



## OPINION OF THE EUROPEAN CENTRAL BANK

of 21 October 2011

on recovery and resolution measures for credit institutions

(CON/2011/84)

### Introduction and legal basis

On 28 September 2011, the European Central Bank (ECB) received a request from the Irish Minister for Finance for an opinion on the proposed parliamentary committee stage amendments to the Central Bank and Credit Institutions (Resolution) (No 2) Bill 2011 (hereinafter the 'draft law'). On 11 October 2011, the ECB received a letter from the Minister indicating the report stage amendments for the ECB's consideration.

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 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<sup>1</sup>, as the draft law relates to the Central Bank of Ireland (CBI) and 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**

The ECB published Opinion CON/2011/39<sup>2</sup> on the draft Central Bank and Credit Institutions (Resolution) Bill 2011 (the 'No 1 Bill') on 26 April 2011. Following a change in government, the No 1 Bill lapsed and was reintroduced to Parliament in the near identical form of the draft law. This Opinion concerns the amendments.

The draft law was one of the actions implementing the financial assistance programme agreed between the Minister, the European Commission, the ECB and the International Monetary Fund, to restore confidence in the banking sector and achieve financial stability in the Irish economy<sup>3</sup>, alongside the Credit Institutions (Stabilisation) Act 2010 on which the ECB issued Opinion CON/2010/92 on 17 December 2010 (the '2010 Act').

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<sup>1</sup> OJ L 189, 3.7.1998, p. 42.

<sup>2</sup> All ECB opinions are available on the ECB's website at [www.ecb.europa.eu](http://www.ecb.europa.eu).

<sup>3</sup> See the Memorandum of Understanding on specific economic policy conditionality, 3.12.2010, p. 4, available on the Commission's website at [www.ec.europa.eu](http://www.ec.europa.eu).

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The amendments to the No 1 Bill include the following: (i) a new section to provide for cooperation between the CBI and relevant foreign authorities in respect of the CBI's resolution powers under the draft law; (ii) extra provisions to allow the CBI to require authorised credit institutions, and their subsidiary or holding companies, to provide information in connection with transfer orders in respect of their assets and/or liabilities; (iii) a new section to deal with valuations of such assets and liabilities; (iv) new provisions on which creditors of authorised credit institutions or their subsidiary or holding companies may apply for compensation where they are subject to transfer orders and how such compensation is to be calculated; (v) new provisions to extend the scope of the CBI's powers in respect of the liquidation of authorised credit institutions; and (vi) amendments to other legislation, including to the 2010 Act.

### **2. General observations**

- 2.1 The ECB welcomes that the amendments address several specific issues raised by the ECB in Opinion CON/2011/39, whilst the comments in that Opinion remain valid for the issues not addressed.
- 2.2 Prior to the amendments, the draft law would apply to banks, building societies and credit unions licensed in Ireland (hereinafter 'authorised credit institutions'), but only to the extent that such institutions were not 'relevant institutions' under the 2010 Act, which includes Irish licensed banks to which financial support has been given by the Minister. Thus, relevant Irish licensed banks would not have been subject to both the draft law's resolution regime and the 2010 Act's stabilisation regime contemporaneously. This has been amended by the draft law, where the CBI's liquidation powers under the draft law are concerned. Relevant institutions are now to be included within the definition of 'authorised credit institutions'. Therefore, under the draft law, the CBI will be able to exercise its liquidation resolution powers over all authorised credit institutions, including Irish licensed banks credit institutions which are subject of the 2010 Act and which have received financial support from the Minister, which is welcomed by the ECB.
- 2.3 Under the draft law in its current form, credit unions are no longer 'relevant institutions' under the 2010 Act, as Part 5 of Schedule 2 of the draft law will delete the reference to credit unions in the definition of 'relevant institution'. Consequently, the 2010 Act will no longer apply to credit unions except to the extent that any orders or requirements have been made in regard to them under the 2010 Act and therefore, credit unions will be fully subject to the draft law's resolution regime. Furthermore, the ECB understands and welcomes that legislation will shortly be introduced which will provide for a strengthened regulatory framework for credit unions, including effective governance and stabilisation requirements.
- 2.4 Opinion CON/2011/39 welcomed the wider powers under the draft law that will be available to the CBI to manage and resolve financial institutions which are financially distressed and whose demise would threaten the stability of the financial system. The ECB notes, however, that in certain instances, the draft law does not clearly link the exercise of resolution tools to the objectives of the

draft law and would welcome further clarity in this regard. By way of example, section 10(2) of the draft law provides that the purpose of the resolution fund (hereinafter the 'Fund') is to provide a source of funding for the resolution of financial instability or a serious threat thereto in an authorised credit institution. The ECB would welcome the draft law clarifying that the use of resolution tools, such as the establishment of the Fund, should be linked to the objectives of the draft law, for example by making specific reference to the requirement to satisfy the intervention conditions prior to the exercise of any resolution tool provided for in the draft law.

