



EUROPEAN CENTRAL BANK

EUROSYSTEM

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ECB-PUBLIC

OPINION OF THE EUROPEAN CENTRAL BANK

of 11 May 2018

on the governance and financial independence of the Central Bank of Cyprus

(CON/2018/23)

Introduction and legal basis

On 8 February 2018 the European Central Bank (ECB) received a request from the Ministry of Finance of the Republic of Cyprus for an opinion on a draft law amending the Central Bank of Cyprus Law of 2002¹ (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/EC², 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 draft law introduces amendments to the Central Bank of Cyprus Law of 2002 (hereinafter the 'CBC Law') in respect of (a) the governance structure of the CBC; (b) the provisions relating to the independence of the directors of the CBC; and (c) the capital of the CBC and its alteration. The draft law also contains a provision that removes the task of managing public debt from the CBC, as this function is performed by the Public Debt Management Office (Γραφείο Διαχείρισης Δημόσιου Χρέους) pursuant to the Law of 2012 on public debt management³.

1.2 *The CBC's governance structure*

1.2.1 The explanatory memorandum for this opinion notes that the draft law reorganises the governance of the CBC with a view to rendering it more efficient and effective. The draft law establishes a new decision-making body, the executive committee, comprised of the governor, the deputy governor and two executive directors. The composition of the board of directors remains as it is, consisting of the governor, the deputy governor, two executive directors and five non-executive directors.

1.2.2 The draft law redefines the duties of the CBC's decision-making bodies in order to reflect the new governance structure. In particular, the board of directors is responsible, *inter alia*, for (a) oversight of the CBC's administration; (b) defining the CBC's strategy, except for matters falling within the

¹ Ο περί της Κεντρικής Τράπεζας της Κύπρου Νόμος του 2002 (Ν. 138(I)/2002).

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).

³ Ο Περὶ τῆς Διαχείρισης τοῦ Δημόσιου Χρέους Νόμος τοῦ 2012 (Ν. 195(I)/2012).

fields of competence of the European System of Central Banks (ESCB), the competence of the ECB pursuant to Council Regulation (EU) No 1024/2013⁴, and the competence of the Single Resolution Board (SRB) pursuant to Regulation (EU) No 806/2014 of the European Parliament and of the Council⁵; (c) the approval of the CBC's budget, annual accounts and financial statements; and (d) the organisation of the CBC, including the general framework establishing the powers and duties of the CBC's employees, the framework for the appointment, promotion and disciplinary procedure of the CBC's employees and the internal procedures of the CBC. The draft law confers on the board of directors all powers under the CBC Law that are not specifically reserved for the governor, the deputy governor or the executive committee. The board may from time to time delegate any of its powers to any of its members, to the executive committee or to any employees of the CBC on such terms and for such periods as the board will decide.

- 1.2.3 The executive committee is responsible, amongst other tasks, for (a) the day-to-day activities of the CBC and the management of the CBC's business; (b) the implementation of policy decisions taken by the ECB and SRB; (c) the carrying out of tasks and the exercise of powers granted to the CBC by virtue of the Treaty and the Statute of the European System of Central Banks and of the European Central Bank (hereinafter the 'Statute of the ESCB'); (d) the implementation of the CBC's objectives, in particular the CBC's primary objective to ensure price stability, and the CBC's tasks pursuant to Articles 5, 5A and 6 of the CBC Law, including the CBC's ESCB-related tasks, the supervision of authorised credit institutions, the macroprudential supervision of the financial system and the provision of services or performance of the role of banker and financial agent for Cyprus in financial matters⁶; (e) the oversight of payment, clearing and settlement systems; and (f) the submission of recommendations to the board with respect to the CBC's strategy, except for matters which fall within the fields of competence of the ESCB, the competence of the ECB pursuant to Council Regulation (EU) No 1024/2013, and the competence of the SRB pursuant to Regulation (EU) No 806/2014.
- 1.2.4 In addition, the draft law removes the provisions on the establishment and operation of the CBC personnel committee and confers on the executive committee the power to appoint, suspend or dismiss any employees of the CBC, except as regards senior directors whose appointment, suspension and dismissal falls within the competence of the board of directors, and to conduct other relevant tasks of the personnel committee and generally act as a personnel committee.
- 1.2.5 The draft law further provides that the members of the executive committee will head certain directorates and/or departments of the CBC and will each be responsible for separate executive

⁴ Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

⁵ Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (OJ L 225, 30.7.2014, p. 1).

⁶ According to Article 5 of the CBC Law, the primary objective of the CBC is to ensure price stability. Without prejudice to this primary objective, the CBC shall support the general economic policy of the State. Article 5A provides that the CBC is an integral part of the ESCB. The CBC shall perform all tasks required for the achievement of its objectives including those under Article 6. Article 6 lists the main tasks of the CBC, which reflect the basic ESCB tasks under Article 127 (2) of the Treaty and which also include, among others, the licensing and supervision of authorised credit institutions, the macroprudential supervision of the financial system in order to ensure the stability of the financial system and the provision of services or performance of the role of banker and financial agent for Cyprus in financial matters.

tasks within the CBC. The executive committee will confer on each executive director executive responsibility for one or more divisions of the CBC. The draft law also requires the executive committee to provide the board of directors, on a regular basis or as requested, with detailed information required for the exercise of the board's powers. The executive committee members will have no voting rights at meetings of the board of directors on matters pertaining to the oversight of the administration of the CBC, for which the board is responsible, and in connection with the management of the day-to-day activities of the CBC, for which the executive committee is responsible.

