OPINION OF THE EUROPEAN CENTRAL BANK
of 4 April 2023
on the imposition of a temporary solidarity contribution
(CON/2023/9)

Introduction and legal basis
On 13 March 2023 the European Central Bank (ECB) received a request from the Lithuanian Ministry of Finance for an opinion on a draft law on the imposition of a temporary solidarity contribution (hereinafter the ‘draft law’).

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\(^1\), as the draft law concerns Lietuvos bankas and 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 imposes an obligation on credit institutions\(^2\) that, on 31 December 2022, held at least EUR 400 million in deposits from clients who are residents of Lithuania to pay a temporary solidarity contribution. As noted in the explanatory memorandum accompanying the draft law, this threshold is set considering that EUR 400 million of deposits represents 1 % of the deposit market of Lithuanian residents and covers credit institutions with a more significant share of residents’ deposit portfolios. At the same time the threshold imposes an obligation to contribute on those deposit takers that have a surplus of liquid funds held with Lietuvos bankas.

1.2 The explanatory memorandum states that the rationale for the draft law is based, inter alia, on the following elements: (1) the exceptionally high levels of liquid funds in credit institutions in euro area member countries as a result of monetary and fiscal measures in recent years; (2) the strong increase in credit institutions’ interest income on loans and a large excess of liquid funds, following the increase of key interest rates by the ECB; (3) an exceptionally high liquidity, which only creates a limited incentive for credit institutions to raise deposit interest rates; and (4) the Lithuanian governmental support to companies and residents that reduced the negative impact of the pandemic,

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\(^2\) Comprising banks established in Lithuania, foreign banks established in Lithuania and branches of Member State banks in Lithuania, central credit unions and credit unions operating in accordance with the Laws of the Republic of Lithuania on Central Credit Union and Credit Unions (Lietuvos Respublikos centrinių kredito unijų įstatymas, Lietuvos Respublikos kredito unijų įstatymas).
the energy crisis and the military invasion of Ukraine on the credit risk exposure of companies and households.

1.3 The explanatory memorandum further points out that inflation, the rise of interest rates and the high levels of liquid assets in the credit institutions’ system may further increase the banking sector’s profits.

1.4 The draft law aims to set the temporary solidarity contribution for the period from the adoption of the draft law, planned for April 2023, until 31 December 2024, while the draft law will remain in force until 15 June 2025.

1.5 The base for the temporary solidarity contribution is calculated as the net interest income that is 50% greater than the average net interest income in the credit institution’s consolidated financial statements in the four-year reference period. The explanatory memorandum explains that the base is set at 50% in order to provide space for further growth of credit institutions’ loan portfolios and to avoid adverse effects on the resilience of credit institutions and on overall financial stability. Possible adverse effects on the resilience of credit institutions and overall financial stability have been taken into account when determining the four-year reference period, chosen to neutralise one-off factors. Lietuvos bankas’ stress tests show that Lithuanian credit institutions are resilient to large-scale economic shocks and able to absorb significant increases in credit losses under normal circumstances. The parameters for the calculation of the temporary solidarity contribution are said to have been calibrated in such a way as to consider the credit needs of the economy. This leaves room for interest income to increase due to the growth of loan portfolios or any other positive scenarios in the market, and the remaining net interest income would be sufficient to cover unexpected losses (e.g. in case of a deterioration in the quality of loans).

1.6 Net interest income base is the difference between interest income and interest expenditure (costs), calculated in accordance with applicable accounting standards and presented in the credit institution’s consolidated financial statements. The base is reduced by the deposit insurance premiums paid to the Deposit Insurance Fund and by contributions to the Single Resolution Fund in accordance with Regulation (EU) No 806/2014 of the European Parliament and of the Council.

1.7 Further, to calculate the temporary solidarity contribution a 60% rate is then applied to the base.

1.8 Credit institutions subject to the obligation must pay the advance temporary solidarity contribution on a quarterly basis. The advance temporary solidarity contribution must be paid to the State budget after the end of the quarter and by the last day of the second month of the next quarter.

1.9 The proceeds collected under the draft law will be used to finance military mobility and military transport infrastructure projects.

1.10 Lietuvos bankas must submit to Valstybine mokesciu inspekcija (State Tax Inspectorate) the information necessary for the administration of the temporary solidarity contribution.

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3 For 2023, the reference period starts on 1 January 2018 and ends on 31 December 2021. For 2024, the reference period starts on 1 January 2019 and ends on 31 December 2022.