### **3. Adaptation of the Irish resolution framework to future Union legislation on a Union crisis management and bank resolution regime**

The Irish resolution framework may have to be adapted in the light of the forthcoming Commission's legislative proposals on a Union crisis management and bank resolution regime.

### **4. Resolution Fund**

The draft law provides that 'the Minister may contribute to the Fund such sums as he or she considers appropriate from the Central Fund or the growing produce of the Central Fund'<sup>4</sup>. Such contributions would be in addition to, amongst other sources of funding, contributions made by authorised credit institutions to the Fund. The ECB recommends that the draft law should provide that the level of such additional contributions by the Minister should be linked to the purpose of the Fund as set out in section 10(2) of the draft law.

### **5. Bridge banks**

The ECB welcomes that a bridge bank is to be wholly owned by the CBI or its nominees<sup>5</sup>. However, the ECB assumes that the nominees will be another State entity, for example the National Treasury Management Agency, and would welcome clarification in this regard. Moreover, the ECB reiterates<sup>6</sup> that it would welcome an express provision in the draft law that the CBI as a shareholder in a bridge bank will in no event assume or finance any obligation of a bridge bank, and that this role will remain, under any circumstances, consistent with the prohibition on monetary financing under Article 123 of the Treaty. In this respect, the ECB would welcome further clarification in the draft law to address any potential liability that might attach to the CBI or its nominees in regard to its ownership of the bridge bank.

Second, the ECB notes that draft amended section 17 provides that the CBI may set up a bridge bank only if, having regard to any of the matters in section 9(6) of the draft law that appear to be relevant to the CBI in the circumstances, it would be in the public interest to do so. The ECB notes that this need to show that

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<sup>4</sup> Section 12(1) of the draft law.

<sup>5</sup> Section 17(3) of the draft law.

<sup>6</sup> See Opinion ECB/2011/39, paragraph 3.6.

the setting up of the bridge bank in the public interest does not expressly apply to the other resolution tools and therefore appears to set the bridge bank apart from the other tools in this respect. In that case, however, it is unclear whether the decision to set up a bridge bank requires the intervention conditions in section 8 of the draft law to be first fulfilled, as is the case with the other resolution tools (section 21(1)(a) in respect of transfer of assets and liabilities and section 55(a) in respect of special management). These matters should be further clarified in the draft law for the bridge bank to remain effective and of equal rank with the other resolution tools.

## 6. Disclosure of information

The ECB notes the inclusion, in respect of transfer orders, of the new section 23 which providing that notwithstanding any other rule of law, the CBI may disclose information that it obtains to a potential transferee. The ECB would welcome clarification in the draft law to address either (i) how such disclosure is to interact with other disclosure obligations or disclosure prohibitions provisions of national and Union law, for example Directives 2003/6/EC<sup>7</sup>, 2004/109/EC<sup>8</sup>, 2006/48/EC<sup>9</sup> and 2006/49/EC<sup>10</sup>, and the stock exchange rules etc., that might apply to transferors and transferees, or (ii) where such other obligations or prohibitions do apply, that they are to be disregarded when section 23 applies.

## 7. Transfer orders

### 7.1 Valuation and compensation

Paragraph 3.8 of Opinion CON/2011/39 noted that the draft law did not set out any specific approach to valuation of assets to be transferred by virtue of a transfer order. The ECB therefore welcomes the inclusion of extensive new provisions to deal with (i) the calculation of the value of the assets to be transferred 'market value' (section 28), (ii) circumstances where creditors of transferor institutions may apply for compensation (section 35) and (iii) the appointment of an 'assessor' to calculate any such compensation due to such a creditor (section 36).

