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**Opinion of the European Central Bank of 4 February 2009 at the Request of the Latvian Financial and Capital Market Commission on Draft Amendments to Certain Legal Acts in Connection with the Financial Turmoil**

European Central Bank (ECB)

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## **OPINION OF THE EUROPEAN CENTRAL BANK**

**of 4 February 2009**

**at the request of the Latvian Financial and Capital Market Commission  
on draft amendments to certain legal acts in connection with the financial turmoil**

**(CON/2009/10)**

### **Introduction and legal basis**

On 2 February 2009 the European Central Bank (ECB) received a request from the Latvian Financial and Capital Market Commission (FCMC) for an opinion on draft amendments to the following legal acts (hereinafter the 'draft amendments'): (a) the Law on deposit guarantees; (b) the Law on credit institutions; (c) the Law on civil procedure; and (d) the Law on the Financial and Capital Market Commission.

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 provisions<sup>1</sup>, as the draft amendments relate to 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 amendments**

- 1.1 The main objectives of the draft amendments to the Law on deposit guarantees are: (a) to clarify further the definition of the 'unavailability' of deposits; (b) to provide that compensation will be paid within a maximum period of twenty working days; and (c) to provide that if the resources of the Latvian Deposit Guarantee Fund are insufficient, compensation will be paid to depositors from the State budget.
- 1.2 The main objective of the draft amendments to the Law on credit institutions is to extend the FCMC's powers to allow it to deal more effectively with troubled banks.

In particular, the FCMC is authorised to take measures in any of the following circumstances: (a) if a credit institution fails to comply with national or EU laws and regulations; (b) if a credit

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

institution's operations threaten its own stability or solvency, the security or stability of the banking sector in Latvia, or to cause significant losses to the economy of the State: (c) if there is an excessive outflow of deposits or other secured funds from a credit institution.

The measures that the FCMC may take include: (a) requiring the credit institution to take the necessary steps to remedy such situation or submit a plan of action to the FCMC by a set deadline; (b) issuing a warning to the credit institution; (c) giving the credit institution's decision-making bodies, managers and members binding written orders necessary to remedy such situation; (d) establishing restrictions on the rights and actions of the credit institution, including entirely or partially suspending its authority to provide financial services, as well as restrictions on fulfilment of its obligations; (e) imposing restrictions on the credit institution in relation to execution of deposit obligations; (f) appointing one or more authorised representatives from the FCMC to the credit institution; (g) imposing on the credit institution the responsibility to reduce the level of risk in relation to its transactions, services and systems; (h) requesting Latvijas Banka to suspend the provision of credit to the credit institution; (i) imposing fines.

Under the draft amendments, an authorised representative of the FCMC may be appointed to take over the management of the credit institution with a wide range of powers to administer it. The operations of the credit institution's shareholders in general meeting, its council, board and other executive institutions, as well as the persons authorised to bind the credit institution, will be suspended. The authorised representative will be authorised to call and participate in meetings of the credit institution's shareholders, council or board with the right to propose issues to be reviewed. No decision may be adopted if it is opposed by the authorised representative.

- 1.3 The main objective of the draft amendments to the Law on civil procedure is to reduce the period for the Court to decide on an insolvency from 15 days to five days.
- 1.4 The main objective of the draft amendments to the Law on the Financial and Capital Market Commission is to provide for the FCMC's rights to take decisions to restrict the rights, obligations and operations of market participants.

## **2. General observations**

- 2.1 In line with the 'Declaration on a concerted European action plan of the euro area countries' issued by the Heads of State of the euro area on 12 October 2008 (hereinafter the 'Declaration')<sup>2</sup>, the ECB notes that Member States must act in a coordinated manner to avoid significant differences in national implementation having a counter-productive effect and creating distortions in global banking markets. 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. These principles were also endorsed for

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<sup>2</sup> The Declaration is available on the French Presidency's website at [www.ue2008.fr](http://www.ue2008.fr)

all Member States by the European Council on 16 October 2008. The Declaration also acknowledges the need to work in cooperation with the ECB.

- 2.2 As a general remark and in line with its previous opinions<sup>3</sup>, the ECB reiterates the importance of ensuring that the regulatory practice under the draft amendments will be conducted in full compliance with the relevant Community law provisions, including EU single market principles and financial services legislation, as well as competition and State aid rules. In the latter respect, the ECB draws the consulting authority's attention to the Commission's recently adopted guidance on compliance by financial sector support schemes with EU State aid rules<sup>4</sup>.

### 3. Specific observations

#### 3.1 Draft amendments to the Law on deposit guarantees

As noted in past ECB opinions, deposit protection is an important element of the financial safety net and contributes to safeguarding financial stability<sup>5</sup>. The ECB notes, with reference to the proposed shortening of the payout periods for the guaranteed deposits, that this is also the objective of the amendments currently proposed to Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes<sup>6</sup>. In line with its opinion on the proposed amendments to Directive 94/19/EC<sup>7</sup>, the ECB welcomes the Latvian authorities' intention to significantly reduce delays in payouts of guaranteed deposits and thereby strengthen depositors' confidence. At the same time, a pragmatic approach should be taken to introducing the necessary reduction in payout delays, thereby preserving the credibility of the deposit-guarantee scheme. This implies, *inter alia*, establishing efficient operational processes for verifying claims and paying depositors.