2. Monetary policy context

2.1 The current surge in euro area inflation poses significant challenges to the conduct of monetary policy. Energy was the dominant component of overall inflation. However, inflation has become broad based and is projected to remain too high for too long. In view of these developments and guided by its primary objective to maintain price stability\(^5\), the ECB has taken determined action to ensure a timely return of inflation to the 2\% target over the medium term. Net purchases of assets have ended, the asset purchase programmes’ portfolio is declining at a measured and predictable pace and the key ECB policy rates have been raised with the intention of dampening demand and guarding against the risk of a persistent upward shift in inflation expectations. The ECB stands ready to adjust all instruments within its mandate to ensure that inflation returns to the ECB’s medium-term target and to preserve the smooth functioning of monetary policy transmission.

2.2 As the normalisation of the ECB’s monetary policy continues, it is important to recall that monetary policy operations always have distributional implications. Naturally, they have effects on incomes and the profitability of credit institutions. From a monetary policy perspective, credit institutions play a special role for ensuring the smooth transmission of monetary policy measures to the wider economy. In this context, an adequate capital base helps credit institutions to avoid abrupt adjustments to their lending to the real economy\(^6\).

2.3 Evidence shows that net interest income typically tends to expand on impact as policy rates increase. This effect is higher the larger the weight of short-term or variable interest rate loans, as is the case in Lithuania where the bulk of household and company loans are granted at variable rates\(^7\). However, this effect can be offset by lower lending volumes, losses recorded in the securities portfolio and an increase in provisions resulting from a deterioration of the quality of the credit portfolio. The realisation of downside risks in the current environment may significantly reduce the repayment capacity of debtors. The net effect of monetary policy normalisation on bank profitability might therefore be less positive, or even negative, over an extended horizon. The temporary solidarity contribution targets the portion of net interest income that is 50\% greater than the average net interest income over a four-year reference period (with a 60\% rate applied to such net interest income) and thus would allow credit institutions to retain the portion (40\%) of their net interest income that is 50\% greater than the average over a four-year reference period. Nonetheless, as the temporary solidarity contribution is solely levied on net interest income, rather than broader profits, it may be the case that the temporary solidarity contribution is still levied even if downside scenarios materialise with adverse developments for a credit institution. Moreover, as the temporary solidarity contribution is levied to volumes of net interest income, caution is required to ensure that it does not unduly penalise credit institutions experiencing strong growth in business or involved in mergers. More generally, caution must be taken to ensure that the temporary solidarity contribution does not impact the ability of individual credit institutions to build strong capital bases and adequately provision for increased impairments and a deterioration in credit quality. This is particularly relevant in the context of current market tensions. Damaging the ability of credit institutions to maintain adequate

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\(^5\) See Article 127(1) TFEU.

\(^6\) See paragraph 2.2 of Opinion CON/2022/36. All ECB opinions are published on EUR-Lex.

\(^7\) See Lietuvos bankas, 2022 Financial Stability Review, p. 61.
capital bases could endanger a smooth bank-based transmission of monetary policy measures to the wider economy.

3. Financial stability context

3.1 Imposing a financial contribution on the banking sector could have negative economic effects by making credit institutions less resilient to economic shocks. A sound capital base of credit institutions is essential to fulfil their role of credit intermediaries within the economy. Higher costs and reduced credit supply can adversely affect real economic growth.

3.2 The higher net interest income associated with excessive liquidity is only one of the consequences of the normalisation of monetary policy and tightening of financial conditions. As noted above, increasing interest rates can also create potential losses on outstanding loan portfolios. Moreover, in the long term, the rise in inflation can have negative effects on companies’ financial situations, increasing the credit risk for credit institutions. These effects are not reflected in the temporary solidarity contribution, and it is unlikely they will fully materialise in the upcoming years when this temporary solidarity contribution is levied. These different factors should be considered to ensure that credit institutions remain well capitalised and positioned to absorb potential future losses.

3.3 In its current design, the temporary solidarity contribution could create disincentives to attract new deposit funding and provide lending to the real economy. At the same time, domestic and foreign investors could have less appetite to invest in credit institutions as the temporary solidarity contribution decreases the profitability outlook of credit institutions. In addition, the draft law could make it more difficult for credit institutions to build up extra capital buffers and increase resilience to withstand future economic shocks. Therefore, the potential negative effects of the temporary solidarity contribution on the banking sector and its impact on financial stability should be closely monitored, particularly within the current context of higher uncertainty and increased volatility in financial markets.