The ECB also welcomes the elaboration in the draft law dealing with where a transferor may dispute the valuation of transferred assets and/or liabilities determined by the CBI for the purposes of a transfer order (section 48). The ECB notes that, where such a dispute arises, the CBI must appoint an independent valuer to determine whether a competitive process was carried out by the CBI and if not, what the likely market value would have been had such a competitive process been

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<sup>7</sup> Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse) (OJ L 96, 12.4.2003, p. 16).

<sup>8</sup> Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (OJ L 390, 31.12.2004, p. 38).

<sup>9</sup> Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (OJ L 177, 30.6.2006, p. 1).

<sup>10</sup> Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (OJ L 177, 30.6.2006, p. 201).

carried out (section 48(3)). In determining the likely market value in such circumstances, the independent valuer is to assume various particulars set out in section 48(5)(a) to (e). The ECB would recommend the inclusion of a further point (f), whereby the independent valuer should also assume that the competitive process would have been carried out on the basis that the institution concerned had not received any state financial assistance.

## 7.2 *Consideration for the transfer and publication*

The ECB notes that the draft law now includes a specific obligation on the CBI to publish details of the consideration calculated for assets and/or liabilities transferred under a transfer order (section 29 in conjunction with section 31(1)(b)). The ECB also notes that Union law already imposes specific disclosure obligations and prohibitions. While the ECB welcomes the obligation to publish the consideration from a transparency perspective, it would welcome clarification in the draft law as to the interaction and priority between the consideration disclosure to be made pursuant to the draft law and disclosure obligations or prohibitions under Union law and the national regulations transposing it. The ECB also queries whether the draft law should provide some flexibility to the CBI as regards whether to publish all the contents of a transfer order, in particular details of the consideration.

## 8. **Prohibition on monetary financing**

The ECB emphasises that it is important that national provisions comply with the monetary financing prohibition under Article 123 of the Treaty. This provision prohibits central banks from providing overdraft facilities or any other type of credit facility to the public sector, including any financing of the public sector's obligations vis-à-vis third parties<sup>11</sup>.

The draft law<sup>12</sup> provides that the CBI may make payments and charge them to the deposit protection account, to facilitate the transfer of accounts of eligible depositors of an authorised credit institution subject to the CBI's liquidation powers under the draft law and for the purpose of cooperating in the pursuit of Objective 1<sup>13</sup> of a liquidator. The draft law further provides that, where the CBI makes such payments and charges them to the deposit protection account, the amount of the payments, with the approval of the Minister, must be repaid to the CBI out of the Central Fund or the growing produce of that Fund within three months. Furthermore, any amount paid out of the Central Fund to the CBI must be repaid to the Central Fund from the deposit protection account with interest at the rate or rates that the Minister determines, or without interest<sup>14</sup>.

Thus, the ECB understands that the draft law implies that the CBI may temporarily finance the Irish DGS' tasks, until it is reimbursed by the Central Fund, and that the CBI may not be entitled to be

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<sup>11</sup> See Article 1(b)(ii) 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 104(b)(1) of the Treaty (OJ L 332, 31.12.1993, p. 1).

<sup>12</sup> Section 81(1)(b) of the draft law.

<sup>13</sup> See section 80(1) (a) of the draft law.

<sup>14</sup> See section 81(2) of the draft law.

reimbursed if the Minister does not consent<sup>15</sup>. Such advance payments by the CBI in the context of the operation of its liquidation powers under the draft law are incompatible with the monetary financing prohibition and consequently, the draft law needs to be amended. The only compatible forms of central bank financing of deposit guarantee schemes are: (a) intraday credit in line with the general rules on provision of such credit by the central bank; and (b) short-term emergency liquidity financing under strict conditions established in the ECB's Convergence Reports, i.e. if such funding is short term, addresses urgent situations, systemic stability aspects are at stake and decisions are at the NCB's discretion<sup>16</sup>. These conditions need to be listed in the draft law<sup>17</sup> where emergency liquidity financing by the CBI of the Irish DGS is foreseen by the draft law. In this respect, it is noted that central bank support extended to deposit guarantee schemes should not amount to a systematic 'pre-funding' operation.

