



EUROPEAN CENTRAL BANK

## OPINION OF THE EUROPEAN CENTRAL BANK

of 15 July 2005

**at the request of the Ministry of Finance of the Czech Republic  
on a draft law on the integration of financial market supervisors**

(CON/2005/24)

1. On 31 May 2005 the European Central Bank (ECB) received a request from the Ministry of Finance of the Czech Republic for an opinion on a draft law on the amendment of laws in connection with the integration of financial market supervisors (hereinafter the 'draft law'). The draft law represents the first stage in a broad reorganisation of financial market supervision in the Czech Republic. The draft law amends a number of separate laws<sup>1</sup> and it is proposed that it will enter into force on 1 January 2006 (hereinafter the 'effective date').
2. The ECB's competence to deliver an opinion is based on the first, second, third, fifth 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 provisions<sup>2</sup> as the draft law relates to currency matters, means of payment, a national central bank, payment and settlement systems and also rules applicable to financial institutions that 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.

Integration of financial market supervisors

3. The draft law reorganises financial market supervision in the Czech Republic in several respects. The main change is to reduce the number of financial market regulators from four to two. Under the draft law, both the Office for the Supervision of Cooperative Banks (OSCB) (a separate state supervisory body) and the Office for the Supervision of Insurance and Pension Funds (which forms part of the Ministry of Finance) will cease to exist. Instead, the two regulators will be the Securities Commission, which will be renamed the Financial Market Commission, and Česká národní banka

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<sup>1</sup> The draft law provides for amendments to 27 existing laws including the Act establishing ministries and other central administrative bodies of the Czech Republic No 2/1969 Coll., as amended, the Act on the Securities Commission No 15/1998 Coll., as amended, the Act on Česká národní banka No 6/1993 Coll., as amended (hereinafter the 'ČNB Act'), the Act on insurance No 363/1999 Coll., as amended, the Act on supplementary pension insurance with state contribution No 42/1994 Coll., as amended, the Act on savings and credit cooperatives No 87/1995 Coll., as amended (hereinafter the 'Cooperative Banks Act'), the Act on the financial arbiter No 229/2002 Coll., as amended and the Act on banks No 21/1992 Coll., as amended.

<sup>2</sup> OJ L 189, 3.7.1998, p. 42.

(ČNB). The responsibilities of the Office for the Supervision of Insurance and Pension Funds will pass to the Financial Market Commission. ČNB will be responsible for supervising savings and credit cooperatives (hereinafter ‘cooperative banks’), including their participation in designated payment systems licensed by ČNB under a separate law<sup>3</sup>.

4. The ECB welcomes in principle the changes to the organisation of financial market supervision and oversight in the Czech Republic laid down by the draft law. The streamlining of financial market supervision into just two authorities should prevent inefficient overlaps and create a basis for more efficient supervision over financial institutions and markets in the Czech Republic. In that context, the fact that the responsibility for supervising banks, foreign branches and also now cooperative banks is being placed under one roof within ČNB constitutes a positive development.
5. As set out in the explanatory memorandum accompanying it, the draft law represents the first stage in a broad reorganisation of financial market supervision and oversight in the Czech Republic. During the second stage of this reorganisation, which is intended to take place, at the latest, when the Czech Republic adopts the euro, it is intended to merge the supervisory functions of both ČNB and the Financial Market Commission into a single supervisory authority. The ECB should be formally consulted on this future legislative initiative. However, as it is not clear at this moment whether any future single supervisory authority will be within or outside ČNB, the ECB would already at this stage like to draw attention to the need to ensure that ČNB can perform its tasks smoothly in relation to financial stability and the oversight of payment and securities settlement systems (for the latter, see paragraphs 13 to 15 below).

#### Supervision of cooperative banks

6. Under the draft law, responsibility for the supervision of cooperative banks is assigned to ČNB. While cooperative banks remain governed by specific legislation and do not fall under the legislation governing other banks, they will be supervised largely on the same basis as other banks, for example as regards licence terms, prudential rules and notification obligations. In particular, cooperative banks will be required to observe the same minimum reserve requirements as those applicable to banks and branches of foreign banks. They will also be required to participate in the deposit insurance scheme for banks and to contribute a fixed annual percentage of their deposits to the Deposits Insurance Fund, as banks and branches of foreign banks currently do under the Act on banks. Unlike its powers vis-à-vis banks and branches of foreign banks, however, ČNB will not have statutory powers to impose a regime of enforced administration<sup>4</sup> on a cooperative bank.

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<sup>3</sup> Under the Act on payment systems No 124/2004 Coll. as amended. The ECB notes in this regard that payment systems not licensed by ČNB fall outside the legal regime established by the Act on payment systems and are not therefore regulated by ČNB. ČNB is, however, generally responsible for the ‘reliability and efficiency of payment systems and their development’ pursuant to Article 2(2) c) of the ČNB Act.

