



EUROPEAN CENTRAL BANK

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OPINION OF THE EUROPEAN CENTRAL BANK

of 28 October 2016

on amendments to the Law on Hrvatska Narodna Banka

(CON/2016/52)

Introduction and legal basis

On 4 October 2016 the European Central Bank (ECB) received a request from the Ministry of Finance of the Republic of Croatia for an opinion on draft amendments to the Law on Hrvatska Narodna Banka (hereinafter the 'draft law')¹.

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/EC², as the draft law relates to Hrvatska Narodna Banka (HNB). 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 draft law enables the State Audit Office to perform an annual audit of the business operations of HNB, in addition to the existing audit of prepared financial statements and overall operations performed by independent external auditors. In particular, the draft law proposes that the State Audit Office will carry out an audit of the efficiency of HNB's business operations in line with the regulations governing the working methods of the State Audit Office and in compliance with the provisions of the Law on HNB. Under the draft law this audit of HNB's business operations will imply: (a) verification of documents, deeds, reports, internal control systems, and accounting, financial and other procedures and other records for the purpose of expressing an opinion as to whether HNB's annual financial statements are prepared in accordance with the applicable financial reporting and legal framework; (b) a procedure for the evaluation of whether activities, financial transactions and information are in all relevant regards in line with the applicable regulations governing HNB's business operations; (c) a procedure for the evaluation of whether HNB's programmes, projects and activities are realised efficiently, in accordance with the principles of effectiveness, efficiency and purposefulness; and (d) an evaluation of other tasks and

¹ The ECB has adopted its opinion based on the proposed draft law (as proposed by the Ministry of Finance) sent for consultation, but also taking into account the explanatory memorandum accompanying the draft law submitted to the Croatian Parliament by a group of Members of Parliament on 14 October 2016, published on the Croatian Parliament's website, see www.sabor.hr.

² 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).

procedures that the State Audit Office deems relevant for the preparation of its report on the business operations of HNB.

- 1.2 The draft law provides that HNB will be obliged to make available to an authorised state auditor all requested documentation and information for the purpose of performing an audit, and to make it possible for an authorised state auditor to have an insight into classified documents for the purpose of performing an audit. The draft law specifies that authorised state auditors may use such documentation and information only for the purpose of performing an audit, and that the State Audit Office shall have to ensure the confidentiality of information and documents received in this respect.
- 1.3 The draft law requires the Governor of HNB to submit, within eight days after receiving the draft report, to the State Audit Office a response to the facts described in the draft report. Thereafter the report on the performed audit, including the Governor's response, is required to be delivered to the Governor. The Governor may raise an objection to the report within eight days. The Chief State Auditor is required to decide on the Governor's objection within 30 days. The report on the performed audit of HNB will be published and the Governor is required to deliver, within 60 days, to the State Audit Office, a written response on the measures taken pursuant to the findings of the audit.
- 1.4 The draft law clarifies that, regardless of the provisions of the regulations governing the working methods of the State Audit Office, the State Audit Office will have no power to propose a dismissal of any member of the Council of HNB.
- 1.5 The draft law clarifies that the audit performed by the State Audit Office will be completely separate from the audit carried out by independent external auditors selected in line with the provisions of the Law on HNB.
- 1.6 The draft law contains a number of specific provisions concerning the tasks of HNB relating to the European System of Central Banks (ESCB). In particular, the draft law provides that, within the framework of the audit of business operations, the State Audit Office will not evaluate the activities referring to the realisation of goals and the execution of tasks established by the Treaty, the Protocol on the Statute of the European System of Central Banks and of the European Central Bank (hereinafter the 'Statute of the ESCB') and the Law on HNB. The draft law further provides that the findings of the audit will not refer to the tasks of HNB relating to the ESCB. It also provides that the State Audit Office may be granted an insight into confidential data referred to in Article 37 of the Statute of the ESCB, in line with the rules of the ESCB.
- 1.7 In addition to the provisions concerning the State Audit Office, the draft law requires HNB, once a year, to submit to the Croatian Parliament (a) semi-annual information about the financial condition, the level of price stability achieved and the implementation of monetary policy; and (b) an annual report on its performance and business operations. The draft law further provides that the Croatian Parliament has to discuss these documents, and vote for or against their adoption. The explanatory memorandum accompanying the draft law further clarifies that these documents will be discussed at the Plenary Session of the Croatian Parliament, and voted on in terms of the acceptance or non-acceptance thereof. The explanatory memorandum also emphasises that during the discussion on

these documents in the Croatian Parliament, in line with HNB's independence, the independence enjoyed by the members of the HNB bodies in charge of decision-making must not be brought into question, nor will the discussion have any impact on it, and that the special status of the Governors must be respected in terms of their membership in the ECB General Council. The explanatory memorandum further states that, at the same time, HNB and the Croatian Parliament must respect the confidentiality requirements that flow from the Statute of the ESCB.

