



EUROPEAN CENTRAL BANK

EUROSYSTEM

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ECB-PUBLIC

OPINION OF THE EUROPEAN CENTRAL BANK

of 11 June 2021

on the role of the Central Bank of Cyprus as regards the issuance of government guarantees to credit institutions (CON/2021/21)

Introduction and legal basis

On 11 May 2021 the European Central Bank (ECB) received a request from the Ministry of Finance of the Republic of Cyprus for an opinion on (a) the Law on the issuance of government guarantees towards credit institutions for the granting of loans to businesses and self-employed persons¹ (hereinafter the 'Law') and (b) a draft Decree on the issuance of government guarantees towards credit institutions for the granting of loans to businesses and self-employed persons² (hereinafter the 'draft decree').

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 (TFEU), as the Law contains provisions which concern the Central Bank of Cyprus (CBC) and the tasks conferred on the ECB pursuant to Article 127(6) of the Treaty concerning policies relating to the prudential supervision of credit institutions. 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 Law and the draft decree

1.1 The Law empowers the Minister for Finance, following the approval of the Directorate-General for Competition of the European Commission and subject to any requirements imposed by the European Commission, to grant government guarantees up to a total of one billion euro to credit institutions for the purpose of granting new low-interest loans to businesses and/or self-employed persons³. These guarantees are granted for the purpose of increasing the liquidity in the economy and must not be used to facilitate the repayment or restructuring of any outstanding performing or non-performing facilities. Credit institutions must pass the benefit of the guarantees on to the businesses and/or self-employed persons receiving the new loans. The potential borrowers need to prove that they were not facing financial difficulties on 31 December 2019, but that they face financial difficulties due to the impact of the COVID-19 pandemic after that date. The explanatory note that accompanies the

¹ Ο περί της Έκδοσης Κυβερνητικών Εγγυήσεων προς Πιστωτικά Ιδρύματα για την Παραχώρηση Δανείων σε Επιχειρήσεις και Αυτοτελώς Εργαζομένους Νόμος του 2021 (Ν. 110(I)/2021).

² Το περί της Έκδοσης Κυβερνητικών Εγγυήσεων Προς Πιστωτικά Ιδρύματα για τη Παραχώρηση Δανείων σε Επιχειρήσεις και Αυτοτελώς Εργαζομένους Διάταγμα του 2021.

³ The total amount of government guarantees provided for is made up of: EUR 300,000,000 for loans to self-employed persons and micro businesses; EUR 550,000,000 for loans to small and medium-sized businesses; and EUR 150,000,000 for loans to large businesses.

consultation request of the Ministry of Finance explains that the aim of the Law is to address the effects of the measures taken to contain the COVID-19 pandemic.

- 1.2 The Law stipulates that the government guarantees must be granted by 31 December 2021, for a minimum period of three months and a maximum period of six years. In addition, the government guarantees must cover any losses that may be incurred as a result of loans granted, up to a maximum of 70% of losses incurred by the Government, with the relevant credit institution retaining a minimum of 30% of losses. The potential borrowers are required to provide security for the loans by mortgaging any unmortgaged immovable property or other assets, unless no such property or assets are available, in which case the loan granted is unsecured. The loans may be granted to potential borrowers in order to cover liquidity needs, working capital and investments in Cyprus. If a credit institution refuses a loan application, the applicant has the right to file a complaint with the Monitoring Committee mentioned in paragraph 1.4 below.
- 1.3 Further, the Law envisages that credit institutions will be invited to apply for government guarantees during a period of thirty days from the date on which the draft decree is adopted by the Minister for Finance. A contract will then be entered into between the Government and each of the interested credit institutions that apply, on the expiry of which the respective government guarantee will lapse. Government guarantees are to be allocated to individual credit institutions according to their share of total domestic deposits and their share of total performing domestic loans, excluding amounts relating to companies registered or established but not physically present in Cyprus and excluding interbank deposits and loans. The provision of government guarantees is to be subject to payment of pro rata fees by the credit institutions. The maximum amount of guarantees that may be provided to any one credit institution is 25% of its Tier 1 and Tier 2 capital on 31 December 2020.
- 1.4 Without prejudice to the powers of the CBC, the Law establishes a Monitoring Committee to monitor the implementation of the provisions of the Law and the decrees adopted under it, and to coordinate their proper and effective implementation. The Committee is to be comprised of: the Accountant General or the Deputy Accountant General, acting as chair; one officer of the Ministry of Finance appointed by the Minister for Finance; two officers of the CBC appointed by the Minister for Finance on the recommendation of the Governor of the CBC; and the Auditor General, or his or her representative, as observer. The Monitoring Committee must prepare a report every two months for the attention of the Minister on all matters that fall within its remit, which it must submit every two months to the Parliamentary Committee on Financial and Budgetary Affairs. The Minister shall also provide the same Parliamentary Committee with a quarterly update in connection with the said report.
- 1.5 The Law empowers the Minister for Finance to issue decrees for the purposes of ensuring a better implementation of the Law, and in particular to determine matters such as the procedure for and terms on which the guarantees are granted, the amount of the fee paid by the credit institutions, the applicable interest rate, and a recommendation to credit institutions to suspend payment of instalments, other than the amount relating to interest, for a period of 12 months from the date of commencement of the loan agreement.
- 1.6 In the event of an infringement by a credit institution or borrower of any provision of the Law and/or the decrees adopted under it, or of any terms and conditions of the guarantees, the Minister for Finance may impose an administrative penalty ranging from EUR 1,000 to EUR 500,000 depending

