



EUROPEAN CENTRAL BANK
EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 24 January 2012

**on a guarantee scheme for the liabilities of Italian banks and on the exchange of lira banknotes
(CON/2012/4)**

Introduction and legal basis

On 15 December 2011, the ECB received a request from the Italian Ministry of Economic Affairs and Finance (the ‘Ministry’) for an opinion on Article 8 of Decree-Law No 201 of 6 December 2011 on equity, growth and fiscal consolidation¹ (hereinafter the ‘Decree-Law’). This Opinion also considers Article 26 of the Decree-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 first, third and sixth indents 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 provisions², as the Decree-Law concerns currency matters, the Banca d’Italia 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 Decree-Law

1.1 Article 8 of the Decree-Law establishes a guarantee scheme for the liabilities of Italian banks³ until 30 June 2012⁴, in accordance with the Communication from the Commission on the application, from 1 January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis (the ‘2011 Communication’)⁵. The Ministry will provide⁶ (i) a guarantee⁷ for the liabilities of Italian banks⁸, provided they fulfill a number of requirements, including in particular

1 *Gazzetta Ufficiale* No 284, 6.12.2011.

2 OJ L 189, 3.7.1998, p. 42.

3 Meaning banks having their registered office in Italy. See Article 8(5).

4 Such date may be further extended by means of decrees of the President of the Council of Ministers, on a proposal of the Minister for Economic Affairs and Finance, and in accordance with Union law. See Article 8(1) of the Decree-Law.

5 OJ C 356, 6.12.2011, p. 7.

6 Up to EUR 200 million per year from 2012 to 2016. Such amounts are deposited in an account to cover any activation of the guarantees. Additional financial needs will be addressed by the funds allocated to the Ministry. See Article 8(4).

7 Unconditional, irrevocable, first demand guarantees may be provided on principal and interest. See Article 8(3) and (11) of the Decree-Law.

8 In accordance with the 2011 Communication, instruments that qualify as regulatory capital under Banca d’Italia Circular No 263 of 27 December 2006, Title I, Chapter 1, Section 2 are excluded from the scope of the guarantee. See Article 8(12) of the Decree-Law.

that they have been issued by banks after the entry into force of the Decree-Law and have a residual maturity (a) between three months and five years; or (b) up to seven years from 1 January 2012, if they are covered bonds⁹ issued by Italian banks; and (ii) a guarantee for emergency liquidity assistance operations conducted by the Banca d'Italia¹⁰.

- 1.2 A guarantee may be provided on the basis of an assessment conducted by the Banca d'Italia on the relevant bank, concerning (i) capital adequacy; and; (ii) capacity to discharge the obligations assumed¹¹. According to the Decree Law, the Banca d'Italia is closely involved in the management of the guarantee scheme, and is entrusted with several functions, including biannual monitoring of the operations conducted and their effect on the economy¹². The Banca d'Italia is also closely involved in the management of the beneficiary institutions' compliance with the conditions set out in the Decree Law¹³, has an advisory function in view of possible changes to the framework¹⁴, and a responsibility for handling banks' applications for admission¹⁵ and recourse¹⁶ to the scheme, as well as guarantee payments¹⁷.
- 1.3 Banknotes and coins denominated in lire lapse within 10 years from the date on which they ceased to be legal tender¹⁸, and a deadline is imposed for the exchange of such banknotes and coins at all branches of the Banca d'Italia¹⁹. Article 26 of the Decree-Law brings forward the deadline to the date of entry into force of the Decree-Law and specifies that the countervalue of unexchanged banknotes and coins, to be allocated to the Italian Treasury, is to be subsequently credited to the Italian Government Bonds Sinking Fund.

2. General observations

- 2.1 The ECB welcomes the Decree-Law as a crucial step in enhancing financial stability in Italy. At the same time, the ECB wishes to make the following comments on several technical aspects of the Decree-Law.

⁹ Pursuant to Article 7bis of Law No 130 of 30 April 1999 (*Gazzetta Ufficiale* No 111, 14.5.1999).

¹⁰ See Article 8(34) of the Decree-Law.