- 1.8 Finally, the draft law reduces the permissible number of six-year terms of office of members of the HNB Council to no more than two (at present it is possible to serve additional terms without restriction), while introducing transitional arrangements for the existing members of the HNB Council. In particular, the draft law provides that members of the Council who are appointed on the basis of the current Law on HNB will continue to be members of the Council until the expiry of their terms of office.

2. General observations

- 2.1 The purpose of the draft law is similar to that of a previous legislative initiative on which the ECB issued Opinion CON/2016/33³, which was not adopted by the Croatian Parliament. On this occasion the draft law is more detailed than the previous legislative initiative, and seeks in certain respects to respond to the ECB Opinion.
- 2.2 The explanatory memorandum accompanying the draft law states that the Law on the State Audit Office will also be amended so that it allows the State Audit Office to perform the audit of HNB's business operations. At this point no draft legislation to this effect has been submitted to the ECB for consultation. Should the Law on the State Audit Office be amended at a later date as suggested in the explanatory memorandum, the ECB reminds that it should be consulted on such amendments.

3. Specific observations

3.1 *State Audit Office's audit of HNB*

- 3.1.1 As noted in the ECB Opinion CON/2016/33⁴, the principle of institutional independence referred to in Article 130 of the Treaty and Article 7 of the Statute of the ESCB refers to the fact that the exercise of central bank powers and the performance of the tasks and duties conferred on central banks must not be subject to external instructions or government influence. In particular, where a national central bank's (NCB's) operations are subject to the control of a state audit office or similar body charged with controlling the use of public finances, the scope of the control (a) should be clearly defined by the legal framework; (b) should be without prejudice to the activities of the NCB's independent external auditors to examine all books and accounts of the NCB⁵ and, further, in line with the principle of institutional independence; (c) should comply with the prohibition on giving instructions to an NCB and its decision-making bodies; and (d) should not interfere with the NCB's

³ See Opinion CON/2016/33. All ECB opinions are published on the ECB's website at www.ecb.europa.eu.

⁴ See paragraph 2.1.1 of Opinion CON/2016/33.

⁵ For the activities of the independent external auditors of the NCBs see Article 61 of the Law on HNB.

ESCB-related tasks⁶. The state audit should be conducted on a non-political, independent and purely professional basis⁷.

- 3.1.2 By establishing rules on the scope of the audit of HNB, the draft law seeks to take into account the principle of central bank independence and the related requirements and safeguards referred to in paragraph 3.1.1. However, the draft law is in this respect unclear, contradictory and fails to satisfy these requirements and safeguards in a number of important respects.
- 3.1.3 *First*, the scope of the State Audit Office's control of HNB's operations is not clearly defined by the legal framework. In particular, the draft law excludes from the scope of the audit activities related to the realisation of goals and the execution of tasks established by the Treaty⁸, the Statute of the ESCB and the Law on HNB. However, in its other provisions⁹, the draft law broadens the scope of the audit to include *inter alia*, the procedure of evaluation whether programmes, projects and activities of HNB are realised efficiently and whether activities, financial transactions and information are in any relevant aspect in line with the regulations governing the business operations of HNB. The exclusion from the scope of the audit of HNB's activities referring to the realisation of goals and the execution of tasks under the Law on HNB would seem, literally read, to have the consequence of excluding all of HNB's activities pursuant to the Law on HNB from the scope of the State Audit Office's audit. Since this does not appear to be consistent with the manifest intention of the draft law and more importantly with a number of its proposed provisions as described above, the coexistence of such provisions which on the one hand exclude some activities and on the other they seem to include them casts legal doubt on the precise scope of the audit by the State Audit. Moreover, the proposed 'evaluation of other tasks and procedures'¹⁰ grants undefined powers to the State Audit Office in respect of its choice as to what it deems relevant for the preparation of its report on HNB's business operations.
- 3.1.4 *Second*, the scope of the State Audit Office's control of HNB's operations, as proposed by the draft law, is not without prejudice to the activities of HNB's independent external auditors to examine all HNB's books and accounts. The draft law states that the audit of business operations will imply the verification of, *inter alia*, accounting, financial and other procedures and other records for the purpose of expressing opinions whether HNB's annual financial statements are prepared in accordance with applicable financial reporting and legal requirements. In this respect, the ECB notes that the task of evaluating HNB's financial statements belongs to the independent external auditors¹¹. The draft law should be adapted so that the State Audit Office may not verify or express opinions regarding the HNB's financial statements, since this may interfere with the work of HNB's independent external auditors who, given their independence and expertise, are better placed than a State body to audit the financial statements of an NCB. In addition, a duplication of opinions regarding HNB's financial statements may negatively affect the credibility of HNB's accounts.