<sup>4</sup> Enforced administration is a special regulatory power of ČNB under Articles 26, and 27-33 of the Act on banks enabling it to take over the management of any bank, where shortcomings in the activities of the bank could put at risk the financial stability of the banking system and where the shareholders, in ČNB’s view, have not taken sufficient steps to eliminate those shortcomings.

7. The ECB broadly welcomes the provisions of the draft law pursuant to which ČNB will supervise cooperative banks, as this approach is consistent with ČNB's overall responsibility for the supervision of credit institutions. It is also consistent with the definition of 'credit institution' laid down in the Consolidated Banking Directive<sup>5</sup>, which implicitly includes cooperative banks, as they receive deposits or other repayable funds from the public and grant credits for their own account. The fact that certain regulatory instruments, such as enforced administration, will not be available in relation to cooperative banks is not *per se* of concern, although it should be ensured that all credit institutions are regulated as far as possible on an objective and transparent basis. The regulatory regime applicable to one type of credit institution should not differ fundamentally from that applicable to another, merely because the former is less economically significant than the latter.

#### ČNB's succession to the OSCB's rights and obligations

8. Under the draft law, the basic position is that ČNB will become the OSCB's legal successor from the effective date, whereupon the OSCB's rights, obligations and liabilities arising from property and other legal relations will pass from the OSCB to ČNB<sup>6</sup>. Making ČNB the legal successor to the liabilities of a separate supervisory authority raises issues relating to ČNB's financial independence and its compliance with the prohibition on monetary financing under the Treaty. However, the draft law also lays down certain financial commitments of the Czech State to cover ČNB's potential liabilities in respect of the activities of the OSCB. In particular, the draft law provides that, from the effective date, ČNB will be substituted for the OSCB as a party to any proceedings to which the OSCB is currently a party<sup>7</sup> and that the State will meet any financial obligations incurred by ČNB as a result of it being substituted for the OSCB in any such proceedings<sup>8</sup>.
9. Moreover, the ECB understands that pursuant to the Czech State Liability Act<sup>9</sup> the State is primarily liable for any damage caused by unlawful decision or improper administrative action by a legal entity or person in the course of executing public authority on the State's behalf. The carrying out of supervision clearly constitutes the exercise of a public authority. The entity or person carrying out public authority could be the State (or any organisational unit of the State), ČNB, the OSCB, or any other person provided it has separate legal personality. The ECB therefore

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<sup>5</sup> Article 1(1) of Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions, OJ L 126, 26.5.2000, p. 1. Directive as last amended by Directive 2004/69/EC (OJ L 125, 28.4.2004, p. 44).

<sup>6</sup> Paragraph 4 of Article IX of the draft provisions amending the Cooperative Banks Act. However, the draft law also states that from the effective date any claims and obligations of the OSCB vis-à-vis the State incurred in connection with repayable financial aid provided to the OSCB by the State under the Cooperative Banks Act will pass to the Cooperative Banks Reinsurance Fund. Paragraph 5 of Article IX of the draft provisions amending the Cooperative Banks Act.

<sup>7</sup> Except in the case of proceedings relating to claims of the OSCB vis-à-vis the State incurred in connection with repayable financial aid provided to the OSCB by the State, which pass to the Cooperative Banks Reinsurance Fund and not to ČNB.

<sup>8</sup> Paragraph 6 of Article IX of the draft provisions amending the Cooperative Banks Act.

<sup>9</sup> Act No 82/1998 Coll. as amended, of 17 March 1998, on State liability for damages caused in the course of the exercise of public authority by decisions or improper administrative action ; especially Articles 3 and 13.

understands that, besides the specific financial commitments of the State under the abovementioned provisions of the draft law, the State will remain liable on the basis of the State Liability Act for any damage caused to third parties as a result of any unlawful decision or improper administrative action of the OSCB carried out in the exercise of its public authority. Accordingly, as regards legal proceedings, the State remains liable for settling the financial obligations of the OSCB, irrespective of whether those obligations arise in proceedings initiated before the effective date or thereafter - provided the proceedings concern the OSCB's supervisory activities.

10. The ECB understands that pursuant to the draft law<sup>10</sup> the State will also be required to meet any financial obligations incurred by ČNB arising from non-supervision related proceedings, such as employment relations or liquidation proceedings.
11. Furthermore, in the event that the State pays out damages for an unlawful decision or improper administrative conduct of the OSCB on the basis of its primary obligations under the State Liability Act, the ECB understands that this would not give the State any right of financial recourse against ČNB or any of its officials<sup>11</sup>, in view of the fact that ČNB will not have been involved in any way whatsoever in the supervision of cooperative banks prior to the effective date.
12. The ECB welcomes the abovementioned provisions of the draft law in view of the fact that, in conjunction with the State Liability Act, they appear to insulate ČNB from financial obligations resulting from the OSCB's activities. These provisions do not therefore require assessment from the perspective of ČNB's financial independence and its compliance with the prohibition on monetary financing under the Treaty.