¹¹ See Article 8(2) of the Decree-Law.

¹² See Article 8(6) of the Decree-Law.

¹³ See Article 8(7) of the Decree-Law.

¹⁴ See Article 8(20) and (33) of the Decree-Law.

¹⁵ See Article 8(21), (22), (24) and (25) of the Decree-Law.

¹⁶ See Article 8(26) of the Decree-Law.

¹⁷ See Article 8(27) of the Decree-Law. In addition, according to Article 8(30), operations conducted by the Banca d'Italia to address liquidity needs against the provision of a pledge or a loan disposal benefit until 31 December 2012 from a special regime, more favourable than the regime under Law No 170 of 21 May 2004 (*Gazzetta Ufficiale* No 164, 15.7.2004), implementing Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements (OJ L 168, 27.6.2002, p. 43).

¹⁸ See Article 3 of Law No 96 of 7.4.1996 (*Gazzetta Ufficiale* No 85, 12.4.1997) and Article 52-ter of Legislative Decree No 213 of 24.6.1998 (*Gazzetta Ufficiale* No 157, 8.7.1998), respectively. This legislation was amended by Article 87 of Law No 289 of 27 December 2002 (*Gazzetta Ufficiale* No 305 of 31.12.2002), i.e. the '2003 Budget Law', which was the subject of Opinion CON/2002/31. All ECB opinions are published on the ECB's website at www.ecb.europa.eu.

¹⁹ Article 87 of the 2003 Budget Law also introduced an obligation for the Banca d'Italia to pay to the Government the value of the banknotes not submitted for exchange by that date. Pursuant to the amended provisions, the Banca d'Italia and the Ministry also estimated the amount of banknotes which would have not been submitted for exchange, and on that basis the Banca d'Italia carried out in two instalments an interim payment of 90% of the estimated amount.

2.2 *Proper timing to consult the ECB*

The ECB received the consultation request only on 15 December 2011 although the Decree-Law entered into force on 6 December 2011. As specified in the consultation request, the Decree-Law was presented to Parliament for conversion into law within 60 days. The consulting authority requested the ECB to consider the consultation as a matter of urgency, without however setting a time limit. As underlined in several ECB opinions, Article 3 of Decision 98/415/EC provides that the consulting authorities may set a time limit for the submission of an ECB opinion, but it may not be less than one month, unless a shorter time limit is justified with reasons for the extreme urgency²⁰. Hence, the Ministry has not consulted the ECB in accordance with Decision 98/415/EC. The ECB would therefore like to remind the consulting authority of the importance of consulting the ECB at an appropriate point in time ‘enabling the authority initiating the draft legislative provision to take into consideration the ECB’s opinion before taking its decision on the substance’²¹.

2.3 *Compliance with the Union legal framework, temporary nature of the scheme and pricing of guarantees*

National legislative provisions need to fully comply with Union law, including competition and State aid rules. In particular, national authorities should seek to coordinate their responses to the current financial situation with their Union partners, in order to act in a united manner and to avoid that national measures adversely affect the functioning of the single market and the other Member States. In this respect, it is essential that Member States comply with the European Commission’s communications²² on the application of State aid rules to support measures in favour of banks and government guarantee schemes for bank debt, including with regard to the temporary nature²³ of the acceptability of such aid measures and the need for credit institutions receiving State support to submit to the Commission restructuring plans. Against this background, the ECB understands that the pricing terms and conditions for the State guarantees under the Decree-Law are aligned with the conditions established by the Commission for the relevant reference periods²⁴ and expects that such pricing terms will be applied to financial institutions benefiting from the granted State guarantees.

²⁰ On 26 October 2011 the ECB wrote to the Ministry, together with consulting authorities in other Member States, encouraging them to take the measures necessary to ensure effective compliance with Article 4 of Decision 98/415/EC, by duly consulting the ECB on draft legislative provisions falling within its field of competence, including provisions which are not subject to parliamentary approval, at an appropriate stage of the legislative process. In that context they should put in place appropriate internal procedures to ensure that consultation of the ECB takes place at an appropriate stage, which enables the consulting and/or adopting authority to take into consideration the ECB’s opinion before the legislative provision in question is adopted.

