



OPINION OF THE EUROPEAN CENTRAL BANK

of 2 October 2012

on preparations and legal amendments required for the introduction of the euro

(CON/2012/73)

Introduction and legal basis

On 20 July 2012, the European Central Bank (ECB) received a request from the Latvian Ministry of Finance for an opinion on a draft law on the introduction of the euro (hereinafter the ‘draft law on the euro’), a draft law on amendments to the Law on Latvijas Banka (hereinafter the ‘draft law on Latvijas Banka’) and a draft law on amendments to the Law on prevention of conflict of interests in activities of public officials (hereinafter the ‘draft law on PCI’) (hereinafter collectively referred to as the ‘draft laws’).

The ECB’s competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union and the first, second and third 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 provisions¹, as the draft laws relate to currency matters, means of payment and Latvijas Banka. 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.

1. Purpose of the draft laws

The purpose of the draft laws is to prepare for the introduction of the euro and to ensure the compatibility of Latvian legislation with the Treaty and the Statute of the European System of Central Banks and of the European Central Bank (hereinafter the ‘Statute of the ESCB’), as well as Latvia’s compliance with all adaptation requirements under Article 131 of the Treaty.

1.1 *The draft law on the euro*

The purpose of the draft law on the euro is to ensure that the introduction of the euro in Latvia is done in an efficient and transparent manner. In particular, the draft law determines measures related to the cash changeover, the exchange of non-cash and electronic money and the dual display of prices of goods and services. It also provides for measures for the adaption of accounting practices and the adjustment of financial markets for the introduction of euro, as well as provisions concerning the amendment and enforcement of the law.

¹ OJ L 189, 3.7.1998, p. 42.

1.2 *The draft law on Latvijas Banka and the draft law on PCI*

The draft law on Latvijas Banka addresses a number of issues raised by the ECB and the European Commission in their Convergence Reports² in relation to the Law on Latvijas Banka. In particular, amendments are made to the provisions concerning Latvijas Banka's independence, prohibitions on monetary financing and privileged access and the legal integration of Latvijas Banka into the Eurosystem.

The draft law on PCI addresses a personal independence issue previously identified by the ECB in relation to Article 31 of the Law on Latvijas Banka³. It now clarifies that the Governor, the deputy Governor and members of the Council of Latvijas Banka are only permitted to hold other offices in accordance with laws or international agreements ratified by the Latvian Parliament, Cabinet regulations and order and only if the holding of other offices does not threaten the independence of Latvijas Banka.

2. Observations on the draft law on the euro

2.1 Article 3 of the draft law on the euro provides that the day on which the euro is introduced in Latvia shall be the day on which the Council abrogates the derogation. The ECB notes that this day may not happen to coincide with the day on which the abrogation enters into force. Therefore, Article 3 should be amended to explicitly refer to the entry into force of the abrogation of the derogation.

2.2 In this context, the ECB also notes that Article 44 of the Treaty establishing the European Stability Mechanism (ESM)⁴ (hereinafter the 'ESM Treaty') provides that the ESM Treaty shall be open for accession by other Member States of the EU upon their application for membership⁵. These 'other' Member States are those which have not adopted the euro at the time of signature of the ESM Treaty. Article 44 of the ESM Treaty provides further that the Member State shall file with the ESM its application for membership after the adoption by the Council of the European Union of the decision to abrogate the Member State's derogation from adopting the euro in accordance with Article 140(2) of the Treaty. Article 44 of the ESM Treaty also provides that, following the approval of the application for membership by the ESM's Board of Governors, the new ESM Member shall accede upon deposit of the instruments for accession with the Depository.

3. Observations on the draft law on Latvijas Banka and draft law on PCI

3.1 The ECB welcomes the Latvian government's efforts to achieve the required level of legal convergence and notes that the legal convergence of the amended Law on Latvijas Banka will be

² See the ECB's Convergence Report 2012, p. 237; European Commission Convergence Report 2012, p. 71.

³ See the ECB's Convergence Report 2012, p. 238.

⁴ <http://www.european-council.europa.eu/media/582311/05-tesm2.en12.pdf>.

⁵ Recital 7 of the ESM Treaty states 'All euro area Member States will become ESM Members. As a consequence of joining the euro area, a Member State of the European Union should become an ESM Member with full rights and obligations, in line with those of the Contracting Parties'.

also assessed in the ECB's next Convergence Report. In the meantime, the ECB makes the following observations as regards the central bank independence and legal integration of Latvijas Banka into the Eurosystem.

3.2 *Institutional independence*

The draft law on Latvijas Banka amends Article 43 of the Law on Latvijas Banka concerning the powers of the independent external auditors of Latvijas Banka in a manner compatible with the Treaty. In addition, the ECB notes that Article 43(1) of the Law on Latvijas Banka provides that the Parliament shall supervise Latvijas Banka. The ECB understands that 'supervision' in this context refers to the Parliament's right to ask questions pursuant to the Law on the Rules of Procedure of the Parliament⁶ so as to enhance Latvijas Banka's accountability for its decisions. This is compatible with the principle of institutional independence of Latvijas Banka.

