



EUROPEAN CENTRAL BANK

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OPINION OF THE EUROPEAN CENTRAL BANK

of 17 March 2016

on the establishment and operation of immovable property conveyancing organisations

(CON/2016/16)

Introduction and legal basis

On 5 February 2016 the European Central Bank (ECB) received a request from the Cypriot Minister for Finance for an opinion on a draft law establishing and regulating how immovable property conveyancing organisations operate (hereinafter the 'draft law').

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 third indent of Article 2(1) of Council Decision 98/415/EC¹, as the draft law relates to the Central Bank of Cyprus (CBC). 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 law

- 1.1 The purpose of the draft law is to create a new category of institution ('escrow institutions') whose aim is to safeguard the interests of immovable property buyers. The draft law requires any immovable property transfer to be carried out through an escrow institution that provides contract management and immovable property transfer services pursuant to the provisions of the draft law. As noted in the explanatory memorandum accompanying the draft law, escrow institutions will ensure that immovable property transfers will take place as soon as the buyer has fulfilled his contractual obligations. The draft law regulates the terms and conditions governing the licensing and operation of the escrow institutions providing these services. It also entrusts the CBC with authorising, regulating and supervising these institutions.
- 1.2 The draft law addresses the need in Cyprus for title deeds to be issued more quickly, an issue which is being addressed in the framework of the economic adjustment programme for Cyprus.
- 1.3 Under the draft law, only escrow institutions that are incorporated in Cyprus and licensed by the CBC may provide contract management and immovable property transfer services². In addition, the draft law sets out the types of activities that escrow institutions will carry out, as well as the obligations they must meet during the performance of their duties³. Furthermore, the draft law

¹ Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions (OJ L 189, 3.7.1998, p. 42).

² See Article 8(1) and 8(2) of the draft law.

³ See Article 7 and 21 of the draft law.

- defines the CBC's supervisory and regulatory powers with respect to escrow institutions, including the power to take enforcement measures and impose sanctions, and puts in place a comprehensive legal framework that regulates these institutions and the services they provide.
- 1.4 The draft law sets out the application procedure that an escrow institution must go through to obtain authorisation, including the documentation that the applicant institution must submit to the CBC. It also stipulates that the CBC will only grant an authorisation if specific conditions are met. In particular, the CBC must be satisfied that the escrow institution: (a) is in a position to fully comply with the draft law and the CBC directives adopted on the basis of the draft law; (b) has shareholders with the capacity to ensure the organisation's sound and prudent management; (c) has members of its administrative body in good standing with sufficient knowledge, qualifications and experience to carry out their duties; and (d) has no close professional or personal links with any other entity or individual that, in the CBC's opinion, could prevent the CBC from carrying out effective supervision⁴. There are also provisions requiring individuals to notify the CBC of any changes to their special holdings in escrow institutions⁵, which will have to be approved by the CBC. In cases where an individual fails to follow the notification procedure set out in the draft law, the CBC Governor may impose administrative fines of up to one million euro. If the infringement continues, the Governor may impose administrative fines ranging from 200 to 100 000 euro for each day that the infringement continues⁶.
- 1.5 The draft law also sets out: (a) the CBC's supervisory powers over escrow institutions and other supervisory requirements relating to minimum capital requirements; (b) the assessment of the company's management body and key function holders; (c) the procedure for reporting to the CBC; (d) the CBC's access to a company's books and records; (e) the CBC's confidentiality duties; and (f) the imposition of supervisory measures and sanctions by the CBC⁷.
- 1.6 The draft law gives the CBC the power, pursuant to its own directives and guidelines, to: (a) set out procedures to grant, suspend and revoke authorisation for institutions⁸; (b) determine the criteria for measuring the fitness and probity of shareholders, directors and key function holders⁹; (c) regulate the internal organisation and governance of escrow institutions¹⁰ and the fees charged by the institutions for the services they provide pursuant to the draft law and the Law on immovable property contracts and conveyancing¹¹; and (d) to determine the sum insured and the method for determining the sum insured under professional liability insurance as well as the amount of the guarantee against liability as a result of professional negligence¹².

⁴ See Article 8(5) of the draft law.

⁵ See Article 16 of the draft law, which sets out the relevant qualifying thresholds and the procedure for the CBC's approval.

⁶ See Article 16(5) of the draft law.

⁷ See Articles 18 to 23 and 29 to 32 of the draft law.

⁸ See Article 12 of the draft law and Article 31(a) of the draft law.

⁹ See Article 31(b) of the draft law.

¹⁰ See Article 31(c) of the draft law.

¹¹ See Article 31(d) of the draft law.

¹² See Article 31(e) of the draft law.

- 1.7 Finally, the draft law provides that the CBC has the power to require escrow institutions to pay all licensing and supervision costs in accordance with the CBC's directives¹³.