on the severity of the infringement, and a further penalty ranging from EUR 100 to EUR 50,000 for each day the infringement continues taking into account the severity of the infringement. Before proceeding with the imposition of a penalty, the Minister must consult with the CBC in order to ensure that the penalty does not create any financial stability risks. Before imposing the fine, the Minister must also notify the credit institution or loan beneficiary concerned, explain why action is to be taken against it, and allow the right to submit observations within fifteen days from the date of the notice.

- 1.7 The draft decree sets out the details which relate to the granting of the government guarantees, including, but not limited to, the amount and interest rate of the new loans, the definition of the losses that can be covered under the scheme, the criteria for the distribution of the guarantees to credit institutions and the control mechanisms for the use of the guarantees by credit institutions.

2. Observations

- 2.1 The ECB notes that the Monitoring Committee established under the Law has been entrusted with the responsibility of (a) monitoring the implementation of the provisions of the Law and the decrees adopted under it and (b) coordinating their proper and effective implementation. The Committee must also report to the Minister for Finance on all aspects that fall within its remit and its report must be submitted to the Parliamentary Committee on Financial and Budgetary Affairs.
- 2.2 The ECB understands that the Monitoring Committee's role is, as its name implies, confined to an observational or monitoring role, with a duty to report on its observations to the relevant Cypriot authorities. This is evidenced by the fact that the Law does not confer on the Monitoring Committee any decision-making or discretionary powers in relation to the application of the provisions of the Law. Rather, the Law merely confers on the Monitoring Committee a function of reporting as to whether the legal framework is being properly and effectively implemented. In addition, the fact that the Law does not set out any rules of procedure governing the members of the Monitoring Committee or the Committee's operation is another indication that the Committee has no legal powers with regard to taking any decisions on matters relating to credit institutions which fall within the remit of the Law and the decrees adopted under it.
- 2.3 Moreover, with regard to the task of the Monitoring Committee to monitor the implementation of the provisions of the Law and the decrees adopted under it, and given the fact that the Law does not confer any decision-making or discretionary powers on the Monitoring Committee, the ECB understands that the monitoring will be done for the sole purpose of informing the Minister for Finance and the relevant Parliamentary Committee. It is worth noting that the Law does not specify how such monitoring will take place in practice. In particular, the Law does not entrust the Monitoring Committee with any investigative and/or supervisory powers to ensure the compliance of credit institutions with the Law, such as the power to request information from credit institutions⁴ or inspect their books and documents. In the absence of such powers, it is not possible to understand from the Law how the Monitoring Committee might discharge its responsibilities of monitoring the implementation of the provisions of the Law and the decrees adopted under it, and of coordinating

⁴ It is noted that Article 12 of the draft decree stipulates that credit institutions must submit on a half-yearly basis or as and when requested by the Treasury, an electronic file containing a breakdown of the loans granted.

their proper implementation. At any rate, the ECB underlines that any investigative or other type of power and any task that may be conferred on the Monitoring Committee by the legislator would need to be exercised for the sole purpose of fulfilling the tasks of that Committee under the Law and should be without prejudice to the tasks and powers conferred by Union law on the CBC and the ECB as regards the prudential supervision of credit institutions. It is further understood that the Monitoring Committee's responsibility for coordinating the effective implementation of the Law and the decrees adopted under it, is intended to ensure that the underlying objective of granting new low-interest loans to businesses and self-employed persons for the purpose of increasing the liquidity in the Cypriot economy is achieved.