²¹ See Article 4 of Decision 98/415/EC.

²² 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 270, 25.10.2008, p. 8) and the 2011 Communication.

²³ See Opinion CON/2009/24, paragraph 3.1, Opinion CON/2009/54, paragraph 2.5.2, Opinion CON/2009/73, paragraph 3.2, Opinion CON/2011/79, paragraph 4 and Opinion CON/2011/85, paragraph 4.

²⁴ For the period ending on 31 December 2011, see the DG Competition Staff Working Document of 30 April 2010 ‘The application of State aid rules to government guarantee schemes covering bank debt to be issued after 30 June 2010’, which referred to the ‘Recommendations of the Governing Council of the European Central Bank on government guarantees for bank debt’ of 20 October 2008; for the period starting on 1 January 2012 see the 2011 Communication.

The ECB understands that implementing rules will expand on the provisions of the Decree-Law²⁵ and expects to be consulted on any proposed implementing legislation to be adopted on matters within its competence²⁶.

3. Interaction of the Decree-Law with the monetary policy of the euro area

The ECB reminds the consulting authority that government guarantees for bank debt should, when implemented: (i) address the funding problems of liquidity-constrained solvent banks by improving the functioning of the market for bank debt of longer-term maturity; (ii) preserve the level playing field among financial institutions and avoid market distortions; and (iii) ensure consistency in the management of Eurosystem liquidity. In this regard, government guarantees for short-term bank debt with a maturity of three to 12 months may be provided to revitalise the short-term bank debt market²⁷. The ECB welcomes that the Decree-Law does not allow government guarantees for bank debt with a maturity of less than three months²⁸.

Moreover, it is also stressed that it is of the utmost importance that support operations conducted by national authorities do not in any way affect the conduct and the implementation of monetary policy in the euro area²⁹. In this context, the ECB reiterates its view that the extension of a State guarantee to cover interbank deposits should be avoided³⁰, as this could entail substantial distortion in the various national segments of the euro area money market by potentially increasing short-term debt issuance activity across Member States, thereby impairing the implementation of the single monetary policy, which is an exclusive competence of the Eurosystem under Article 127(2) of the Treaty³¹. The extension of a State guarantee to cover interbank deposits could also affect the transmission of monetary policy decisions³² and make it difficult to maintain the necessary level playing field in the euro area between the financial institutions benefiting from a State guarantee, on the one hand, and those not benefiting from a State guarantee, on the other hand.

25 See Article 8(33) of the Decree-Law.

26 See the definition of 'draft legislative provisions' in Article 1(1), and also the sixth indent of Article 2(1) of Decision 98/415/EC.

27 See Opinion CON/2009/12, paragraph 3.3, Opinion CON/2009/49, paragraph 3.9 and Opinion CON/2009/73, paragraph 3.1.

28 See Opinion CON/2008/58, paragraph 3.2, Opinion CON/2009/73, paragraph 3.1, Opinion CON/2009/92, paragraph 3.5, Opinion CON/2011/79, paragraph 3 and Opinion CON/2011/85, paragraph 3.

29 See Opinion CON/2009/73, paragraph 3.1 and Opinion CON/2009/92, paragraph 3.5.

30 See Opinion CON/2008/50, paragraph 3.2, Opinion CON/2009/12, paragraph 3.3.2, Opinion CON/2009/49, paragraph 3.9 and Opinion CON/2009/73, paragraph 3.1.

31 See Opinion CON/2008/48, paragraph 3.7, Opinion CON/2009/12, paragraph 3.3.2, Opinion CON/2009/49, paragraph 3.9 and Opinion CON/2009/73, paragraph 3.1.