6 See the ECB's Convergence Report, June 2016, pp. 26-27 and Opinions CON/2011/9 and CON/2011/53. All ECB convergence reports are published on the ECB's website at www.ecb.europa.eu.

7 See the ECB's Convergence Report, June 2016, pp. 26-27.

8 See Article 61.a(3) of the draft law.

9 See Article 61.a(2) of the draft law.

10 See Article 61.a(2) fourth indent of the draft law.

11 See Article 61 of the Law on HNB.

- 3.1.5 *Third*, in line with the principle of institutional independence, the draft law could usefully clarify the need to comply with the prohibition on giving instructions to HNB and its decision-making bodies. In particular, the provision of the draft law that requires HNB to deliver a written response on the measures taken pursuant to the findings of the audit should not amount to a requirement of HNB to receive instructions from the State Auditor¹².
- 3.1.6 *Fourth*, the scope of the State Audit Office's control of HNB's operations should not interfere with the HNB's ESCB-related tasks. As noted in paragraph 3.1.3, it is legally uncertain whether the HNB's ESCB-related tasks are excluded from the scope of the State Audit Office's audit of business operations. Moreover, although the provisions of the draft law purport to prohibit the State Audit Office from evaluating the activities referring to the realisation of ESCB-related goals and the execution of ESCB-related tasks and from making audit findings relating to HNB's ESCB-related tasks, the draft law specifically provides that the State Audit Office may be granted an insight into confidential data referred to in Article 37 of the Statute of the ESCB. This seems to imply that the State Audit Office would have the right to examine HNB's ESCB-related activities but not to evaluate and make audit findings in respect of them. It is difficult to understand what purpose would be served by such examinations by the State Audit Office in circumstances where the State Audit Office would be unable to make any evaluations or findings as a result of such examinations. The ECB would therefore welcome the exclusion of HNB's ESCB-related tasks from the scope of the State Audit Office's audit of business operations, since this should clearly ensure that the audit would not interfere with HNB's ESCB-related tasks.
- 3.1.7 Regarding confidentiality requirements in particular, Article 37 of the Statute of the ESCB requires the members of the governing bodies and the staff of NCBs, even after their duties have ceased, not to disclose information of the kind covered by the obligation of professional secrecy. The primacy of Union law and the rules adopted thereunder means that national laws on access by third parties (such as the State Audit Office) to documents may not lead to infringements of the ESCB's confidentiality regime. The access of a state audit office or similar body to an NCB's information and documents must be limited and must be without prejudice to the ESCB's confidentiality regime to which the members of NCBs' decision-making bodies and staff are subject¹³. Hence, access by the State Audit Office to HNB's confidential information must be limited to that which is strictly necessary for the performance of the state auditor's tasks. Such access must also be without prejudice both to HNB's independence and to the ESCB confidentiality regime, to which the members of HNB's decision-making bodies and staff are subject. In addition, the relevant provisions in the draft law should be amended to stipulate that the State Audit Office must safeguard the confidentiality of information and documents disclosed by HNB to the same extent as the professional secrecy provisions applied by HNB¹⁴.

3.2 *Croatian Parliament's vote on HNB's semi-annual information and annual report*

- 3.2.1 While the explanatory memorandum emphasises that the independence enjoyed by the members of the HNB bodies in charge of decision-making must not be brought into question during the

¹² See for example paragraph 2.2 of Opinion CON/2016/24.

¹³ See the ECB's Convergence Report, June 2016, p. 27.

¹⁴ See the ECB's Convergence Report, June 2016, Chapter 7.5.3.

discussion on HNB's annual report and other documents in the Croatian Parliament, and that the special status held by the Governors must be respected in terms of their membership in the ECB General Council, and that the Croatian Parliament must respect the confidentiality requirements flowing from the Statute of the ESCB, the ECB understands that the contents of the explanatory memorandum have no legal standing in Croatian law, but constitute mere statements as to the authors' intentions, without providing any statutory or legal guarantees. In addition, the ECB notes that these intentions are not reflected in the draft law.

