



EUROPEAN CENTRAL BANK
EUROSYSTEM

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OPINION OF THE EUROPEAN CENTRAL BANK

of 29 December 2023

on a legislative package on crisis management in the banking sector

(CON/2023/47)

Introduction and legal basis

On 23 October 2023 the European Central Bank (ECB) received a request from the Ministry of Finance of the Republic of Cyprus (hereinafter the 'Ministry') for an opinion on three draft laws. The first draft law relates to extraordinary public financial support (hereinafter the 'draft law on extraordinary public financial support'). The second draft law relates to amendments to the Law on the resolution of credit institutions and investment firms (hereinafter the 'draft law on the resolution of credit institutions'). The third draft law relates to amendments to the Law on the business of credit institutions (hereinafter the 'draft law on the business of credit institutions', and together with the draft law on extraordinary public financial support and the draft law on the resolution of credit institutions hereinafter collectively referred to as the 'draft laws').

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, Article 25.1 of the Statute of the European System of Central Banks and of the European Central Bank and the third and sixth indents of Article 2(1) of Council Decision 98/415/EC¹, as the draft laws relate to (1) the implementation of Union legislation relating to the prudential supervision of credit institutions and to the stability of the financial system, (2) the Central Bank of Cyprus (CBC), (3) rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets and (4) the specific tasks conferred upon 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 draft laws

- 1.1 The purpose of the draft laws is to provide for coordination procedures between the various authorities involved in the application of certain provisions of Directive 2014/59/EU of the European Parliament and of the Council² (hereinafter the 'BRRD'), Regulation (EU) No 806/2014 of the

¹ 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).

² See Article 32(4), point (d), of Directive 2014/59/EU of the European Parliament and of the Council of 15 July 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12.6.2014, p. 190).

European Parliament and of the Council³ (hereinafter the 'SRM Regulation'), and the Law on the business of credit institutions⁴. In particular, the draft laws are intended to apply to cases in which extraordinary public financial support is required in order to prevent or remedy a serious disturbance in the economy and to preserve financial stability in the Republic of Cyprus (hereinafter the 'Republic').

- 1.2 The draft law on extraordinary public financial support lays down rules and procedures for the provision of emergency public financial support to solvent authorised credit institutions (ACIs) without triggering deposit guarantee schemes. Financial support is to be provided for the purpose of addressing a capital shortfall and/or supporting liquidity, in order to prevent or remedy a serious disturbance in the economy and to preserve financial stability in the Republic. This draft law provides for three categories of extraordinary public intervention, which reflect the three forms envisaged in the relevant provisions of the SRM Regulation and the BRRD⁵: (1) a State guarantee to back liquidity facilities provided by the CBC subject to the conditions laid down by the CBC; (2) a State guarantee of newly issued liabilities; and (3) a precautionary recapitalisation, whereby there is an injection of own funds or purchase of capital instruments by the State. The draft law on extraordinary public financial support also provides that the liquidity support includes emergency liquidity assistance.

1.3 *Liquidity support measures and State guarantee of newly issued liabilities*

- 1.3.1 The draft law on extraordinary public financial support provides for the conditions and procedures for a solvent ACI to apply to the Ministry for temporary and precautionary support in the form of State guarantees to back liquidity facilities provided by the CBC and/or in order to issue new debt instruments. The draft law on extraordinary public financial support also sets the preconditions for the provision of State guarantees to back liquidity facilities to an ACI⁶ and such preconditions apply mutatis mutandis in the case of State guarantees for newly issued debt instruments⁷. The amount of any such guarantee is to be limited to what is strictly necessary to restore the ACI's medium-term funding capacity⁸ and must not exceed the ACI's own funds for supervisory purposes other than in duly substantiated cases⁹. A State guarantee to support the liquidity of an ACI may be provided for debt instruments issued by the ACI which are not debt securities that may be classified as own funds¹⁰, and which present the features defined in the draft law on extraordinary public financial support¹¹. The criteria and limitations set out in the draft law on extraordinary public financial support are derived, where available, from the Communication from the Commission on the application, from

³ See Article 18(4), point (d), of Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (OJ L 255, 30.7.2014, p. 1).

