EUROPEAN CENTRAL BANK

OPINION OF THE EUROPEAN CENTRAL BANK

of 6 December 2002

at the request of the Italian Ministry for the Economy and Finance on a draft provision on bond conversion under Law No 483/93

(CON/2002/30)

1. On 3 December 2002, the European Central Bank (ECB) received a request from the Italian Ministry for the Economy and Finance for an opinion on a draft provision entitled "Bond conversion under Law No 483/93" (hereinafter "the draft provision"). It is understood that this provision will be inserted in the draft Budget Law, to be approved by the Italian Parliament by the end of this year.

2. The ECB's competence to deliver an opinion is based on Article 105(4) of the Treaty establishing the European Community and the third indent 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 provisions[1], as the draft provision concerns operations having an impact on the Banca d'Italia's balance sheet. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council of the ECB has adopted this opinion.

3. The draft provision concerns a financial transaction that, according to the letter sent by the Ministry for the Economy and Finance, will result in more transparent reporting of the Banca d'Italia's balance sheet and of the liabilities of the Republic of Italy. More specifically, paragraph 1 of the draft provision provides for the possibility that the government bonds referred to in Article 2(1) of Law No 483 of 26 November 1993 can be converted, with effect from 30 December 2002, into other government bonds with an amount of equal market value, subject to terms first being agreed between the Ministry for the Economy and Finance and the Banca d'Italia. Law No 483/93, in order to meet the requirements of the Treaty, prohibited any kind of credit facility by the Banca d'Italia to the Treasury, and introduced a rule according to which the debt account held by the Treasury with the Banca d'Italia had to be converted into government bonds, with an annual 1% interest rate coupon, to be assigned to the Banca d'Italia. This rule was implemented by the Treasury Decree of 15 November 1994, which provided for an issue of Treasury bonds to be specifically assigned to

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1 OJ L 189, 3.7.1998, p. 42.

the Banca d'Italia, in relation to the compulsory conversion of the debt account with the Treasury. The draft provision provides the possibility of converting the above-mentioned government bonds into other government bonds with an amount of equal market value. Such an operation will be effected for the purposes of Article 8(29), of Law No 887 of 22 December 1984, which allows the Treasury Minister to restructure the public debt, through operations bound, *inter alia*, to change the maturity of or to replace bonds. The terms and conditions of such a transaction will be regulated by an *ad hoc* agreement.

4. According to the second paragraph of the draft provision, as from the tax period current at 31 December 2002, the loss resulting from the decrease in value of assets deriving from the above-mentioned conversion shall be fully deductible in annual instalments of amounts not exceeding one-tenth of its total amount. Moreover, the third paragraph allows the Banca d'Italia to cover the said loss of value by using, on a tax-free basis, the funds deriving from the increase in value of gold, as regards the amounts ascertained at 1 January 1999 and still existing at the time of the conversion. The cost of gold accepted for tax purposes is equal to the value entered in the balance sheet, net of the pertinent revaluation account remaining after the conversion. Finally, the fourth paragraph repeals Article 104(1)(b) of the Consolidated Version of the Income Tax Law approved by Decree No 917 of the President of the Republic of 22 December 1986, which concerns the fiscal treatment applicable to the Banca d'Italia's capital gains on gold.

5. The ECB notes that the draft provision provides that the government bonds referred to in Article 2(1) of Law No 483 of 26 November 1993 can be converted into other government bonds with an amount of equal market value subject to the terms first being agreed between the Ministry for the Economy and Finance and the Banca d'Italia. In order to be consistent with Article 108 of the Treaty, any such conversion requires the consent of the Banca d'Italia.

6. Article 101 of the Treaty prohibits monetary financing of Member States by national central banks (NCBs), including the direct purchase from Member States by NCBs of debt instruments. Regarding Article 101, the ECB has considered the conversion of the essentially non-marketable old government bonds currently reflected on the Banca d'Italia's balance sheet into new marketable government bonds with an amount required to be of equal market value.

7. Article 1(2) 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[2] permits the direct purchase from a Member State by an NCB of securities acquired from the Member State to ensure the conversion into negotiable fixed-maturity securities under market conditions of fixed-maturity claims acquired before 1 January 1994 which are not negotiable or not under market conditions, provided that the maturity of the securities is not subsequent to that of the afore-mentioned claims. As noted in the third recital of Regulation (EC) No 3603/93, it is desirable that NCBs should have on their balance sheets claims negotiable under market conditions, in particular

2 OJ L 332, 31.12.1993, p. 1.

to give the required flexibility to the monetary policy of the European System of Central Banks. Assuming that the maturity (i.e., the duration) of the new securities is not longer than that of the old government bonds, the proposed bond conversion would not contradict the said Regulation.

8. From the point of view of financial reporting, the ECB is of the view that the proposed bond conversion would be beneficial, since it would transform non-marketable claims into marketable claims which would contribute to the transparency of the financial statement of the Eurosystem.

9. However, the ECB notes with concern the context of the government debt conversion at this point in time. It notes that the conversion would result in a significant decline of government debt at a time when public debt in Italy is otherwise rising, partly due to insufficient structural fiscal consolidation. Therefore, what should be the primary objective of the conversion, i.e., the redemption of non-marketable debt, could be perceived as being secondary to the objective of a one-off reduction of government debt.

10. The ECB is of the view that it must be carefully assessed whether the debt reduction in conjunction with expected fiscal developments is consistent with the aims of Article 104(2)(b) of the Treaty, which requires the debt ratio to be "…sufficiently diminishing and approaching the reference value at a satisfactory pace".

11. In line with the *Code of best practices on the compilation and reporting of budgetary statistics by Member States* as published by the European Commission, the ECB notes that there should be an examination of the impact of this operation on the government deficit.

12. The ECB would like to emphasise that this opinion may be subject to further review and consideration in light of the agreement to be concluded between the Ministry for the Economy and Finance and the Banca d'Italia.

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

Done at Frankfurt am Main on 6 December 2002.

The President of the ECB

[signed]

Willem F. DUISENBERG