3.3 *Financial independence*

3.3.1 The ECB welcomes the proposed increase of Latvijas Banka's capital. The principle of financial independence requires a national central bank (NCB) to have sufficient means not only to perform its ESCB or Eurosystem-related tasks but also its national tasks e.g. financing its administration and own operations. Such financial independence is assessed from the perspective of whether any third party is able to exercise either direct or indirect influence not only over an NCB's tasks but also over its ability to fulfil its mandate, both operationally in terms of manpower, and financially in terms of appropriate financial resources⁷. In this respect, financial independence primarily implies that an NCB should always be sufficiently capitalised⁸. In particular, the ECB is of the view that the higher the level of capital, reserves and provisions against financial risks is, the higher the safeguards against future losses are. For this reason, an NCB must be free to independently create financial provisions to safeguard the real value of its capital and assets. Furthermore, Member States may not hamper NCBs from building up their reserve capital to a level which is necessary for a member of the Eurosystem to fulfil its tasks⁹. As mentioned in the ECB's Convergence Reports 2010 and 2012¹⁰, any situation should be avoided whereby for a prolonged period of time an NCB's net equity is below the level of its statutory capital or is even negative, including where losses beyond the level of capital and the reserves are carried over. Any such situation may negatively impact on the NCB's ability to perform not only its ESCB or Eurosystem-related tasks but also its national tasks. Moreover, such a situation may affect the credibility of the Eurosystem's monetary policy. Therefore, the event of an NCB's net equity becoming less than its statutory capital or even negative would require that the respective Member State provides the NCB with an appropriate amount of capital at least up to the level of the statutory capital within a

⁶ *Saiemas Kārtības rullis*, "LV", 96 (227), 18.08.1994.

⁷ See the ECB's Convergence Report 2012, p. 26.

⁸ See the ECB's Convergence Report 2012, p. 25; see also Opinion CON/2010/88. All ECB opinions are published on the ECB's website at www.ecb.europa.eu.

⁹ See the ECB's Convergence Report 2012, p. 27; see also, in this regard, Opinion CON/2008/34, paragraph 4.2.

¹⁰ See the ECB's Convergence Report 2010, pp. 21 and 22 and the ECB's Convergence Report 2012, pp. 25 and 26.

reasonable period of time so as to comply with the principle of financial independence. The financial independence of a central bank may also be strengthened by arrangements whereby the operational costs for the discharge of some of the latter's tasks are borne by the entities concerned by such tasks¹¹.

3.3.2 The ECB understands that the competent Latvian authority has closely cooperated with Latvijas Banka in order to determine the level of authorised and paid-up capital to be effectively increased. Such cooperation not only serves to respect Latvijas Banka's financial independence, but it also takes account of the fact that Latvijas Banka is best placed to assess its required level of reserve capital¹².

3.3.3 The ECB welcomes the new wording of Article 18¹(1) of the Law on Latvijas Banka pursuant to which Latvijas Banka transfers parts of its profit to the State budget following the approval of the annual report by the Council of Latvijas Banka and only after covering losses accumulated in the previous years, if any. This reflects requirements arising from the financial independence principle¹³. The ECB also welcomes new paragraph 2 that entitles Latvijas Banka to reduce the percentage share of the payment for the usage of state capital where it is needed to increase the reserve capital of Latvijas Banka in relation to the financial risks it is exposed to when executing its tasks.

3.4 *Personal independence*

3.4.1 The ECB welcomes the reference in Article 22(4) of the Law on Latvijas Banka to Article 14.2 of the Statute of the ESCB as regards the grounds for dismissal of the Governor, the Deputy Governor or a member of the Council of Latvijas Banka. As specified in the ECB's Convergence Reports¹⁴, NCB statutes must ensure that Governors and other members of an NCB's decision making bodies may not be dismissed for reasons other than those mentioned in Article 14.2. The purpose of this requirement is to prevent the authorities involved in the appointment of Governors, particularly the government or parliament, from exercising their discretion to dismiss a Governor.

Under Article 22(4) of the Law on Latvijas Banka, as a precondition for the Latvian Parliament deciding to dismiss the Governor, Deputy Governor or a member of the Council of Latvijas Banka based on serious misconduct (being a ground for dismissal provided by Article 14.2), a national court has to find the relevant official guilty of breaching the law. The ECB acknowledges that under Article 22(4) the court is entitled to rule only on a breach of law by the relevant official but it does not have the power to decide whether the breach of law amounts to serious misconduct. Still, Article 22(4) limits the scope of the Union law concept of 'serious misconduct' to breaches of the law, whereas the conditions for dismissal should not be specified by the national legislator¹⁵. Article 22(4) should either be fully aligned with Article 14.2 or should omit any mention of

11 See Opinion CON/2012/35, paragraph 2.

12 See the ECB's Convergence Report 2012, p. 27; see also Opinion CON/2010/88, paragraph 2.1.

13 See the ECB's Convergence Report 2012, p. 27.

14 See, for example, the ECB's Convergence Report 2012, p. 24.

15 See Opinion CON/2011/38 paragraph 2.1; see also Opinions CON/2012/26 and CON/2012/43.

grounds for dismissal, given that Article 14.2 is directly applicable. Further, the ECB recommends that the procedures, including any court ruling, for the dismissal of the Governor, Deputy Governor or a member of the Council of Latvijas Banka be kept clearly distinct from the substantive provisions on the grounds for dismissal, i.e. in a separate legal provision, to ensure full consistency with the provisions of the Statute of the ESCB.