⁴ See Article 32C(2), point (d), of the Law on the business of credit institutions.

⁵ See Article 18(4), point (d), of the SRM Regulation and Article 32(4), point (d), of the BRRD.

⁶ See Article 7 of the draft law on extraordinary public financial support.

⁷ See Article 13 of the draft law on extraordinary public financial support.

⁸ See Article 6(13) of the draft law on extraordinary public financial support.

⁹ See Article 6(15) of the draft law on extraordinary public financial support.

¹⁰ See Article 12 of the draft law on extraordinary public financial support.

¹¹ See Article 12 of the draft law on extraordinary public financial support.

1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis (hereinafter the '2013 Banking Communication')¹² of the European Commission.

- 1.3.2 The provision of any State guarantee to an ACI must receive prior authorisation from the Commission and must relate to an ACI whose solvency is confirmed by the competent authority¹³. The competent authority is the CBC or the ECB¹⁴ depending on the significance of the requesting credit institution for the purposes of the SSM Regulation. The CBC, in its capacity as the national designated authority¹⁵, assesses whether the support is necessary in order to prevent or remedy a serious disturbance in the economy of the Republic and to preserve financial stability in the Republic¹⁶. The CBC, again in its capacity as the national designated authority, then submits to the Minister for Finance (hereinafter the 'Minister') a recommendation based on its conclusions¹⁷. The draft law on extraordinary public financial support provides for several procedural steps after the receipt of a positive recommendation from the CBC, up to the notification of the proposed State guarantees to the Commission for its approval. Following the completion of certain procedural steps by the ACI and CBC, the Minister must, within two months of receiving the Commission's approval, submit a final draft restructuring plan to the Commission confirming the profitability and financial capacity of the ACI in the long term without support from the Republic where the ACI is to be provided with a State guarantee for new liabilities or renewed liabilities for which, at the time of the granting of the new State guarantee, the total outstanding guaranteed liabilities (including guarantees provided before the date of receipt of the Commission's approval) exceed both the proportion of 5 % of the total liabilities and the total amount of EUR 500 million¹⁸. The submission of a final restructuring plan is also required whenever the Ministry receives a request for the activation of the State guarantees, and in such situations this plan must be submitted by the Minister to the Commission within two months from the submission of the activation request¹⁹.

1.4 *Precautionary recapitalisation*

- 1.4.1 Under the draft law on extraordinary public financial support, a precautionary recapitalisation may be provided in the form of an injection of own funds or the purchase of capital instruments²⁰, and may only be requested by an ACI that needs recapitalisation, based on any stress test scenario at the level of the Republic, the Union or the Single Supervisory Mechanism (SSM), or in the context of an asset quality review or an equivalent review carried out by the competent authority²¹. Precautionary

¹² See Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') (OJ C 216, 30.7.2013, p. 1), in particular paragraphs 59 and 60.

¹³ See definition of 'competent authority' in Article 2 of the draft law on extraordinary public financial support referring to the competent authority as defined in Article 4(1), point (40), of Regulation (EU) No 575/2013 and/or the European Central Bank for the purpose of carrying out the tasks conferred on it in accordance with 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) (hereinafter the 'SSM Regulation').

¹⁴ See Article 7 of the draft law on extraordinary public financial support.

¹⁵ See definition of term 'national designated authority' in Article 2 of the draft law on extraordinary public financial support.

¹⁶ See Article 6(1) of the draft law on extraordinary public financial support.

¹⁷ See Article 6(1) of the draft law on extraordinary public financial support.

¹⁸ See Article 6(9) of the draft law on extraordinary public financial support.

¹⁹ See Article 6(10) of the draft law on extraordinary public financial support.

²⁰ As provided in Article 32C(2), point (d)(iii), of the Law on the business of credit institutions.

²¹ See Article 16(1) of the draft law on extraordinary public financial support.

recapitalisation may be provided only if the ACI is not deemed insolvent and is unlikely to become insolvent and the preconditions for the write-down or conversion of capital instruments under the relevant provisions of Cypriot law²² or of the SRM Regulation are not fulfilled²³. The ACI is deemed solvent based on confirmation by the competent authority²⁴.

