EUROPEAN CENTRAL BANK

EUROSYSTEM

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OPINION OF THE EUROPEAN CENTRAL BANK

of 9 October 2017

on judicial relief granted to holders of qualified bank credit

(CON/2017/41)

Introduction and legal basis

On 11 September 2017 the Slovenian Ministry of Finance reconsulted the ECB on a draft Act on judicial relief granted to holders of qualified bank credit (hereinafter the 'draft law'). The ECB already delivered an opinion on an earlier version of the draft law[1].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 (hereinafter 'TFEU') and the third indent of Article 2(1) of Council Decision 98/415/EC[2] as the draft law relates to a national central bank (NCB). 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')[3] governing Banka Slovenije's liability for damages with respect to extraordinary measures imposed by Banka Slovenije. These provisions 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 In its second consultation request the Slovenian Ministry of Finance has informed the ECB that due to a significant divergence of views among the key stakeholders, the draft law has been subject to further consultation and changes, and the Ministry has therefore requested an additional ECB opinion. The Ministry has also stated that Opinion CON/2017/16 has already been taken into account to the greatest extent possible in the new version of the draft law.

1.3 The main purpose of the draft law remains unchanged, namely to remedy the unconstitutionality declared by the Slovenian Constitutional Court. The key changes to the new version of the draft law, as compared with the version of the draft law on which the ECB was previously consulted, are summarised below.

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1 See Opinion CON/2017/16. All ECB opinions are published on the ECB's website at www.ecb.europa.eu.

2 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).

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

1.4 Compared with the previous version[4], the draft law now provides that the action for the recovery of damages may only be filed only against Banka Slovenije, since the Republic of Slovenia only acts as a third-party intervener in the procedure. Thus, the compensation will always be paid to the eligible plaintiffs by Banka Slovenije. Even though the draft law states that Banka Slovenije is liable for damages, it also provides that the Republic of Slovenia will, based on a special agreement to be concluded between Banka Slovenije and the Republic of Slovenia, temporarily advance to Banka Slovenije the funds for the full amount needed to pay the compensation to plaintiffs declared to be eligible for compensation based on a final court decision. These amounts (together with the interest on late payment accrued) must be reimbursed by Banka Slovenije to the Republic of Slovenia within six months of the compensation being paid unless Banka Slovenije files an action against the Republic of Slovenia within the same six-month period and proves in a separate court procedure that Banka Slovenije is not liable for the damages resulting from the imposition of the extraordinary measures. In this respect, Banka Slovenije must prove that Banka Slovenije and any persons acting on its behalf had acted with the due diligence of an expert when adopting the extraordinary measures and had reasonable grounds to believe that the conditions for activating the extraordinary measures laid down in the relevant provisions of ZBan-1 were fulfilled. In such situations Banka Slovenije does not need to provide any of its own financial resources to pay the compensation, provided that it proves that its actions, which resulted in the write-down of subordinated liabilities, were not unlawful. The burden of proof was already on Banka Slovenije in the previous version of the draft law, which stated that Banka Slovenije had to prove its due diligence in relation to specific actions. However, it is now envisaged that the question of the lawfulness of Banka Slovenije's actions willnot be determined in proceedings initiated under the draft law by the affected parties but in a separate procedure between Banka Slovenije and the Republic of Slovenia.

1.5 The draft law retains the provisions in the previous version pursuant to which Banka Slovenije must publish on its website: (1) the decision on the imposition of an extraordinary measure, (2) the estimation of the value of the assets prepared in accordance with the relevant provisions of the ZBan-1 and (3) documents reflecting the contractual relationship between Banka Slovenije and the person who submitted the valuation of the assets. All personal and confidential information must be redacted before such publication. Following the publication of this information, the applicants may also file a motion to the court to oblige Banka Slovenije (and certain other entities) to submit

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4 In the previous version of the draft law it was envisaged that any compensation for damages resulting from the extraordinary measures would be paid either by Banka Slovenije or the Republic of Slovenia. If no liability could be attributed to Banka Slovenije, then compensation would be paid by the Republic of Slovenia. In particular, Banka Slovenije would be partly or wholly free from liability if it could prove that it had acted with due diligence 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 conditions for the use of extraordinary measures were fulfilled. If Banka Slovenije was only partly free from liability, then Banka Slovenije would have been nonetheless obliged to pay damages to former holders of qualified liabilities, whereas financial resources for the compensation exceeding the liability of Banka Slovenije would have been provided by the Republic of Slovenia within three months of the publication of the court decision in the Official Journal. The ECB stated in its opinion that a requirement that Banka Slovenije must pay compensation for damages, to the extent that it results in Banka Slovenije assuming the liability of the State, would not be in line with the monetary financing prohibition laid down in Article 123 of the Treaty. See paragraph 2.1 of Opinion CON/2017/16.

evidence to the court without redacting personal or confidential information. The procedure for the submission and disclosure of evidence to the court has been redefined. Compared with the previous version of the draft law, Banka Slovenije is no longer obliged to publish on its website and disclose to the applicants the reports on the asset quality review (hereinafter the 'AQR reports'). However, the draft law still provides that a redacted valuation of the assets of the affected banks is to be published, and plaintiffs fulfilling certain preconditions may request the court to order full disclosure of these documents.