3.4.2 Personal independence also entails ensuring that no conflict of interest arises between the duties of members of NCB decision-making bodies involved in the performance of ESCB-related tasks in relation to their respective NCBs (and of Governors in relation to the ECB) and any other functions which such members of decision-making bodies may have and which may jeopardise their personal independence. As a matter of principle, membership of a decision-making body involved in the performance of ESCB-related tasks is incompatible with the exercise of other functions that might create a conflict of interest. In particular, members of such decision-making bodies may not hold an office or have an interest that may influence their activities, whether through office in the executive or legislative branches of the state or in regional or local administrations, or through involvement in a business organisation. Particular care should be taken to prevent potential conflicts of interest on the part of non-executive members of decision-making bodies¹⁶. The clarification in the draft law on PCI addresses the ECB's concerns in a way which adheres to the principle of institutional independence. However, national laws, international agreements, national regulations or orders that would permit the Governor and the other members of the Council of Latvijas Banka to combine their office with other offices pursuant to the draft law on PCI may raise concerns as regards their personal independence as referred to in Article 130 of the Treaty. The draft law on PCI should be further amended to clarify that holding other offices may be permitted if it does not pose a threat, not only to the independence of Latvijas Banka, but also to the personal independence of the Governor, Deputy Governor and of the other members of the Council of Latvijas Banka.

3.5 *Legal integration into the Eurosystem*

Article 34(3) of the Law on Latvijas Banka does not recognise the ECB's powers with respect to 'the requirements for euro cash processing systems and the quality requirements for euro banknote processing, as well as the registration and reporting requirements for merchants engaged in cash processing and recycling'. In particular, the ECB considers it essential that any draft legislation implementing Decision ECB/2010/14 on the authenticity and fitness checking and recirculation of euro banknotes¹⁷ does not deviate from its common provisions, unless explicitly provided for in Decision ECB/2010/14¹⁸. Therefore, the Law on Latvijas Banka should provide that such activities are performed in compliance with Union law¹⁹.

¹⁶ See the ECB's Convergence Report 2012, p. 25.

¹⁷ OJ L 267, 9.10.2010, p. 1.

¹⁸ See Opinion CON/2011/94.

¹⁹ See, in particular, Article 6(1) of 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) and Decision ECB/2010/14.

3.6 *Contribution to financial stability*

In accordance with the Eurosystem's role under Article 127(5) of the Treaty to contribute to the smooth conduct of policies pursued by competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system, and taking into account institutional developments, such as the central banks' support to the European Systemic Risk Board²⁰, the ECB is of the view, in line with its stance on this issue²¹, that the task of contributing to the stability of the financial system should be explicitly referred to in the Law on Latvijas Banka²².

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

Done at Frankfurt am Main, 2 October 2012.

[signed]

The President of the ECB

Mario DRAGHI

²⁰ See recital 9 of Council Regulation (EU) No 1096/2010 of 17 November 2010 conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board (OJ L 331, 15.12.10, p.162) and recital 6 of Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board (OJ L331, 15.12.10, p.1).

²¹ See Opinions CON/2004/16, paragraph 5, Opinion CON/2007/31, paragraph 3.1, CON/2010/10, paragraph 2.3, and CON/2012/44, paragraph 2.2.

²² The ECB notes that this reference to the contribution of the central banks to financial stability or the stability of the banking or financial system is provided for in various statutes of NCBs, including the following: Austria: Art. 44b(1) of the Federal Act on the Oesterreichische Nationalbank; Belgium: Art. 12 of the Law establishing the Organic Statute of the National Bank of Belgium; Bulgaria: Art. 2.6 of the Law on the Bulgarian National Bank; Cyprus: Article 6.2 of the Central Bank of Cyprus Laws of 2002 to 2007; Czech Republic: Art. 2(2) of the Act on the Czech National Bank; Estonia: §2(3) of the Eesti Pank Act; Finland: Section 3 of the Act on the Bank of Finland; Hungary: Art. 12 of the Law on the Magyar Nemzeti Bank; Ireland: Section 26(2)(a) of the Central Bank Reform Act 2010; Lithuania: Art. 8(4) of the Law on the Bank of Lithuania; Luxembourg: Art. 2.6 of the Organic law of the Banque centrale du Luxembourg; Malta: Art. 5 of the Central Bank of Malta Act; The Netherlands: Section 3(2) of the Bank Act 1998; Poland: Art. 3 of the Act on the National Bank of Poland; Romania: Art. 2 of the Law on the Statute of the Banca Națională a României; Slovenia: Art. 4(3) of the Banka Slovenije Act; Slovakia: Art. 2(3) of the Act on the National Bank of Slovakia; United Kingdom: Section 2A of the Bank of England Act 1998.