- 1.4.2 Before the submission of a request for precautionary recapitalisation to the Ministry, the ACI must submit a recapitalisation plan to the competent authority, meaning the ECB in the case of significant institutions and the CBC in the case of less significant institutions. If the recapitalisation plan is deemed unsatisfactory by the competent authority, the ACI may immediately request recapitalisation²⁵. If the measures taken by the ACI to achieve the objectives of the recapitalisation plan, even before fully completed, are deemed insufficient by the competent authority, the ACI may make a request for a precautionary recapitalisation²⁶. If the recapitalisation plan is deemed satisfactory by the competent authority, the ACI implements this plan and informs the competent authority of the results of the measures adopted in implementing the plan.
- 1.4.3 The request for State intervention must be submitted to the Ministry and notified to the competent authority, meaning the ECB in the case of significant credit institutions and the CBC in its capacity as national designated authority and competent authority in the case of less significant institutions. It must include, inter alia: (1) a list of the ACI's instruments and loans that will be subject to burden-sharing measures, indicating their financial value; (2) an estimate of the real value of the ACI's assets and liabilities, for the purposes of assessing whether the creditors would be worse off were the ACI to become insolvent; and (3) a restructuring plan prepared in accordance with Union State aid rules²⁷. The CBC, being the national designated authority, must, within 60 days from receipt of the request for precautionary recapitalisation, assess the request and prepare and submit a report and recommendation to the Minister on the need for a precautionary recapitalisation of the ACI.
- 1.4.4 The maximum amount of precautionary recapitalisation is to consist of the difference between the losses resulting from the extreme and baseline scenarios under a stress test at the level of the Republic, the Union or the SSM, or in the context of an asset quality review or an equivalent review conducted by the competent authority²⁸.
- 1.4.5 The precautionary recapitalisation is subject to the Commission's approval of the restructuring plan pursuant to the Union's State aid framework²⁹.
- 1.5 *State guarantee for emergency liquidity assistance*
 - 1.5.1 The draft law on extraordinary public financial support provides that the Minister may issue a State guarantee concerning the collateral assets or the realisation value of such assets that were provided by the ACI as collateral for emergency liquidity assistance conducted by the CBC in compliance with

²² See Article 31 of the Law on the resolution of credit institutions and investment firms.

²³ See Article 16(2) of the draft law on extraordinary public financial support.

²⁴ See Article 16(3) of the draft law on extraordinary public financial support.

²⁵ See Article 17(2) of the draft law on extraordinary public financial support.

²⁶ See Article 17(3) of the draft law on extraordinary public financial support.

²⁷ See Article 17(1) of the draft law on extraordinary public financial support.

²⁸ See Article 16(4) of the draft law on extraordinary public financial support.

²⁹ See Article 17(1), point (c), and (12) of the draft law on extraordinary public financial support.

the systems established by the ECB³⁰. An ACI benefiting from such guarantee for the provision of emergency liquidity assistance is required to submit a restructuring plan confirming its profitability and long-term funding capacity without the support of the Republic, in order, in particular, to limit reliance on the temporary liquidity assistance provided by the CBC³¹.

- 1.5.2 The draft law on the resolution of credit institutions aims to implement the exercise of the discretion set out in certain provisions of the BRRD³² to enable the resolution authority, in the very exceptional case of a systemic crisis, to intervene directly to avoid the liquidation of an ACI or to achieve resolution objectives using public financial stabilisation tools (public equity support tool and temporary public ownership tool) subject to certain conditions. Public financial stabilisation tools are used as a last resort, after other resolution tools have been assessed and used to the greatest extent possible.
- 1.5.3 The draft law on the business of credit institutions aims to better transpose certain provisions of the BRRD³³.

