BANKA SLOVENIJE
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Government of the Republic of Slovenia
Mr Marjan Šarec, prime minister
Gregorčičeva 20-25
1000 Ljubljana

Re: Open letter to the prime minister with regard to the Bank of Slovenia's position on the bill for the Act on Judicial Relief Granted to Holders of Qualified Bank Credit

Dear Prime Minister,

At the Bank of Slovenia we are aware that the government has begun its discussion of the bill for the Act on Judicial Relief Granted to Holders of Qualified Bank Credit (the ZPSVNIKOB), and that discussions will continue in the next meeting. We were briefed on the first draft of the bill in February by the Ministry of Finance, and also provided our remarks within the framework of the public discussions. Having only been informed after the meeting of the government that our key remark was not taken into account, we are writing to ensure that our views are conveyed to you in person.

Were it to be passed as it stands, the bill on which we were briefed within the framework of the public discussions would breach a fundamental principle of central banking and would have a major impact on the Bank of Slovenia's position. This we had highlighted in the remarks sent to the Ministry of Finance (which we are enclosing for you), while a similar opinion was also expressed by the ECB. We feel that these views urgently need to be taken into account, if the new law, which aims to resolve the position of certain holders of qualified liabilities, is to comply with EU legislation and the constitution.

The key is that the bill introduces the concept of the Bank of Slovenia's objective liability for any deprivation on the part of former holders of qualified liabilities in the event of any difference being identified between the actual treatment of former qualified liabilities during the imposition of extraordinary measures and the treatment that was required on the basis of regulations and established practice. The Bank of Slovenia would be required to refund a difference of any type, irrespective of liability, i.e. even if any deprivation was not the result of unfair or unlawful conduct by the Bank of Slovenia. **The concept of objective liability for the aforementioned deprivation breaches the principle of the prohibition of monetary financing, which is a fundamental principle of central banking on the basis of the TFEU and the Statute of the ESCB and of the ECB.** Under EU law and national law, bank resolution and the financing of resolution measures is a matter for the government, and not the central bank (see Articles 101 and 75 of Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms). The ECB has repeatedly warned of this in a number of opinions, including in the enclosed opinion, which also refers to the bill discussed here (in particular, see point 2.1.2). The ECB notes that "while resolution tasks may be considered to be central banking tasks, provided that they do not undermine an NCB's independence in accordance with Article 130 of the Treaty, the discharge of these tasks by central banks may not extend to the financing of resolution funds or other financial arrangements related to resolution proceedings as these are governmental tasks". The ECB also notes the possibility of using resolution financing arrangements in accordance with Directive 2014/59/EU, and also that Regulation (EU) No 806/2014 of the European Parliament and of the Council envisages that "on the one hand, the resolution fund may be used to pay compensation to shareholders or creditors if, following an evaluation, they have incurred

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greater losses than they would have incurred under normal insolvency proceedings while on the other hand, in the case of non-contractual liability, the Single Resolution Board would compensate for any damage caused by it or by its staff in the performance of their duties. The draft law should establish liability arrangements that clarify that the Bank of Slovenia is not liable to pay compensation for damages in circumstances that would mirror the compensation foreseen under Directive 2014/59/EU and Regulation (EU) No 806/2014 to be paid from resolution financing arrangements to shareholders or creditors when a second independent valuation (carried out after resolution actions have been effected) determines that shareholders or creditors have incurred greater losses than they would have incurred under normal insolvency proceedings, as otherwise the Bank of Slovenia would *de facto* finance measures akin to resolution proceedings. The Bank of Slovenia may not finance a government task."

The ECB also highlights the impact on the financial independence of the Bank of Slovenia that might occur should the law be enacted with its present content, according to which the Bank of Slovenia would be required to cover any difference from its reserves. As the ECB states (in point 2.2 of its opinion), "Member States may not put their central banks in a position where they have insufficient financial resources and inadequate net equity to carry out their ESCB or Eurosystem-related tasks, as well as their national tasks". The independence of the Bank of Slovenia is also constitutionally guaranteed and protected.