- 3.2.2 While the draft law does not explicitly clarify the precise implications of the Croatian Parliament's vote on HNB's annual report and semi-annual information regarding HNB's financial condition, the level of price stability achieved and monetary policy implementation, the reference in the draft law to the Croatian Parliament voting for or against the adoption of them seems to imply that the adoption of HNB's annual report and semi-annual information on HNB's financial condition, the level of price stability achieved and monetary policy implementation is contingent on a positive vote of the Croatian Parliament.
- 3.2.3 As the ECB stated in its Opinion CON/2016/33, in line with the principle of institutional independence under Article 130 of the Treaty and Article 7 of the Statute of the ESCB, the NCBs and the members of their decision-making bodies are prohibited from seeking or taking instructions from Union institutions, bodies or agencies, from any government of a Member State or from any other body. In addition, the governments of the Member States are prohibited from seeking to influence the members of the NCBs' decision-making bodies whose decisions may affect the fulfilment of the NCBs' ESCB-related tasks. If national legislation mirrors Article 130 of the Treaty and Article 7 of the Statute, it should reflect both prohibitions and not narrow the scope of their application.
- 3.2.4 Furthermore, the rights of third parties to approve, suspend, annul or defer an NCB's decisions are incompatible with the Treaty and the Statute as far as ESCB-related tasks are concerned¹⁵. Therefore, the Croatian Parliament's competence to vote on and adopt HNB's annual report on its activities and semi-annual information regarding HNB's financial condition, the level of price stability achieved and monetary policy implementation would affect HNB's institutional independence, as it goes beyond the transparency and accountability obligation of a central bank towards a national Parliament. As regards the compatibility of a dialogue between NCBs and third parties with central bank independence, the ECB refers to paragraph 2.2.3 of Opinion CON/2016/33, which clarifies that such a dialogue is welcome and compatible with central bank independence provided that (a) this does not result in interference with the independence of the members of the NCB's decision-making bodies; (b) the special status of Governors in their capacity as members of the ECB's General Council is fully respected; and (c) confidentiality requirements resulting from the Statute of the ESCB are observed. A decision of the Croatian Parliament whether to adopt the abovementioned annual report and semi-annual information seems to imply that the Croatian Parliament could give direct or indirect instructions to HNB and its decision-making bodies and members, for example as regards amending HNB's annual report or

¹⁵ See the ECB's Convergence Report, June 2014, p. 22.

challenging HNB's assessment regarding price stability and the implementation of monetary policy. Any right of the Parliament to approve, suspend, annul or defer HNB's decisions would be contrary to HNB's institutional independence under the Treaty and the Statute of the ESCB¹⁶.

3.3 *Reduction of the number of terms of office of HNB's Governor and the other members of HNB's Council*

3.3.1 The ECB welcomes the introduction of a provision in the draft law which explicitly guarantees that, notwithstanding that the members of the HNB's Council may henceforth only be appointed to a maximum of two terms of office, the current members of HNB's Council who have been appointed on the basis of the existing provisions of the Law on HNB will continue to be members until the expiry of their terms of office.

3.3.2 The ECB notes that the explanatory memorandum accompanying the draft law published on the web-pages of the Croatian Parliament states that these provisions of the draft law will not be applied retroactively and that the current members of the Council of HNB, as well as the persons who were members previously, will be able to be members in the future¹⁷. As previously noted¹⁸, the ECB shares this understanding, in accordance with the principles of the rule of law, legal safety, legal predictability and legal certainty under the Croatian Constitution, that the requirement that members of HNB Council may be appointed for a maximum of two terms of office does not apply in respect of terms which were served before the date the draft law comes into effect¹⁹. This implies that the current and past members of HNB Council will be able to serve two terms in the future, and that terms served in the past are not included and do not count towards the calculation of the limitation of two terms. For the sake of legal certainty, and taking account that the explanatory memorandum has no legal standing as a matter of Croatian law, an express provision could be usefully added to the text of the draft law, so that the members of the Council of HNB have a clear understanding as to the maximum number of terms of office which they may serve.

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

Done at Frankfurt am Main, 28 October 2016.

[signed]

The President of the ECB

Mario DRAGHI

¹⁶ See paragraphs 3.5, 3.6 and 3.7 of Opinion CON/2008/31.

¹⁷ See explanatory memorandum accompanying the draft law submitted to the Croatian Parliament by a group of Members of Parliament on 14 October 2016, published on web-pages of the Croatian Parliament; see www.sabor.hr

¹⁸ See paragraph 2.3.2 of Opinion CON/2016/33.

¹⁹ See the Decision of the Constitutional Court of the Republic of Croatia U-III-930/2015, 31 March 2015.