2. General observations

- 2.1 The ECB notes that the aim of the draft law is to provide legal certainty and confidence with regard to the transparency and safety of the sales process in the Cypriot real estate market. These measures will have an impact on the payment of arrears that affect bank balance sheets in Cyprus, which may be indirectly beneficial to preserving financial stability in Cyprus.
- 2.2 By giving the CBC specific regulatory and supervisory authority over escrow institutions, the draft law is primarily aimed at ensuring that these institutions carry out their activities properly that individuals and organisations that purchase real estate in Cyprus are adequately protected.
- 2.3 The ECB underlines that, as regards conferring new tasks on a central bank within the European System of Central Banks (ESCB), it is necessary to assess such a conferral against the prohibition of monetary financing under Article 123 of the Treaty¹⁴. The ECB has developed the guidance set out in paragraphs 2.3.1 to 2.3.3 of this Opinion, in the form of general and specific considerations, on the basis of which it may determine whether a new task conferred on an ESCB national central bank (NCB) is to be considered a central banking task or a government task for the purposes of the monetary financing prohibition. The concrete assessment of whether the CBC's task of supervising escrow institutions should be considered a central banking task or a government task is addressed in paragraph 3.1 of this opinion.

2.3.1 *General considerations*

First, genuinely new tasks, or those tasks that do not form an integral part of the central banking tasks already assigned to an NCB in the past, must be systematically categorised as central banking or government tasks. In recognition of the Member States' diverse legal frameworks, central banking traditions and national set-ups, the tasks currently discharged by an NCB as central banking tasks are not reviewed and re-categorised, but may be reassessed if they are subject to legislative amendments of substance.

Second, the principle of financial independence requires that the Member States may not put their NCBs in a position where they have insufficient financial resources to carry out their ESCB- or Eurosystem-related tasks.

Third, central banking tasks comprise in particular those tasks that are related to the ones listed in Article 127(2), (5) and (6) of the Treaty.

Fourth, new tasks conferred on an NCB that are atypical of NCBs' tasks, or which are clearly discharged on behalf of and in the exclusive interest of the government or of other public entities, should be considered as government tasks.

¹³ See Article 8(7) of the draft law.

¹⁴ See paragraph 2.3 of Opinion CON/2015/22. All ECB opinions are published on the ECB's website at www.ecb.europa.eu.

2.3.2 *Specific considerations*

An important criterion for qualifying a new task as a government task is the impact of the task on an NCB's institutional, financial and personal independence. In particular, the following should be taken into account.

First, it should be assessed whether the performance of the new task will create inadequately addressed conflicts of interests with existing central banking tasks, without necessarily complementing the existing central banking tasks. If a conflict of interest arises between existing and new tasks, there should be sufficient mitigation measures in place to adequately address that conflict. Complementarity between the new task and existing central banking tasks should not, however, be interpreted broadly, as this could lead to the creation of an indefinite chain of ancillary tasks. The assessment of the complementarity of a new task should also take into account the financing of that task.

Second, it should be assessed whether, without new financial resources, the performance of the new task places a disproportionate burden on the financial or organisational capacity of the NCB concerned, and may negatively impact its capacity to properly perform existing central banking tasks.

Third, it should be assessed whether the performance of the new task is aligned with the institutional set-up of the NCB, in particular as regards central bank independence and accountability considerations.

Fourth, it should be assessed whether the performance of the new task entails substantial financial risks.

Fifth, it should be assessed whether the performance of the new task expose the members of the NCB's decision-making bodies to political risks that: (a) are disproportionate; (b) could have an impact on their personal independence, including, in particular the guarantee of the term of office under Article 14.2 of the Statute of the European System of Central Banks and of the European Central Bank.

- 2.3.3 Any final assessment on the qualification of a task given to an NCB as either falling within the scope of central banking tasks or government tasks should be guided by the objective of ensuring that the prohibition of monetary financing within the Eurosystem and the ESCB is consistently applied, to the extent that it applies to its members.

3. **Specific observations**

3.1 *Conferring the task of supervising escrow institutions on the CBC*

The draft law designates the CBC as the supervisory authority for escrow institutions. This broadens its current functions and activities, which include supervising the activities of authorised credit institutions, including asset management activities¹⁵ and other financial institutions, and

¹⁵ In accordance with Article 6(2)(d) of the Laws of 2002 to 2007 on the Central Bank of Cyprus, the CBC exercises supervision of banks. Banks are allowed to provide asset management services by virtue of item 11 in Annex IV to the Laws of 1997 to 2015 on the business of credit institutions.

ensuring the stability of the financial system¹⁶. In the light of the guidance set out in paragraphs 2.3.1 to 2.3.3, it must be assessed whether the CBC's new task constitutes a breach of the prohibition of monetary financing.

3.1.1 *Principle of financial independence*

The principle of financial independence requires NCBs to have sufficient means to carry out not only their ESCB-related tasks, but also their national tasks, from an operational and financial perspective¹⁷. Further, when allocating specific non-ESCB-related tasks to the NCBs, additional staff and financial resources must also be allocated so that these tasks can be carried out in a manner that will not affect the NCBs' operational capacity to perform their ESCB-related tasks¹⁸. In this regard, the draft law provides that the CBC has the power to require that escrow institutions pay all the costs related to their licensing and supervision in accordance with the CBC directives¹⁹, so as to safeguard the CBC's financial independence.