Consequently, the ECB proposes amending the draft law either to (i) clarify that there will be no such advance financing by the CBI, or (ii) specify in section 81 that the Minister transfers the necessary amounts from the Central Fund to the CBI before the CBI makes any payments related to the performance of the Irish DGS' tasks. Alternatively, it should provide expressly that any advance payments by the CBI are only intraday. If, in addition, short-term emergency liquidity financing of Irish DGS operations by the CBI is foreseen, conditions for such financing referred to above should be expressly listed in the draft law. In such case, when exercising its discretion to grant a loan, the CBI has to ensure that by doing so it is *de facto* not taking over a State task. Moreover, to rule out any breach of the monetary financing prohibition, it may be useful to specify in the draft law that the credit facilities extended by the CBI to the Irish DGS are based on adequate collateral and are granted without prejudice to Article 123 of the Treaty<sup>18</sup>.

## 9. Central bank independence

In relation to the same provisions of the draft law as mentioned in the previous paragraph, the ECB refers to the principle of financial independence under which a national central bank (NCB) must have sufficient means not only to perform its tasks related to the European System of Central Banks (ESCB), but also its national tasks, e.g. financing its administration and own operations<sup>19</sup>. Financial independence also implies that an NCB should always be sufficiently capitalised<sup>20</sup>. Previous ECB opinions pointed out that the allocation to the NCBs of specific non-ESCB related tasks, such as tasks in the area of financial supervision or consumer protection, needs to be accompanied by the allocation of adequate human and financial resources allowing such tasks to be carried out in a manner which will not affect the NCBs' operational capacity to carry out their ESCB-related tasks<sup>21</sup>. In particular, the ECB has advocated a

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15 See section 8(1) of the Financial Services (Deposit Guarantee Scheme) Act 2009.

16 See the ECB's Convergence Report, May 2010, p. 25.

17 See paragraphs 2.2 to 2.8 of ECB Opinion CON/2008/5 and paragraph 3.1.3 of ECB Opinion CON/2011/76.

18 See paragraph 13 of the ECB Opinion CON/2001/32 and paragraph 2.7 of the ECB Opinion CON/2008/5.

19 See the ECB's Convergence Report, May 2010, p. 21.

20 See the ECB's Convergence Report, May 2010, p. 21.

21 See for instance paragraph 3 of ECB Opinion CON/2007/8 and paragraph 3.3 of ECB Opinion CON/2011/76.

prudent approach in this respect when reimbursement arrangements are proposed in national legislation to finance the non-ESCB related tasks<sup>23</sup>. In addition to the monetary financing prohibition observations made in paragraph 8, the respective provision of the draft law, in conjunction with the provision of the Financial Services (Deposit Guarantee Scheme) Act 2009 that the CBI may not be entitled to be reimbursed if the Minister does not consent, raises concerns in respect of the CBI's financial and institutional independence to the extent that in practice the CBI will not be able to autonomously avail itself of sufficient financial resources to fulfil its mandate<sup>22</sup>.

Opinion CON/2011/39 noted that the draft law allowed the Minister in certain circumstances to make orders mitigating any unfairness or undue hardship caused by the operation of an effective 'switch-off' of certain rights, such as netting and set-off, of counterparties dealing with authorised credit institutions under relevant agreements. The ECB recommended amending the relevant section to require the Minister to consult with the CBI prior to making any such order and the ECB welcomes that the draft law has now been amended<sup>23</sup>.

#### **10. 2010 Act amendments**

The draft law will make substantial amendments to the 2010 Act. The ECB understands that such amendments are mainly designed to mirror the amendments made to the No 1 Bill to ensure coherent, robust and effective resolution and stabilisation mechanisms and to reflect the authorities' experience from litigation of a number of resolution orders under the 2010 Act. The ECB notes for example the mirror insertions relating to, for example, (i) applications to set aside transfer orders under the 2010 Act (14 day window now instead of 5 day window under both the stabilisation and resolution regimes), (ii) the publication and effectiveness of transfer orders. In addition, the ECB welcomes the clarification that stabilisation orders made under the 2010 Act are intended to fall within Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions<sup>24</sup>.

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

Done at Frankfurt am Main, 21 October 2011.

[signed]

*The President of the ECB*

Jean-Claude TRICHET

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<sup>22</sup> See the ECB's Convergence Report, May 2010, p. 21.

<sup>23</sup> Section 101(1) of the draft law. Opinion CON/2011/39 also refers to the need for a 'relationship framework' between the Minister and the Governor. See also Opinions CON/2010/92 and CON/2009/93 concerning the 'relationship framework'.

<sup>24</sup> OJ L 125, 5.5.2001, p. 15. See for example the insertion of a new sub-section 2A in section 29 of the 2010 Act dealing with subordinated liabilities orders.