However, for such a step-up clause to be fully effective, a specific provision in the articles of association of the financial institution in question would be necessary to enable it to redeem such shares at its own discretion if the capital injection provided by the State Treasury is no longer needed³⁵. The ECB notes that in this regard, by establishing such an open-ended scheme, the draft law is not fully in line with the Declaration, which clearly draws attention to the need for any domestic support schemes and for the legal framework that provides for them to be temporary in nature, even if these can be extended or renewed³⁶.

3.8 *Technical remarks*

The ECB points to a possible omission in Article 15(2) of the draft law, which applies some effects of placing the financial institution under compulsory administration only to bodies of a bank. It seems that insurance companies are also intended to be covered by this provision. For reasons of

³² See Article 14(9) of the draft law.

³³ See Article 25 of the draft law.

³⁴ See the Commission's communication on recapitalisation measures, paragraph 19 of which specifies that '...pricing conditions should provide an incentive for the bank to redeem the State as soon as the crisis is over'. See also paragraph 7 of the Recommendations and paragraph 3.2 of ECB Opinion CON/2008/79.

³⁵ One possible way of achieving this effect would be amend the list of required elements in the guarantee agreement specified in Article 6(5) of the draft law to include a clause enabling compulsory redemption of shares held by the State Treasury, as provided for under Article 359 of the Code of Commercial Companies of 15 September 2000 (Dz.U. of 8 November 2000 No 94, item 1037, as amended).

³⁶ See statement in the Declaration that '... 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* (emphasis is ours) and will be applied under close scrutiny of financial authorities ...'. See also Commission's communication on rescue measures, paragraph 24.

clarity the ECB therefore suggests replacing the references to ‘bank’ in Article 15(2) by references to ‘financial institution’.

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

Done at Frankfurt am Main, 9 March 2009.

[signed]

The President of the ECB

Jean-Claude TRICHET