2. General observations

2.1 *Compliance with the Union's legal framework*

National legislative provisions that aim at providing public support to the banking sector must fully comply with Union law, including the criteria governing the provision of extraordinary public financial support to credit institutions under the SRM Regulation and the BRRD, and must also take into account related Commission communications on the application of State aid rules to support measures for banks. Nonetheless, the ECB stresses that while the draft laws go beyond a simple transposition of Union law requirements, insofar as the draft laws transpose certain Union law requirements, the ECB opines neither on whether the draft laws effectively transpose Article 32(4), point (d), of the BRRD into Cypriot law, nor on the effectiveness of the application of the SRM Regulation in the Cypriot legal sphere. Instead, the ECB's focus is on those provisions that may impact on the role and the specific tasks conferred on the ECB by the SSM Regulation concerning the prudential supervision of credit institutions.

2.2 *The role of the ECB as competent supervisory authority*

The draft law on extraordinary public financial support envisages a role for the ECB, as the competent supervisory authority for significant institutions within the SSM, in the procedures leading to the provision of public support. The ECB emphasises that its role in this respect is derived from Union rather than national law, in particular the SSM Regulation. In principle, national law cannot on its own, in the absence of a firm basis in Union law, transfer responsibilities to a Union institution such as the ECB. In this respect, the attribution of the role envisaged for the ECB under the draft law on extraordinary public financial support can be considered to be overall in line with the specific prudential supervisory tasks conferred on the ECB under the Union legal framework, insofar as the

30 See Article 22(2) of the draft law on extraordinary public financial support.

31 See Article 22(3) of the draft law on extraordinary public financial support.

32 See Article 37(10) and Articles 56, 57 and 58 of the BRRD.

33 See Article 32(4) of the BRRD.

relevant provisions of the draft law on extraordinary public financial support are interpreted in the light of and within the limits of the prudential supervisory tasks assigned to the ECB under Union law. The ECB stresses the importance of ensuring cooperation and the exchange of information between the national authorities and the competent supervisory authority, in accordance with this framework.

3. Specific observations

3.1 *Stress and basic scenario-based losses*

3.1.1 The draft law on extraordinary public financial support provides that specified precautionary recapitalisation is to be capped at the difference between stress and basic scenario-based losses established under Republic, Union or SSM-wide stress tests or asset quality reviews or equivalent exercises conducted by the competent authority³⁴.

3.1.2 Under Regulation (EU) No 1093/2010 of the European Parliament and of the Council³⁵ the European Banking Authority (EBA) may also perform such tests, and this is also explicitly mentioned in the SRM Regulation and the BRRD³⁶. In view of this, it may also be appropriate to make reference to the EBA and to clarify that under the SRM Regulation the capital shortfall resulting from such tests must be confirmed by the competent authority³⁷.

3.2 *Extent of consultation with the ECB prior to the provision of precautionary recapitalisation*

3.2.1 Article 17(7) of the draft law on extraordinary public financial support provides that the report and the recommendation prepared by the national designated authority and submitted to the Minister on the need for precautionary recapitalisation, following consultation with the competent authority, must include at the very least the following: (a) the supervisory measures already taken by the competent authority; (b) the efficacy of the proposed support in favour of the ACI at the minimal possible cost to taxpayers; (c) whether, in the opinion of the national designated authority, the ACI was unable to raise sufficient capital from its existing shareholders or from the market or in any other manner; (d) the assessment of the long-term viability of the applicant ACI, given that the proposed precautionary recapitalisation is to be provided in the form of a capital injection or a purchase of capital instruments; (e) whether the relevant preconditions are fulfilled in relation to the proposed precautionary recapitalisation; (f) the restructuring plan submitted by the ACI to the competent authority; and (g) the opinion of the competent authority as to whether it considers the recapitalisation plan to be satisfactory.

3.2.2 The ECB understands that, where the ECB is to be consulted, such consultation will be limited to matters within its fields of competence under Union law.

3.2.3 Further, the ECB notes that a clarification of Article 17(7), point (f), of the draft law on extraordinary public financial support may be required. Under the draft law on extraordinary public financial

³⁴ See Article 16(4) of the draft law on extraordinary public financial support. The definition of the term 'competent authority' is contained in Article 1 of the draft law on extraordinary public financial support.

