BANKA SLOVENIJE

EVROSISTEM

Clarification of the Bank of Slovenia's role in drafting secondary legislation for the Bad Bank

01/31/2013 / Press release

In recent days the media have reported extensively on the drafting of secondary legislation for the creation of a bad bank (the Bank Asset Management Company, the BAMC) in accordance with the Measures of the Republic of Slovenia to Strengthen the Stability of Banks Act (the ZUKSB). Here the media have focused in particular on the commentary and recommendations given by international institutions - the European Commission, the ECB and the IMF - with regard to the activities to date in the drafting of the secondary legislation.

The Bank of Slovenia is working with the Ministry of Finance, which is responsible for drafting secondary legislation on the basis of the ZUKSB, on drafting the secondary legislation setting out the terms and methods for the implementation of individual measures at banks, not only the recapitalisation of the banks, and the transfer of the banks' bad assets and other risks to the bad bank, but also the issue of state guarantees. As early as at the time of discussing the draft ZUKSB, the Bank of Slovenia emphasised that it was vital that the implementation of these measures at the banks be based on the findings of Bank of Slovenia supervision with regard to each bank's ability to meet its supervisory requirements in connection with capital adequacy in accordance with the Banking Act, and that other criteria for implementing measures at the banks would be unjustifiable and would open the door to speculation and moral hazard without addressing the actual problems at the bank in question. In this aspect particular criticism of the arrangements deriving from the ZUKSB has also come from the international institutions, which have also recommended that the legislation be amended as appropriate.

When the ZUKSB was being debated the Bank of Slovenia warned that it does not set out adequate powers for the Bank of Slovenia in the decision-making process for the implementation of measures at banks. Accordingly, the Bank of Slovenia supports the findings of the international institutions that the ZUKSB is deficient in this sense, and consequently the regulation of these issues in the secondary legislation can only be very limited. The Bank of Slovenia will therefore endeavour to ensure that the secondary legislation setting out the terms and methods for the implementation of potential measures at banks provides as far as possible (given the legal framework) for an appropriate role for the Bank of Slovenia in the process of deciding whether it is justifiable to carry out a particular measure at a bank. Here it is important to note that the precept for any action at a bank is the finding by the Bank of Slovenia that the bank requires a capital increase to ensure its capital adequacy. The transfer of the bank's bad assets and other risks (claims and assets that could incur further losses in the future, thereby reducing the value of the investment in a capital increase) to the bad bank or a special-purpose vehicle established by the bank may also be included (although not necessarily) as a specific element in the capital increase process, whether funded by the government or the BAMC. In no instance therefore should the measure of transferring a bank’s claims and other assets to the bad bank be allowed to be carried out as an independent measure; such a transfer should only be carried out as part of the process of bank's recapitalisation to ensure its capital adequacy.

A separate package of secondary legislation is intended to regulate issues regarding the establishment, mandate and operation of the bad bank (the BAMC), and is being drafted by the Ministry of Finance. In these activities to date the ministry has merely outlined its precepts for drafting this legislation, which do not give clear answers to important questions regarding the operation of the bad bank and regarding the fiscal effects. The Bank of Slovenia was not involved in the preparation of these precepts, which the ministry also sent to the aforementioned international institutions for review and assessment. During the legislative process of the ZUKSB, the Bank of Slovenia drew the ministry’s attention to certain key issues, which the international institutions are now also raising. The Bank of Slovenia even drafted a separate proposal of the act regulating the establishment of a special agency responsible for deciding on measures to be taken at banks in light of the requirements of the Banking Act, and could if necessary also decide to establish a special-purpose vehicle to which banks’ claims and other problematic assets could be transferred where this is deemed necessary in the capital increase process. It is our opinion that the arrangements that we have proposed would guarantee the independence and expertise of the agency, and consequently the bad bank, which would focus on issues of bank stabilisation. The numerous criticisms that are now being raised by the international institutions could have been avoided, had there been greater balance and expertise in the debate when the ZUKSB was being adopted. The Ministry of Finance failed to show any willingness to engage in such debate during the drafting process.

The Bank of Slovenia must again state its often-expressed opinion that from the point of view of fiscal effects the most appropriate bank stabilisation measure is a direct capital increase, which would eliminate the problem of the banks’ capital adequacy, while the risk arising from a further deterioration in the credit portfolio could be eliminated via the issue of state guarantees to the banks. A deterioration in the banking system’s credit portfolio and the associated new requirements for capital increases will not be averted merely by segregating certain bad assets from the banks, but only by appropriately rehabilitating the real sector so that it is once again able to repay loans. The rehabilitation of the real sector is the actual problem that the government and the economy must urgently address before or at least simultaneous with the issue of resolving the banks.

Despite the numerous misgivings expressed by the Bank of Slovenia when the ZUKSB was being adopted, and now echoed by the international institutions in connection with the establishment and operation of the BAMC, it supports efforts to establish the institution at the earliest possible juncture, where certain aspects of the operation of the BAMC in the role of bad bank could be left until later. The Bank of Slovenia supports the findings of the international institutions that subsequent activities should aim to elaborate a number of significant circumstances surrounding the establishment of a bad bank, a definition of the assets that could be transferred to the bad bank, and the operation (governance) of the bad bank, taking international good practice and the international institutions’ recommendations into account. However, as explained above, in addition to its role as a bad bank (i.e. assuming and managing the banks’ bad assets and other risks), the BAMC will have other major functions in carrying out stabilisation measures, both in capital increases at banks and in the issue of guarantees to banks for risk-bearing assets, which in the Bank of Slovenia’s opinion is the most suitable and most effective instrument of stabilisation. With regard to the establishment of BAMC functioning as the bad bank, it would be sensible to re-examine and redefine clear guidelines and objectives on the basis of a wide-ranging expert discussion, including analysis of the fiscal effects, and to draft any amendments to the law accordingly.