32 See Opinion CON/2009/12, paragraph 3.3.2, Opinion CON/2009/49, paragraph 3.9 and Opinion CON/2009/73, paragraph 3.1.

4. The role of the Banca d'Italia in managing the scheme and the prohibition on monetary financing

- 4.1 Under the Decree-Law, the Banca d'Italia is closely involved in managing the scheme. First, it will assess the eligibility of the beneficiary institutions with particular regard to their capital adequacy and ability to discharge the obligations assumed³³. Second, it will support the Ministry in ensuring the compliance of the beneficiary institutions with the general conditions for the provision of the guarantees³⁴. In line with its previous opinions³⁵, the ECB reiterates that the functions to be performed by the Banca d'Italia in managing the guarantee scheme need to comply with the monetary financing prohibition as regards the remuneration of the Banca d'Italia for its involvement. Such functions must be conducted in a manner fully compatible with the Banca d'Italia's institutional and financial independence under the Treaty and the Statute of the European System of Central Banks and of the European Central Bank.
- 4.2 The involvement of the Banca d'Italia must not go beyond the traditional task of a fiscal agent and all the guarantees must be financed from the State's budget³⁶. The role of the Banca d'Italia must comply with the monetary financing prohibition in Article 123 of the Treaty, which prohibits overdraft facilities or any other type of credit facility with an NCB in favour of the public sector, including 'any financing of the public sector's obligations vis-à-vis third parties'³⁷. This means in particular that no bridge financing may be provided by an ESCB central bank to enable a Member State to honour its obligations in respect of State guarantees of bank liabilities. Under the Decree-Law, payments of State guarantees are carried out by the Banca d'Italia in its capacity as fiscal agent for the Italian Government. If the normal procedure cannot be followed, Article 8(27) of the Decree-Law provides that the Banca d'Italia will make payments to creditors, to be recorded on a suspense account³⁸ and settled in the following 90 days. The ECB understands that pursuant to Article 5(4) of the Consolidated Law on the public debt³⁹, any payment by the Banca d'Italia in its capacity as government fiscal agent is recorded daily in the Treasury account held by the Government with the Banca d'Italia. According to Article 5(1) of the Consolidated Law, such Treasury account may not have a negative balance, and in general, Article 5(1) of the Consolidated

33 The Banca d'Italia will assess against the following benchmarks: (i) the capital ratios at the date of the last supervisory reporting should not be below minimum requirements; and (ii) income producing capacity should be adequate to meet the guaranteed liabilities. See Article 8(23) of the Decree-Law. In this respect, the Banca d'Italia will benefit from its role as supervisory authority of the banking sector: see Title III, and in particular Article 51 of Legislative Decree No 385 of 1 September 1993 (*Gazzetta Ufficiale* No 230, 30.9.1993).

34 See Article 8(8) of the Decree-Law.

35 See, in particular, Opinion CON/2008/52, paragraph 3.2 and Opinion CON/2008/65, paragraph 3.1.

36 See, e.g. Opinion CON/2008/58, paragraph 4.2, Opinion CON/2008/65, paragraph 3.2 and Opinion CON/2011/76, paragraph 3.1. See also the ECB Annual Report 2010, p.120, and the ECB Convergence Report, May 2010, p. 25.

37 See Article 1(1)(b)(ii) of 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).

38 See Article 8(27) of the Decree-Law.

39 Decree of the President of the Republic No 398 of 30 December 2003 (*Gazzetta Ufficiale* No 57, 9.3.2004, S.O. No 37).

Law prohibits the Banca d'Italia from granting any kind of overdraft facility to the Government⁴⁰. However, the ECB notes that the provisions regarding the suspense account lack some clarity. Thus, for the sake of legal certainty, the ECB recommends regulating more transparently the suspense account, as well as any other sub account of the Treasury account.

5. Emergency liquidity assistance operations collateralised by a State guarantee and the prohibition on monetary financing

The Decree-Law provides for the possibility for the Ministry to provide a State guarantee on discretionary loans made by the Banca d'Italia to Italian banks and to Italian branches of foreign banks in severe liquidity crises (emergency liquidity assistance)⁴¹. The ECB notes that emergency liquidity assistance, granted by the national central bank (NCB) independently and at its full discretion to a solvent credit institution on the basis of a collateral security in the form of a State guarantee, is in principle possible, provided that a number of conditions are met in order to ensure the NCB's compliance with the monetary financing prohibition under Article 123 of the Treaty. As noted in previous opinions, the relevant criteria are the following: (i) it must be ensured that the credit provided by the NCB is as short term as possible; (ii) there must be systemic stability aspects at stake; (iii) there must be no doubts as to the legal validity and enforceability of the State guarantee under applicable national law; and (iv) there must be no doubts as to the economic adequacy of the State guarantee, which should cover both principal and interest on the loans, thus fully preserving the NCB's financial independence⁴².