³⁵ See Article 32 of Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 1).

³⁶ See Article 18(4) of the SRM Regulation.

³⁷ See Article 18(4) of the SRM Regulation.

support, the application for precautionary recapitalisation by the ACI is to be submitted to the Ministry and the restructuring plan is to be approved by the Commission³⁸. The application is only notified to the competent authority. The reference under Article 17(7), point (f), to the restructuring plan being submitted by the ACI to the competent authority may not be fully in line with these provisions as the restructuring plan would need to be submitted to the Ministry of Finance together with the application for precautionary recapitalisation and notified to the competent authority and national designated authority.

3.3 *Role of the competent authority in respect of the measures provided for under Article 19(1) of the draft law on extraordinary public financial support*

3.3.1 The draft law on extraordinary public financial support provides that an ACI must take all measures necessary to retain its funds from the time when it knows or should have known of the capital needs³⁹ and lists various actions which cannot be performed by the ACI without the prior consent of the Commission.

3.3.2 The ECB understands that this provision aims at implementing the restrictions listed under the 2013 Banking Communication⁴⁰ and is without prejudice to the general rules provided in Regulation (EU) No 575/2013 of the European Parliament and of the Council⁴¹ (hereinafter the 'CRR') which assign to the competent authorities the power to approve some of those actions (e.g. share or hybrid capital instrument buy-backs) when certain specific conditions are met.

3.4 *Assent of the competent authority for conversion of capital instruments*

3.4.1 The draft law on extraordinary public financial support provides that an ACI with a capital shortfall which, if not addressed in a timely manner, may lead to the provision of precautionary recapitalisation must, having obtained the assent of the competent authority, the national designated authority and the Council of Ministers, and having taken all appropriate and reasonable measures in the circumstances to remedy the capital shortfall, initiate a procedure for the variation of the terms of issue of its capital instruments by their holders, with a view to strengthening its basic own funds, including its share capital⁴².

3.4.2 The ECB understands that this provision aims at supporting the implementation of other measures to reduce capital needs as per the 2013 Banking Communication⁴³ and that the competent authority's role referred to in the draft law is therefore aligned with the reference in the 2013 Banking Communication. This role must be without prejudice to the application of the CRR provisions related to the Common Equity Tier 1 instruments classification⁴⁴ and the reduction of own funds and eligible

³⁸ See Article 17(1) of the draft law on extraordinary public financial support.

³⁹ See Article 19 of the draft law on extraordinary public financial support.

⁴⁰ See paragraph 47 of the 2013 Banking Communication.

⁴¹ 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).

⁴² See Article 20(1) of the draft law on extraordinary public financial support.

⁴³ See paragraph 35 of the 2013 Banking Communication.

⁴⁴ See Article 26(3) of the CRR.

liabilities⁴⁵, as specified in Commission Delegated Regulation (EU) No 241/2014⁴⁶ and the related EBA Reports on the monitoring of Common Equity Tier 1, Additional Tier 1, Tier 2 and TLAC/MREL eligible liabilities instruments⁴⁷ as well as associated supervisory guidance, such as the ECB Guide on options and discretions available in Union law⁴⁸.

This opinion will be published on EUR-Lex.

Done at Frankfurt am Main, 29 December 2023.

[signed]

The President of the ECB

Christine LAGARDE

⁴⁵ See Articles 77 and 78 of the CRR.

⁴⁶ Commission Delegated Regulation (EU) No 241/2014 of 7 January 2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for Own Funds requirements for institutions (OJ L 74, 14.3.2014, p. 8).

⁴⁷ See European Banking Authority, EBA Report on the monitoring of CET1 instruments issued by EU institutions of 8 December 2021 (EBA/REP/2021/36) and EBA Report on the monitoring of additional Tier 1 (AT1) and TLAC/MREL eligible liabilities instruments of European Union (EU) institutions – update (EBA/Rep/2023/23), available on the EBA's website at www.eba.europa.eu.

⁴⁸ Available on the ECB's Banking Supervision website at www.bankingsupervision.europa.eu.