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 assessment of the conditions necessary for imposing extraordinary measures, as laid down in Article 253.a of the ZBan-1 and whether the valuation of the respective bank's assets as laid down in Article 261.b of the ZBan-1, were correctly carried out or not. In this respect, the previous version of the draft law referred to the standards of banking supervision adopted by the ECB, the European Commission and the European Banking Authority (EBA) that are to be taken into account by the court when determining whether the conditions for imposing extraordinary measures were fulfilled. The draft law omits the reference to the standards of banking supervision adopted by the ECB, the European Commission and the EBA in cases where the court determines that the valuation of the assets of the bank referred to in Article 261.b of the ZBan-1 was incorrect. However, pursuant to the draft law the court will need to verify whether the methods and the basic premises underlying the methods used in assessing the conditions necessary for imposing extraordinary measures, as laid down in Article 253.a of the ZBan-1, contravened the ZBan-1 and the standards of banking supervision adopted by the ECB, the European Commission and the EBA.

1.7 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 five members selected through a public tender procedure, which will deliver an opinion to the court. The selection procedure and the criteria for selecting members of the special committee of experts arefurther elaborated in the draft law. Compared with the previous version, it no longer provides that the European Commission, the ECB and the EBA will be informed of the public tender procedure by the court.

1.8 An exemption from the mandatory application of the draft law, whichwas not present in the previous version, is introduced in situations where a criminal offence has been declared to have been committed in relation to Banka Slovenije's decision on an extraordinary measure by a final criminal court judgement. In such cases, the general rules for the recovery of damages and the general procedure will apply instead of the special provisions of the draft law.

1.9 The draft law still provides the same standardised formula for calculating compensation, but the procedure for payment has been amended. Following the finality of the court decision establishing that the plaintiffs are eligible for compensation, the affected stakeholders file a separate application to Banka Slovenije requesting the calculation and payment of the compensation from Banka Slovenije. Compared with the previous version, the request for payment is decided via an administrative procedure involving two entities, whereby the plaintiff may challenge Banka

Slovenije's decision if the plaintiff does not agree with the calculation. The Ministry of Finance willl decide on any appeal against Banka Slovenije's decision on the calculation of compensation, which may be further challenged via the judicial review process for administrative acts.

2. Observations

2.1 As noted in the ECB's opinion on the previous version of the draft law, 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[5] 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, would not be in line with the monetary financing prohibition laid down in Article 123 of the Treaty[6]. It is understood that Banka Slovenije would only be liable for the damages which the court establishes as being caused by and directly attributable to Banka Slovenije not acting with the required due diligence[7]. It is assumed that when making this assessment on Banka Slovenije's liability in accordance with Article 27.1 of the draft law all relevant elements for determining the scope of its liability will be taken into account.

2.2 The arrangement envisaged by the draft law, whereby Banka Slovenije would need to initiate a court procedure in order to establish the liability of the Republic of Slovenia, in order to prove that Banka Slovenije had acted with the required due diligence, needs to include sufficient and effective safeguards concerning the standard against which Banka Slovenije's due diligence is to be ascertained. The effective reversal of the burden of proof, to assume wrongdoing on the part of Banka Slovenije unless proven otherwise, combined with the absence of such safeguards, could render the envisaged arrangement inconsistent with the monetary financing prohibition in so far as it might result in Banka Slovenije assuming the liability of the Republic of Slovenia for damages that were not directly attributable to Banka Slovenije.

2.3 Regarding the question of whether Banka Slovenije and any persons acting on its behalf acted with the due diligence of an expert when adopting the extraordinary measures, the ECB recalls that, earlier this year, the ECB was consulted, and issued an opinion, on a draft law amending the Bank of Slovenia Act and establishing rules for the auditing of Banka Slovenije's operations by the national Court of Audit (hereinafter the 'draft audit law')[8]. The draft audit law established a legal basis for auditing any actions taken by Banka Slovenije over the past ten years. As noted in Opinion 2017/24, the draft audit law can be regarded as having a retroactive character. As

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5 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).

