



E U R O P E A N C E N T R A L B A N K

OPINION OF THE EUROPEAN CENTRAL BANK

Of 13 January 2006

at the request of Eesti Pank

on a draft decree establishing a procedure to calculate and comply with reserve requirements and draft decree amending Decree No 12 of 12 July 2002 on credit institutions' prudential ratios

(CON/2006/3)

1. On 30 December 2005 the European Central Bank (ECB) received a request from Eesti Pank for an opinion on a draft decree establishing a procedure to calculate and comply with reserve requirements and a draft decree amending Decree No 12 of 12 July 2002 on credit institutions (hereinafter 'draft decrees').
2. The ECB's competence to deliver an opinion is based on Article 105(4) of the Treaty and the sixth 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 provisions¹, as the legislative proposal contains provisions concerning rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets. In addition, under Article 2(2) of Decision 98/415/EC, the authorities of Member States other than participating Member States are obliged to consult the ECB on any draft legislative provisions on the instruments of monetary policy. 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.
3. The main objective of the draft decrees is to take precautionary financial sector policy measures to address the potential risks related to continuing strong credit growth, in particular the brisk increase in home mortgages. In particular, the draft decrees increase the risk weighting from 50% to 100% for all loans secured by mortgages on residential property located in Estonia in the capital adequacy calculation. By repealing a provision in Decree No 12 of 2 July 2002 on credit institutions' prudential ratios, as amended, the risk weighting of 50% (category III) no longer applies to loans secured by first-ranking mortgages on residential property located in Estonia. Instead, these loans will be classified as category IV risks weighted as 100%.
4. In addition, the draft decrees provide that where the risk weighting of the loans secured by first-ranking mortgages on residential property remains below 100% in the calculation of the compulsory reserve requirement for all credit institutions, including the branches of foreign credit

¹ OJ L 189, 3.7.1998, p. 42.

institutions, loans issued with the aim of purchasing and/or renovating housing are to be included in the reserve requirement calculation basis to the extent by which the actually applied risk weighting remains below 100%.

5. The minimum reserve requirement for credit institutions is one of Eesti Pank's main policy instruments. It operates a currency board system under which the Estonian kroon's exchange rate has been fixed against the euro. Due to the currency board arrangement, Eesti Pank does not carry out open market operations.
6. The legal framework underlying the Eurosystem's minimum reserve system is laid down in: (i) Article 19 of the Statute of the European System of Central Banks and the European Central Bank; and (ii) Council Regulation (EC) No 2531/98 of 23 November 1998 concerning the application of minimum reserves by the European Central Bank²; and (iii) Regulation ECB/2003/9 of 12 September 2003 on the application of minimum reserves³; and (iv) relating to the definition and calculation of the reserve base, Regulation ECB/2001/13 of 22 November 2001 concerning the consolidated balance sheet of the monetary financial institutions sector⁴. The purpose of these legal acts, which are directly applicable to and binding on euro area credit institutions, is to ensure that the terms and conditions for the Eurosystem's minimum reserve system are uniform throughout the euro area. In the Eurosystem's framework, reserve requirements primarily pursue the aims of stabilising money market interest rates, and creating or enlarging a structural liquidity shortage. Moreover, reserve requirements are calculated from banks' liabilities, particularly deposits and debt securities issued.
7. The current Estonian minimum reserve system therefore differs quite substantially from the Eurosystem's reserve requirement framework. In its 2004 Convergence Report, the ECB noted that Estonian law does not anticipate Eesti Pank's legal integration into the Eurosystem⁵. The draft decree establishing a procedure to calculate and comply with reserve requirements would further widen the divergence between the two. According to the draft decree, reserve requirements safeguard financial stability by requiring banks to hold liquidity buffers. The draft decree modifies the Estonian minimum reserve system by including banks' assets, i.e. loans secured by mortgages on residential property located in Estonia and hence deviating from a pure liability-based reserve requirement calculation.
8. These significant differences from the legal framework under which the Eurosystem operates will have to be eliminated on adoption of the euro by Estonia. Furthermore, the ECB may have to consider introducing transitional arrangements for the application of the Eurosystem's minimum reserve system for the introduction of the euro in Estonia, as was the case when Greece adopted the

2 OJ L 318, 27.11.1998, p. 1.

3 OJ L 250, 2.10.2003, p. 10.

4 OJ L 333, 17.12.2001, p. 1.

5 Convergence Report 2004, p. 36.

euro on 1 January 2001. This may involve a transitional maintenance period for credit institutions located in Estonia as well as transitional provisions for credit institutions located in other participating Member States.

9. The draft decree establishing a procedure to calculate and comply with the reserve requirement has been drafted on the basis of Article 14(4) of Eesti Pank Act. However, the Decree on the same subject currently in force has been drafted on the basis of Article 14(4) of Eesti Pank Act and Article 80(5) of the Credit Institutions Act, which provides that 'Eesti Pank shall establish the uniform rate of liquid assets to be deposited with Eesti Pank and the procedure for the use of such assets'. Therefore, ECB would welcome a clarification of the legal basis for the draft decree and the relationship with Article 80(5) of the Credit Institutions Act.
10. The ECB notes that Article 9.3 of Appendix 1 of the draft decree establishing a procedure to calculate and comply with reserve requirements does not list all EU Member States. Moreover, under Article 9.4 liquidity portfolio may contain only such debt securities that meet the criteria specified in subsections of Article 9.4. In that context, the draft decree treats the euro area Member States Government's issues differently from the other EU Member States Governments' issues in euro in terms of required minimum credit rating.
11. The ECB would welcome use of terms and concepts derived from Community law in the draft decrees. In particular, Article 9.3, and Articles 9.3.1, 9.4.1 and 9.4.2 of Appendix 1 to the draft decree establishing a procedure to calculate and comply with reserve requirements refer to 'supranational issuers of the EU' and 'euro area countries' instead of 'supranational debt instruments' and 'euro area Member States'.
12. This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 13 January 2006.

[signed]

The President of the ECB

Jean-Claude TRICHET