- 2.4 The Law is silent in relation to the function of the Monitoring Committee of receiving complaints by unsuccessful loan applicants, and does not prescribe the procedure to be followed in the event that such a complaint is submitted, or what the role of the Committee is. In the absence of any specific provisions, the ECB understands that the Monitoring Committee will simply report to the Minister for Finance and to the relevant Parliamentary Committee on the receipt of such complaints, without having the power to take any action towards resolving or adjudicating on any disputes arising out of such complaints.
- 2.5 Considering the tasks conferred on the Monitoring Committee, the ECB understands that the role envisaged for the Monitoring Committee by the Law is essentially that of fiscal oversight. This understanding is also supported by the presence of the Accountant and Auditor Generals, as chair and observer, respectively, in the Monitoring Committee. In view of the mandate of the Monitoring Committee to assist the Government in the application of a State guarantee scheme, a qualified independent entity would be well positioned to monitor compliance with the Law⁵. In the absence of any fiscal oversight mandate or role for the CBC, it is noted that the officials of the CBC are not well positioned for the purposes of fulfilling this mandate.
- 2.6 By the same token, given the CBC's role as a national competent authority for the prudential supervision of credit institutions within the Single Supervisory Mechanism (SSM), the participation of CBC officials in the Monitoring Committee, and especially in potential reporting by the Monitoring Committee, may give rise to legal uncertainty as regards the capacity in which they participate in that Committee and the tasks that they perform in this capacity, which could potentially lead to conflicts of interest. This is particularly relevant in relation to the function of the Monitoring Committee of receiving complaints by unsuccessful applicants against decisions of credit institutions which are themselves supervised by the CBC and the ECB within the SSM. Even though the Monitoring Committee does not enjoy any formal powers in this respect, it should be ensured that, in practice, there is no interference with credit institutions' credit risk management processes and that conflicts of interest with respect to prudential supervisory concerns regarding the need for effective credit risk management are avoided.
- 2.7 In this regard, the national legislator is invited to reconsider the CBC's representation in the Monitoring Committee at the next available occasion, and thus ensure that the legal framework will be monitored by an independent body that is not involved in the prudential supervision of credit

⁵ See paragraph 3.1 of Opinion CON/2019/42 and paragraph 3.2.4 of Opinion CON/2016/17.

institutions⁶. The national legislator could also consider a better delineation of the tasks and powers of the Monitoring Committee in order to ensure legal clarity and certainty in the application of the Law.

- 2.8 In any case, given that the Law does not confer any tasks on the CBC, and given that the Monitoring Committee does not enjoy any decision-making or discretionary powers under the Law, the ECB understands that neither the CBC nor its representatives on the Monitoring Committee can incur any liability in respect of that Committee's activities.
- 2.9 Finally, the Law envisages a consulting role for the CBC in relation to the financial stability implications of the imposition by the Minister for Finance of administrative penalties on credit institutions and borrowers. Given that the Law does not confer any new tasks on the CBC, but rather envisages for it this consulting role and leaves decisions on the imposition of penalties with the Minister, it is understood that the CBC cannot incur any liability in this respect.
- 2.10 The ECB expects to be re-consulted if it is envisaged that: (a) the role of the CBC is to be substantially expanded beyond that provided for by the Law and the decrees adopted under it and the CBC is to extend its participation in the Monitoring Committee beyond the provision of advice in the context of the Committee's monitoring mandate; and (b) powers are to be conferred on the Monitoring Committee that may have an impact on the prudential supervision of credit institutions.

This opinion will be published on EUR-Lex.

Done at Frankfurt am Main, 11 June 2021.

[signed]

The President of the ECB

Christine LAGARDE

⁶ See paragraph 2 of Opinion CON/2013/86.