

The ECB response to the financial markets crisis

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Policy responses of the ECB (I)

- **Liquidity management:**
 - flexibility in terms of liquidity provision (temporary and quantitative, maturity of operations);
 - expanded list of collateral eligible for central bank lending operations;
 - strengthening of cooperation among central banks (e.g. facilitating access to US dollar and Swiss franc liquidity for euro area banks);
 - full-allotment.
- **Emergency liquidity assistance:** liquidity assistance provided by national central banks to illiquid but solvent credit institutions (e.g. Northern Rock).
- **Monetary policy:** interest rate cuts, including the 8 October 2008 coordinated interest rate cut (ECB, FED, Bank of Canada, Bank of England, Sveriges Riskbank, Swiss National Bank).

Policy responses of the ECB (II)

- **Financial stability:**
 - ECB participation in international committees and fora entrusted with the task of restoring market functioning and enhancing the resilience of the financial system.
 - Recommendations of the ECB's Governing Council on government guarantees to banks and on recapitalisation.
 - ECB advisory activity: ECB opinions on draft EU and national legislation related to financial turmoil.

Recommendations of the ECB's Governing Council on government guarantees for bank debt (I)

- **Main objectives of government guarantees:**
 - addressing funding problems of **solvent institutions** by improving the functioning of the market for bank debt of longer term maturities;
 - safeguarding the level playing field among financial institutions in order to avoid market distortions;
 - ensuring consistency with the operational framework of the Eurosystem (relationship with the single monetary policy).
- **Conditions attached to government guarantees:**
 - no guarantees for interbank deposits;
 - conditions other than pricing: capital adequacy requirements, safeguards to ensure that banks provide adequate support to the economy...).

Recommendations of the ECB's Governing Council on government guarantees for bank debt (II)

- **Pricing for guarantees of bank debt with maturities exceeding 1 year:**
 - based on banks' CDS spreads; plus
 - add-on-fee of 50 basis points (operational costs, level playing field considerations).
- **Pricing for guarantees of bank debt with maturities of less than or equal to 1 year: overall flat fee of 50 basis points.**
- **Pricing could be revisited after 6 months to reflect possible changes in market conditions.**

Recommendations of the ECB's Governing Council on the pricing of recapitalisations (I)

- **Main objectives of recapitalisations:**
 - improve the functioning and stability of the banking system;
 - foster an adequate flow of credit to the economy by providing Tier I capital to fundamentally sound institutions (acquisition of preferred or ordinary shares or other hybrid instruments).
- **Conditions attached to State capital:**
 - specific situation of each institution should be taken into account (distinguish between sound and distressed banks, risk factors);
 - effectiveness of recapitalisation measures;
 - interest of taxpayers;
 - level playing fields between institutions;
 - temporary nature of State recapitalisation with incentives to redeem such instruments (banks should be discouraged from maintaining such involvement for an extensive period of time).

Recommendations of the ECB's Governing Council on the pricing of recapitalisations (II)

- **Pricing (required rate of return) for State capital:**
 - **price corridor:**
 - **required rate of return on subordinated debt (lower bound/average required rate of 6%);**
 - **required rate of return on ordinary shares (upper bound/average required rate of 9.3%);**
 - **for preferred shares and hybrid instruments: additional pricing of specific features.**
- **Pricing could be revisited after 6 months to reflect possible changes in market conditions.**

ECB advisory activity (I)

- Article 105(4) of the EC Treaty provides that the ECB shall be consulted:
 - on any *proposed Community act in its fields of competence*;
 - by national authorities regarding any *draft legislative provision in its fields of competence*.
- The ECB issued several opinions on national rescue measures concerning government guarantees, recapitalisation of distressed banks, loans to banks, purchase of banks' assets and deposit guarantee schemes.
- The ECB issued several opinions on draft Community legal acts (e.g. amendments to the Deposit Guarantee Scheme Directive).

ECB advisory activity (II)

- Austria: CON/2008/55
- Belgium: CON/2008/46, CON/2008/50, CON/2008/61, CON/2008/74 and CON/2008/91
- Cyprus: CON/2009/12
- Denmark: CON/2008/54 and CON/2009/6
- Finland: CON/2008/68 and CON/2008/75
- France: CON/2008/56
- Germany: CON/2008/57
- Greece: CON/2008/51 and CON/2008/79
- Hungary: CON/2008/81
- Ireland: CON/2008/44, CON/2008/48, CON/2008/69 and CON/2009/16.
- Italy: CON/2008/58 and CON/2008/65
- Latvia: CON/2008/89, CON/2009/2, CON/2009/10 and CON/2009/11
- Lithuania: CON/2008/66
- Poland CON/2008/80
- Slovenia: CON/2008/76, CON/2008/88, CON/2008/92 and CON/2009/3
- Spain: CON/2008/52, CON/2008/60 and CON/2008/67
- Sweden: CON/2008/59, CON/2008/62

All opinions are available on the ECB's website:
www.ecb.europa.eu

ECB advisory activity (III): highlights

- Common approach and coordination between Member States, in compliance with the Paris Declaration.
- Compliance with Community law, including EU single market principles and financial services legislation, as well as competition and State aid rules.
- Non-discrimination and level playing field:
 - beneficiaries/non-beneficiaries of State support;
 - domestic/subsidiaries of foreign banks;
 - among Member States.

ECB advisory activity (IV): highlights

- **Temporary character of State intervention and exit strategy.**
- **Compliance with the prohibition of monetary financing (Article 101 of the EC Treaty): central banks should not be involved in funding national rescue measures.**
- **Independence of central banks regarding decisions on the provision of emergency liquidity assistance.**

ECB advisory activity (V): highlights

- Interaction with the single monetary policy of the euro area: ensuring consistency with the Eurosystem's liquidity management and its operational framework (exclusion of interbank deposits from the liabilities covered by rescue schemes).
- Prices for State support should be risk-based, market orientated and compliant with the ECB's recommendations.
- Prices and other conditions for State support should help to maintain the level playing field.