Further, and as confirmed also by international standards, sound funding arrangements are critical to the effectiveness of deposit-guarantee schemes and to the maintenance of public confidence in

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<sup>3</sup> See, for example, paragraph 3.3 of Opinion CON/2008/57 of 21 October 2008 at the request of the German Ministry of Finance on a Law on the implementation of a package of measures to stabilise the financial market and an order on its implementation.

<sup>4</sup> See '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' (OJ C 208 of 25.10.2008, p. 8). Also 'Communication from the Commission – The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition', available on the Commission's website at [www.ec.europa.eu](http://www.ec.europa.eu)

<sup>5</sup> See paragraph 8 of ECB Opinion CON/2005/50 of 1 December 2005 at the request of Národná banka Slovenska on a draft law amending the Act No 118/1996 Coll. on the protection of bank deposits and on amendments to certain laws, as last amended; also paragraph 2.5 of ECB Opinion CON/2007/26 of 27 August 2007 at the request of the Polish Minister for Finance on a draft law amending the Law on the Bank Guarantee Fund.

<sup>6</sup> OJ L 135, 31.5.1994, p. 5.

<sup>7</sup> See ECB Opinion CON/2008/70 of 18 November 2008 at the request of the Council of the European Union on a proposal for a Directive of the European Parliament and of the Council amending Directive 94/19/EC on deposit-guarantee schemes as regards the coverage level and the payout delay (OJ L 314, 9.12.2008, p. 1).

the banking system<sup>8</sup>. Directive 94/19/EC does not currently prescribe a method for financing deposit-guarantee schemes, provided that all of the following conditions are satisfied: (a) the costs of financing are borne, in principle, by credit institutions themselves; (b) the financing capacity of the scheme is in proportion to credit institutions' liabilities; (c) the stability of the banking system of the Member State concerned is not jeopardised<sup>9</sup>. The arrangements adopted in the case of the Latvian Deposit Guarantee Fund should therefore be consistent with these broad principles.

Finally, the ECB underlines that the Latvian Deposit Guarantee Fund's funding arrangements must, *inter alia*, comply with the monetary financing prohibition laid down in the Treaty, and in particular with the prohibition on national central banks providing overdraft facilities or any other type of facility within the meaning of Article 101 of the Treaty<sup>10</sup>, as more specifically considered in past ECB opinions<sup>11</sup> and in the ECB's Convergence Reports<sup>12</sup>.

### 3.2 *Draft amendments to the Law on credit institutions*

The ECB welcomes the draft amendments to the Law on credit institutions to the extent that they will strengthen the FCMC's powers to intervene when the stability of either individual credit institutions or the financial system as a whole is jeopardised. Moreover, the ECB notes that in certain cases the FCMC may adopt decisions provided that the Cabinet of Ministers does not object. The ECB emphasises that operational independence of supervisory authorities vis-à-vis the political authorities is an essential and internationally recognised standard for supervision of financial markets. In this respect, the ECB notes that the draft amendments to the Law on credit institutions could give rise to concerns regarding the operational independence of the Latvian supervisory authorities, which should be addressed by introducing appropriate legislative safeguards.

The ECB understands that the proposed provision giving the FCMC the power to request Latvijas Banka to suspend providing credit to a specific credit institution in view of its worsening financial situation should be without prejudice to the principle of central bank independence, as established by Article 108 of the Treaty and repeated in Article 7 of the Statute of the European System of Central Banks and of the European Central Bank<sup>13</sup>. These provisions, *inter alia*, require that Latvijas Banka does not seek or take any instructions from other bodies of the Latvian

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<sup>8</sup> Financial Stability Forum, 'Guidance for Developing Effective Deposit Insurance Systems', September 2001, point V.4 ('Funding'), p. 26. International Association of Deposit Insurers, Core Principles for Effective Deposit Insurance Systems, 29 February 2008.

<sup>9</sup> See the twenty-third recital to Directive 94/19/EC. The proposed amending Directive calls for the Commission to submit a report on a harmonisation of the funding mechanisms of deposit-guarantee schemes by 31 December 2009 to the European Parliament and the Council (see Article 1(6) of the proposed amending Directive, introducing changes to Article 12 of Directive 94/19/EC).

<sup>10</sup> Interpreted in line 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 Treaty (OJ L 332, 31.12.1993, p. 1).

<sup>11</sup> See paragraph 1.2 of ECB Opinion CON/2008/70; see also paragraph 3.1 of ECB Opinion CON/2008/57; as well as paragraph 3.2 of ECB Opinion CON/2008/59 of 24 October 2008 at the request of the Swedish Ministry of Finance on a draft proposal on stabilising measures for the Swedish financial system.

<sup>12</sup> See, for example, the ECB's Convergence Report December 2006, p. 30.

<sup>13</sup> As also expressed in Article 13(2) of the Law on Latvijas Banka.

administration and that such bodies undertake to respect this principle and do not seek to influence Latvijas Banka's decision-making bodies in the performance of their tasks. The ECB therefore recommends redrafting the provision in question to make it clear that while the FCMC may provide a negative assessment of the creditworthiness of a credit institution to Latvijas Banka, it may not request the suspension of credit to that credit institution. This would emphasise that the FCMC's power is without prejudice to Latvijas Banka's independence to decide whether credit should be provided to a credit institution.

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

Done at Frankfurt am Main, 4 February 2009.

[signed]

*The President of the ECB*

Jean-Claude TRICHET