6. Payment by the Banca d'Italia to the Government of the value of unexchanged lira banknotes

The 2003 Budget Law introduced a regime for the treatment of lira banknotes which have not been exchanged by 28 February 2012. The Ministry and the Banca d'Italia estimated the value of such banknotes and the Banca d'Italia had to pay such estimated amount to the Government in three instalments, amounting to 65% by 28 February 2003, 25% by 31 January 2008 and the residual amount by 31 March 2012. The ECB issued Opinion CON/2002/31 on this matter. The Decree-Law provides that all lira notes still in circulation will be withdrawn in favour of the Treasury with immediate effect and their value allocated to State revenue, thereby bringing forward the withdrawal by three months.

⁴⁰ The ECB understands that the suspense account is an accounting unit used to record payments carried out by the Banca d'Italia with funds withdrawn from the Treasury account, before these amounts are debited to the relevant part of the public administration; i.e. in this case, the Ministry. As a consequence, the ECB also understands that recording a payment in the suspense account is only possible insofar as the payment has been financed with the funds held in the Treasury account and this operation has been duly recorded under this account, and that this does not constitute the provision of a temporary overdraft facility to the Treasury.

⁴¹ One of the specific tools available to central banks in a crisis situation is the provision of emergency liquidity assistance to individual banks. This provision of liquidity assistance consists in giving support in exceptional circumstances and on a case-by-case basis to temporarily illiquid but solvent credit institutions. The extension of emergency liquidity assistance falls within the Banca d'Italia's task of contributing to the stability of the financial system. See the ECB's Financial Stability Review, December 2006, pp.171-172, and the ECB Annual Report 1999, p. 98; see also in particular Opinion CON/2008/42, paragraph 4.10, Opinion CON/2008/46, paragraph 3.1 and Opinion CON/2008/58, in particular paragraph 4.1.

⁴² See Opinion CON/2008/42, paragraph 4.11, Opinion CON/2008/48, paragraph 3.9 and footnote 34 and Opinion CON/2008/58, paragraph 4.3 and in particular footnote 20 referring to Opinion CON/2008/46, paragraph 4.3.

ECB-PUBLIC

In light of the ECB's refinement of the principle of financial independence and the monetary financing prohibition in its opinions and Convergence Report, the ECB notes that the provisions according to which the value of legacy banknotes that have not been exchanged into euro is allocated to State revenue raise concerns for the following reasons. Given that the banknotes denominated in the legacy currency are recorded as a liability on an NCB's balance sheet, the revenue should be determined via the relevant NCB's profit and loss account to safeguard its financial independence. Directly allocating to the State the value of unexchanged banknotes denominated in the legacy currency, outside the calculation of profits, and prior to establishing whether the NCB accumulated any losses that have to be covered, constitutes an intra-year payment in advance of the profit distribution breaching the principle of financial independence⁴³.

Moreover, given that the distribution of central bank profits which have not been fully realised, accounted for and audited does not comply with the monetary financing prohibition⁴⁴, a payment to the State by the NCB of the proceeds from the withdrawal of the banknotes, denominated in the legacy currency in advance of the distribution of the NCB's annual profits, raises concerns with regard to the monetary financing prohibition. Against this background, proper safeguards should be in place to ensure that the revenue from the withdrawal of unexchanged banknotes denominated in the legacy currency is only transferred to the State after any potential losses have been covered.

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

Done at Frankfurt am Main, 24 January 2012.

[signed]

The President of the ECB

Mario DRAGHI

⁴³ See ECB Convergence Report, May 2010, p. 23.

⁴⁴ See ECB Convergence Report, May 2010, p. 25.