Here it should also be noted that all of the aforementioned assessments in procedures conducted by the Bank of Slovenia were drawn up by independent, internationally renowned experts, working closely with the government. It was the government that reviewed the processes and methods for assessing the financial position of banks, working closely with the European Commission, on the basis of the requirements of the ZUKSB at the banks that requested state aid. On this basis it also gave commitments for the approval of state aid in connection with the recognition of losses identified at banks, and with regard to the contribution to the coverage of these losses by former holders of qualified liabilities (through extinction). Because of these commitments, the Bank of Slovenia had to take extraordinary measures by extinguishing the qualified liabilities to enable the requisite recapitalisation of banks via state aid. Any discrepancies that might be found in judicial proceedings by the court on the basis of a new experts' assessment with regard to the banks' financial position and asset values could thus in no way be attributed solely to the Bank of Slovenia's conduct, but would need to be judged primarily within the framework of the procedures to award state aid to banks, which not least were also the direct basis for the use of the measure of extinction within the framework of the extraordinary measures (as a condition for the admissibility of state aid). It is also beyond dispute that any deprivation on the part of the former holders is a direct benefit for the rescued banks (for whom subordinated debt would therefore be written off in a larger amount than would be justified), and thus an indirect benefit for the government, which obtained a participating interest of 100% in these banks as a result of the extraordinary measures in the state aid procedure.

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Deprivation of the former holders would therefore entail the unjustifiable enrichment of the government in its role of shareholder at these banks, and of the banks themselves. The burden of damages in the specific case therefore cannot be imposed upon the Bank of Slovenia without consideration of the benefits that were received by the government and the banks, particularly when it is considered that a fundamental rule of the refunding of damage is restoring the original situation. Given that the recovery was undertaken for the purpose of restoring the stability of the banking system in the country, responsibility for paying refunds for deprivation that had nothing to do with culpability or liability cannot be imposed on the Bank of Slovenia.

It should also be highlighted that the proposer has improperly interpreted the guidance of the Constitutional Court with regard to the refund of the deprivation for former holders (point 120 of the grounds of the decision), when it used the guidance as the basis for justifying arrangements under which the Bank of Slovenia would have to pay damages irrespective of culpability. The Bank of Slovenia does not oppose the former holders being entitled to a refund of this type, should deprivation be established of course (i.e. irrespective of culpability), but the rules applying in the EU and the Constitution of the Republic of Slovenia need to be upheld. Having regard for the principle of independence and the prohibition of monetary financing, the Bank of Slovenia could merely provide for the refunding of the damage that is the immediate consequence of the breach (culpability) on the part of the Bank of Slovenia, as defined in Article 223a of the ZBan-1 and Article 20 of the ZBan-2.

In light of the above, we have submitted a proposal for consideration whereby an assessment of the effects and of the reimbursement of the costs of state aid provided by the Republic of Slovenia is used as the basis for determining the amount of the potential refund to the former holders. The purpose of the state aid in bank resolution was not for the government to become the long-term owner of the banks, but rather for the state aid to be refunded as early as possible, and for normal market conditions to be restored. In the event that an assessment of this type reveals that the state aid was fully refunded by the deadlines to which Slovenia committed itself in the state aid approval procedure (i.e. via the handover of a participating interest, dividend payments and other benefits for the budget), this could constitute a basis for determining a refund for the former holders of qualified liabilities that were extinguished as a result of the extraordinary measures. The assets that could constitute a source for refunds of the damage (BAMC, participating interests in banks) were acquired by the government in the bank recovery process, and not by the Bank of Slovenia. The payment of damages on the grounds of erroneous calculations, irrespective of culpability, was addressed by the EU in Directive 2014/59/EU by means of a special fund.

We also note that in the event that the damage is refunded by the Bank of Slovenia from its reserves, as envisaged by the bill, the costs of the refund would be borne by the state budget. In accordance with the Bank of Slovenia Act, the Bank of Slovenia may not allocate profits to the state unless its reserves reach the prescribed level (the Bank of Slovenia ordinarily reaches this level, and allocates profit to the state budget).

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The prohibition of monetary financing and the independence of the Bank of Slovenia are rules that I must uphold as governor, and I must do everything within my power to ensure that they are enforced. I am nevertheless aware that the issue of the judicial protection of the holders of subordinated liabilities needs to be resolved as soon as possible. This is why at the very beginning of the procedure for drafting the bill the Bank of Slovenia drew attention to the key rules of central banking that need to be upheld. The bill that was drafted in 2017 took account of the issue of the prohibition of monetary financing. Our assessment is that reopening issues that have already been resolved is not in the interest of the speedy adoption of the law, and the rectification of the unconstitutionality. I feel that before the bill is discussed again by the government, I must warn you of the unresolved issues that could potentially hinder its enactment. I therefore propose that these issues be reconsidered. As we have said, there are many potential solutions. I therefore kindly ask that you allow these solutions to be examined, and the disputed issues to be resolved before the approval of the bill at the government meeting.

Yours sincerely,

Boštjan Vasle
Governor

Enclosed:
- Comments on bill of 5 March 2019
- Opinion of ECB of 27 March 2019