3.1.2 *Links to tasks listed in Article 127(5) of the Treaty*

Supervision over escrow institutions can be considered a task that is primarily designed to provide legal certainty and confidence with regard to the transparency and safety of the sales process in the Cypriot real estate market. Escrow institutions can further improve the payment of arrears of buyers and sellers of immovable properties, thus affecting the balance sheets of banks, which could indirectly assist in preserving financial stability in Cyprus. However, the ECB does not consider that the CBC's tasks of supervising escrow institutions is related to the financial stability and prudential supervisory tasks referred to in Article 127 (5) of the Treaty, or that it complements the CBC's supervision of financial institutions or the CBC's task of ensuring the stability of the financial system²⁰.

3.1.3 *Atypical tasks*

Currently, escrow institutions do not exist in other Member States; as such, the supervision of such institutions is not assigned to any other ESCB member. The ECB considers this new task to be completely atypical for an NCB.

3.1.4 *Discharge of tasks on behalf of and in the exclusive interest of the government or of other public entities*

The CBC is designated as the sole supervisory authority of escrow institutions. Ensuring that these institutions carry out their functions properly and that immovable/real property buyers are adequately protected are public policy objectives which do not fall within the objectives of a central bank. As such, the draft law is considered as conferring on the CBC a task that is exercised in the exclusive interest of the government and of other public entities. The performance of this task by the CBC raises issues of central bank independence and accountability, in particular with regard to

¹⁶ Article 6(2)(e) of the Laws of 2002 to 2007 on the Central Bank of Cyprus.

¹⁷ See the ECB's 2014 Convergence Report, p. 25.

¹⁸ See, for example, paragraph 3.1.2 of Opinion CON/2016/6.

¹⁹ See Article 8(7) of the draft law.

²⁰ Article 6(2)(e) of the Laws of 2002 to 2014 on the Central Bank of Cyprus.

the CBC assuming accountability in the governance of the sometimes contentious area of real estate transactions.

3.1.5 *Extent to which the performance of the new task is aligned with the institutional set-up of the CBC*

The task conferred on the CBC by the draft law does not appear to fit into the institutional set-up of the CBC. The different nature of this new task, compared to those that are currently exercised by the CBC, means that it could not be readily assimilated into any of the CBC's existing departments.

3.1.6 *Extent to which the performance of tasks is proportionate to the CBC's financial and operational capacity and its ability to perform its ESCB-related tasks*

As noted in paragraph 3.1.1, the draft law provides for the CBC's costs for licensing and supervising escrow institutions to be covered by such institutions. However, conferring this task on the CBC raises questions concerning the CBC's operational capacity. The CBC would need to ensure that it has the necessary staff with the appropriate skills that are considered essential for the supervision of these institutions. The CBC would also need to ensure that its capacity to perform its ESCB-related tasks and existing supervisory functions would not be affected by the assumption of these new tasks.

3.1.7 *Extent to which the performance of tasks entails substantial financial risks*

The draft law contains provisions excluding or limiting the CBC's liability, as well as the liability of any CBC director or officer, for any act or omission committed during the exercise of powers and responsibilities vested in the CBC – either as a result of the draft law or as a result of any regulations issued pursuant to the draft law – unless such an act or omission was not carried out in good faith or was the result of gross negligence²¹. The CBC's liability under the draft law is aligned with the liability concerning its supervision of credit institutions.

3.1.8 *Conclusion*

The new task of supervising escrow institutions, and thereby protecting purchasers of immovable/real property, serves public policy objectives that fall outside the objectives of a central bank. This task is also atypical for an ESCB member and does not complement the CBC's existing supervisory or financial stability functions. For these reasons, this task is not considered by the ECB to be a central banking task, and its conferral on the CBC thus raises issues of central bank independence and accountability, particularly since the task concerns the sometimes contentious nature of real estate transactions.

It is acknowledged that requiring supervised escrow institutions to finance the new supervisory function will have a positive impact on the CBC's financial capacity to assume the new task. In addition, it appears that no substantial financial risks are presented since the CBC's liability under the draft law is aligned with its liability concerning its supervision of credit institutions. However, conferring the new task on the CBC raises questions regarding the CBC's operational capacity to perform the task. The CBC would need to ensure that it has the necessary staff, with appropriate

²¹ See Article 30 of the draft law. See also Principle 2 of the principles established by the Bank for International Settlements, setting out that the supervisor and its staff should be protected against lawsuits for actions taken and/or omissions made while discharging their duties in good faith.

skills, to supervise escrow institutions and ensure that its capacity to perform its ESCB-related tasks and existing supervisory functions would not be affected. In view of these considerations, the ECB wishes to express considerable concern about the proposed assignment of this task to the CBC.

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

Done at Frankfurt am Main, 17 March 2016.

[signed]

The President of the ECB

Mario DRAGHI