#### Oversight of payment and securities settlement systems

13. The responsibility for oversight of payment and securities settlement systems remains divided under the draft law between ČNB, which oversees payment systems it has licensed<sup>12</sup>, and the Financial Market Commission, which oversees securities settlement systems (SSSs)<sup>13</sup>. While the ECB is aware that this split between the oversight of payment systems and securities settlement systems is not, as such, a new development in the Czech Republic, the ECB would like to take this opportunity to share some observations in this regard.
14. As recalled in previous ECB opinions<sup>14</sup>, oversight is one of the core competencies attributed to the Eurosystem by the Treaty. The oversight of payment systems has always been recognised as one of the main functions of national central banks (NCBs) and the framework for this function, although informal, has been effective and successful. A growing number of NCBs see a benefit in

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<sup>10</sup> Paragraph 6 of Article IX of the draft provisions amending the Cooperative Banks Act.

<sup>11</sup> Pursuant to Articles 16-18 of the State Liability Act. The ECB notes however that a theoretical possibility exists of the State having recourse against a former official of the OSCB, who, upon its dissolution, becomes an employee of ČNB.

<sup>12</sup> Pursuant to the Act on payment systems No 124/2002 Coll.

<sup>13</sup> Pursuant to the Act on trading on the capital markets No 256/2004 Coll.

<sup>14</sup> For example ECB Opinion CON/2003/14 of 7 August 2003 at the request of the Banca d'Italia on a draft regulation on payment systems, payment infrastructures and payment instruments.

formalising their oversight role. The majority of NCBs carry out this function on the basis of their organic laws, without any explicit and detailed legal provisions. Article 105(2) of the Treaty and Article 3.1 of the Statute of the European System of Central Banks and of the European Central Bank provide the legal basis for the Eurosystem's oversight function, together with Article 22 of the Statute, which reads: 'The ECB and national central banks may provide facilities, and the ECB may make regulations, to ensure efficient and sound clearing and payment systems within the Community and with other countries'. Within the Eurosystem, oversight activities are performed by NCBs in line with the common oversight policy, as defined by the Governing Council. This will also apply to ČNB once the Czech Republic adopts the euro. In the meanwhile, it should be recognised that payment systems and SSSs are interlinked given the use of the mechanism of "Delivery versus Payment" systems under which settlements of securities and transfers of funds take place simultaneously. There is therefore a strong argument for the model used in some Member States of integrating the oversight of payment and securities settlement systems, and for the NCB to perform this function. Settlement of both legs of such transactions should be subject to similar safeguards to avoid asymmetries with systemic implications. The role of NCBs in SSS oversight is evident given SSSs' crucial role in the functioning of the financial markets and therefore the need for them to be safe and efficient. The NCBs' oversight responsibilities in the context of safeguarding the effectiveness of monetary policy and the overall stability of the financial system mean that they must ensure that SSSs are sufficiently protected against the transmission of systemic disruptions.

15. The joint work on SSSs by the Committee on Payment and Settlement Systems (CPSS), which serves as a forum for the central banks of the Group of Ten countries (G10), and the International Organization of Securities Commissions (IOSCO) is recognition at the international level of the interest and role of central banks in the oversight of securities settlement systems. At a Community level this is reflected in the joint work of the ESCB and the Committee of European Securities Regulators (CESR) in establishing common standards for EU SSSs.
16. Finally, it should be ensured that ČNB has the power to gain access to all information and data relevant for the performance of its oversight tasks. The opportunity could therefore be taken to state clearly in the draft law the powers conferred on ČNB and the consequences for SSS operators of not complying with its requests.

#### New administrative offences regime in the ČNB Act

17. As a final point, the draft law introduces a number of new administrative offences punishable by fine and increases the fines imposed for committing certain existing administrative offences. In particular, the draft law<sup>15</sup> makes it an offence punishable by a fine of up to CZK 1 million to fail to withdraw counterfeit currency from circulation. Further, the fine for breaching the ban on

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<sup>15</sup> Specifically §§ 46c-46d ('administrative offences') of the draft provisions amending the ČNB Act.

unlawfully reproducing monetary symbols or objects imitating money is increased from CZK 5 000 to CZK 500 000. The underlying intention is to transpose the obligation laid down in several Community regulations to make Member States' sanctions in this area 'effective, proportionate and deterrent'<sup>16</sup>. The ECB welcomes the introduction of new administrative offences and the increases in these penalties, which should have a greater deterrent effect on potential offenders.

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

Done at Frankfurt am Main, 15 July 2005.

*The President of the ECB*

Jean-Claude TRICHET

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<sup>16</sup> Council Regulation (EC) No 1338/2001 of 28 June 2001 laying down measures necessary for the protection of the euro against counterfeiting (OJ L 181, 4.7.2001, p. 6), Council Regulation (EC) No 1339/2001 of 28 June 2001 extending the effects of Regulation (EC) No 1338/2001 laying down measures necessary for the protection of the euro against counterfeiting to those Member States which have not adopted the euro as their single currency (OJ L 181, 4.7.2001, p. 11) and Council Regulation (EC) No 2182/2004 of 6 December 2004 concerning medals and tokens similar to euro coins (OJ L 373, 21.12.2004, p. 1).