3.4 The draft law ensures that the solidarity contribution is temporary in nature. Additionally, the proceeds of the temporary solidarity contribution will automatically decrease once excess liquidity and the elevated interest rate income decline, whereas interest expenditure needs may go well beyond the draft law’s time horizon. In line with these considerations, the ECB has previously recommended that a clear separation is necessary between the extraordinary nature of the proceeds and the general budgetary resources of a government to avoid their use for general fiscal consolidation purposes.

3.5 The temporary solidarity contribution can lead to fragmentation in the domestic and European financial system because of the heterogeneous nature of the banking sector. This would particularly be the case where the interest income of some credit institutions is relatively high compared to other activities. It would also be useful to analyse potential behavioural effects, including liquidity aspects of credit institutions that may want to minimise the temporary solidarity contribution, inter alia, by shifting their deposit base.

3.6 Furthermore, the application of the temporary solidarity contribution only to certain Lithuanian credit

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9 See Lietuvos bankas, 2022 Financial Stability Review, pp. 59-64.
10 See paragraph 3.2.2 of Opinion CON/2010/62 and paragraph 3.1 of Opinion CON/2022/36.
institutions could distort market competition and impair the level playing field both within the country and across the banking union.\(^{11}\)

3.7 In light of the above, the ECB recommends that the analysis provided in the explanatory memorandum also includes a thorough analysis of potential negative consequences for the banking sector, detailing in particular the specific impact of the temporary solidarity contribution on the longer-term profitability and capital base of banks and the provision of new lending and competition conditions in the market, to ensure that its application does not pose risks to financial stability, banking sector resilience and avoids market distortion.

### 4. Considerations relating to the prudential supervision of credit institutions

4.1 The ECB understands that the temporary solidarity contribution would, as a practical matter, apply to credit institutions, including those credit institutions directly supervised by the ECB within the framework of the Single Supervisory Mechanism.

4.2 The basis on which the temporary solidarity contribution would be established does not take into consideration the full business cycle and does not include, inter alia, operational expenses other than interest expenditure. As a result, the amount of the temporary solidarity contribution might not be commensurate with the profitability of a credit institution. Thus, as a result of the general application of the temporary solidarity contribution, credit institutions that are not necessarily benefitting from current market conditions could, if they become subject to the temporary solidarity contribution, become less able to absorb the potential downside risks of an economic downturn.\(^{13}\)

### 5. Role of Lietuvos bankas in providing information to the Lithuanian State Tax Inspectorate

The ECB understands that the obligation imposed on Lietuvos bankas under the draft law to submit to the State Tax Inspectorate the information necessary for administration of the temporary solidarity contribution is not a new task of Lietuvos bankas. In accordance with the Lithuanian Law on Tax Administration\(^{14}\), Lietuvos bankas already has the duty to provide all necessary information and data for the performance of the functions of the tax administration. The ECB understands that this duty of Lietuvos bankas is without prejudice to the obligation to maintain professional secrecy in respect of confidential prudential supervisory information under Union law.\(^{15}\)

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11 See paragraph 3.3 of Opinion CON/2022/36.
12 See paragraph 3.4 of Opinion CON/2022/36.
13 See paragraph 4.2 of Opinion CON/2022/36.
14 Article 30(1) of the Lithuanian Law on Tax Administration (Lietuvos Respublikos mokesčių administravimo įstatymas) stipulates that where performing its functions, the tax administrator must cooperate with other State and municipal institutions and agencies of the Republic of Lithuania and institutions as well as ensure the exchange of information. Article 30(2) stipulates that the State and municipal institutions and agencies of the Republic of Lithuania must provide comprehensive assistance to the tax administrator. Article 33(1) stipulates that when performing the functions assigned to it, the tax administrator may obtain from persons the data required for the performance of its obligations. Article 49 establishes that unless the laws provide otherwise, the information and data specified in Article 33(1) of this Law as are necessary for the tax administrator to perform its functions is to be submitted not later than within ten days from the date of receipt of instructions from the relevant tax administrator or within a longer time limit set forth by the tax administrator.
This opinion will be published on EUR-Lex.

Done at Frankfurt am Main, 4 April 2023.

[signed]

The President of the ECB
Christine LAGARDE