6 See paragraph 2.1 of Opinion CON/2017/16.

7 This is without prejudice to the involvement of the CJEU in relation to the interpretation of Union law (including Article 123 of TFEU) with regard to the issues raised by the court proceedings to be initiated by Banka Slovenije on the basis of the draft law.

8 See Opinion CON/2017/16.

previously noted by the ECB[9], introducing measures with a retroactive effect could undermine legal certainty and may not be in line with the principle of legitimate expectations. The prohibition regarding the retroactive effect of legal acts, which is derived from the principle of legal certainty, is also protected by principles of Union law. However, the principle of legal certainty is not absolute and could incorporate limited and well defined exemptions where the purpose to be achieved requires them, as long as the legitimate expectations of those concerned are duly respected. In this respect, the ECB continues to question whether a provision that allows the auditing of Banka Slovenije's actions over the past ten years – or potentially even longer - is compatible with the principle of legal certainty.

2.4 The proposed reimbursement structure also raises concerns from the perspective of the principle of financial and personal independence as enshrined in the Treaties and Article 2 of the Law on Banka Slovenije, as Banka Slovenije is de facto obliged to file a claim against the Republic of Slovenia in order to prove that the necessary due diligence was exercised when issuing the extraordinary measures.

2.5 Even though this is not explicitly stated in the draft law, the ECB understands the provisions in the first paragraph of Article 27 to mean that no interest is payable by Banka Slovenije to the Republic of Slovenia unless Banka Slovenije fails to reimburse the Republic of Slovenia for the amount advanced to it within the six month deadline, in which case Banka Slovenije must,in addition to the amount advanced, also be liable to pay the Republic of Slovenia late payment interest starting from the expiration of the six month deadline.

2.6 As previously noted in Opinion CON/2017/16, national legislation should fully respect the provisions of Directive 2013/36/EU of the European Parliament and of the 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 relating to individual supervised 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. Public disclosure of asset valuations would thus inevitably contravene the principle set out in Article 53 of Directive 2013/36/EU, 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[11].

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9 See paragraph 3.2.2 of Opinion CON/2015/32, paragraph 3.1.2 of Opinion CON/2016/39, paragraph 3.2 of Opinion CON/2016/50 and paragraph 2.4 of Opinion CON/2017/24.

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 See paragraph 2.3 of Opinion CON/2017/16.

2.7 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 Articles 53 and 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 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[12].

2.8 Regarding the draft law's requirement to verify whether the methods and the basic premises underlying the methods used in the assessment of the conditions necessary for imposing extraordinary measures, as laid down in Article 253.a of the ZBan-1, were consistent with the standards of banking supervision adopted by the ECB, the European Commission and the EBA, the ECB reiterates its previous recommendation 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[13].

2.9 Finally, the ECB notes that, pursuant to Article 33 of Council Regulation (EU) No 1024/2013[14], from 3 November 2013 onwards, in view of the imminent assumption of its prudential supervisory tasks under Regulation (EU) No 1024/2103, the ECB was authorised to require the national competent authorities, including Banka Slovenije, together with credit institutions, financial holding companies, mixed financial holding companies and mixed-activity holding companies of euro area Member States, as well as persons belonging to these entities and third parties to whom these entities had outsourced functions or activities, to provide all relevant information for the ECB to carry out a comprehensive assessment, including a balance-sheet assessment, of credit institutions in euro area Member States. The comprehensive assessment conducted by the ECB in this context comprised two components, including an asset quality review (AQR), which was a point-in-time assessment of the accuracy of the carrying value of banks' assets as at 31 December 2013. The AQR was undertaken by the ECB and the national competent authorities, including Banka Slovenije, and was based on a uniform methodology and harmonised definitions. The comprehensive assessment was based on Regulation (EU) No 575/2013 of the European Parliament and of the Council[15] and Directive 2013/36/EU[16]. The ECB notes that the judicial review of the comprehensive assessment, including the underlying uniform methodology, conducted by the ECB in this respect falls outside the competence of the national courts, and falls exclusively

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12 See paragraph 2.4 of Opinion CON/2017/16.

13 See paragraph 2.5 of Opinion CON/2017/16.

14 Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

15 Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

16 See pages 2-4 of the European Central Bank, Aggregate Report on the Comprehensive Assessment: Summary (October 2014), available on the ECB's website at www.ecb.europa.eu.

within the competence of the Court of Justice of the European Union. It would be useful, to avoid any possible doubt on this issue, to introduce a provision into the draft law to clarify this particular point, so that any possible discrepancies between the draft law and Union law in this respect can be avoided.

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

Done at Frankfurt am Main, 9 October 2017.

[signed]

The President of the ECB

Mario DRAGHI