- 1.2.6 The draft law replaces the section on the tasks of the governor and provides that the governor (a) participates *ex officio*, as an independent personality, in the Governing Council and the General Council of the ECB; (b) represents the CBC in its relations with external persons, including the Cypriot government, and in legal proceedings to which the CBC is a party; and (c) signs any contracts concluded by the CBC, its annual reports, financial statements and other documents on behalf of the CBC. In addition, the governor will chair the meetings of the board of directors and the executive committee and will have the casting vote.
- 1.2.7 Under the draft law the governor will no longer be responsible for the tasks of implementing the CBC's policy; managing and controlling the CBC's business; appointing, suspending or dismissing CBC employees; carrying out the tasks and powers granted to the CBC by virtue of the Treaty and the Statute of the ESCB; and overseeing the payment, clearing and settlement systems. The provision granting the governor the power to take decisions as to the issuing of licenses to credit institutions and the carrying out of the business of credit institutions is also removed from the CBC Law. In addition, the draft law introduces a new provision stating that without prejudice to the provisions of Article 10.2 of the Statute of the ESCB, the Governor may appoint an alternate as a member of the Governing Council of the ECB.

1.3 *The independence of directors*

- 1.3.1 The draft law introduces a fit and proper criterion to the eligibility criteria for the appointment of the CBC's executive and non-executive directors. This criterion aims to fulfil the requirements laid down in Article 11 of the CBC's Directive of 2014 on the assessment of the fitness and probity of the members of the management body and managers of authorised credit institutions⁷. The Directive sets out the reputational criteria to be complied with by members of the management body and managers of authorised credit institutions and the means of assessment. A number of factors are taken into account during the assessment, including criminal record, the cumulative effect of more minor incidents, which individually do not impinge on a person's reputation, but may in sum have a material impact, as well as other factors, such as evidence that the relevant person has not been transparent, open and cooperative in his/her dealings with supervisory or regulatory authorities, a declaration of personal bankruptcy or inclusion on a list of unreliable debtors. A person may be considered to be of good repute if there is no evidence to suggest otherwise and nothing to cast reasonable doubt on the presumption of his/her good repute. A person will not be considered to be of good repute if his/her personal or business conduct gives rise to any material

⁷ Η περί της Αξιολόγησης της Ικανότητας και Καταλληλότητας Μελών Διοικητικού Οργάνου και Διευθυντών των Αδειοδοτημένων Πιστωτικών Ιδρυμάτων Οδηγία του 2014.

doubt as to his/her ability to ensure the sound and prudent management of an authorised credit institution. The draft law adds that the eligible candidate should also have recognised and continuous professional experience in monetary, financial and banking matters.

- 1.3.2 The draft law also sets out the procedure for the appointment of the CBC's directors. The Cypriot Council of Ministers appoints the directors following receipt of a formal reasoned opinion by a newly-established independent selection committee. This selection committee will be comprised of three members appointed by the Council of Ministers for a term of five years and will have the mandate of identifying at least three eligible and qualified candidates for every vacancy. Directors are appointed for a period of five years and may be re-appointed for one additional term of office, provided that the term of office for three of the five members appointed for the first time after the entry into force of the draft law would be three years and the term of office of two members would be four years.
- 1.3.3 The draft law extends the grounds for the dismissal of board members to include (i) a conviction for infringement of a confidentiality or professional secrecy obligation; (ii) a conviction for a dishonourable or morally reprehensible offence that constitutes an impediment to the appointment of public office; or (iii) a sentencing to a term of imprisonment for any offence. Where such grounds are applicable, the member, on a proposal from the Minister for Finance, will be dismissed from the board of directors by the Council of Ministers, after she/he has been invited to present her/his defence.
- 1.3.4 A conflict of interest provision has been added whereby persons who themselves or whose relatives up to the first degree have an interest in entities or are members of the board of entities under the supervision of the CBC are ineligible to be appointed as executive or non-executive directors. A similar provision has been added in relation to the appointment of the governor and deputy governor.
- 1.3.5 The draft law further provides that any expenses and damages awarded by the courts in relation to any act or omission of the governor, the deputy governor and any members of the board in the exercise of their duties will be borne by the CBC. This provision will apply irrespective of whether their term of office has expired.
- 1.3.6 Finally, the draft law contains a transitional provision according to which a person who holds a position on the board of directors of the CBC on the date on which the draft law enters into force will retain that position on the same terms until the expiry of his/her term of office.
- 1.4 *The CBC's capital and its alteration*
- 1.4.1 The draft law provides for an automatic recapitalisation of the CBC whenever the CBC's net equity falls below the level of the CBC's capital provided in the CBC Law. Under the draft law, the level of CBC's capital will be raised from EUR 30 million to EUR 90 million. The capital of the CBC can be altered by a decision of the board of directors, which must be notified to the Council of Ministers, provided that any increase in capital entailing additional payments by the State is agreed between the CBC and the Council of Ministers. In addition, the general reserve of the CBC should not exceed twice its capital.

1.4.2 Furthermore, the draft law confers on the board of directors the power to set the maximum level of possible reserves, which include capital, general reserves and provisions. Any additional net profit will be attributed to the State irrespective of any other provision in the CBC Law. The precise level of reserves will be based on an annual report which takes into account the possible risks and means of addressing them, as well as the provisions and the total amount of reserves that need to be held.

2. General observations

- 2.1 When a statute of a national central bank (NCB) (in this case the CBC Law) is amended, the amending law should ensure that central bank independence, guaranteed under Article 130 of the Treaty and Articles 7 and 14.2 of the Statute of the ESCB, is respected. The compatibility of a Member State's legislation, including its NCB's statute, with the requirements of the Treaty and the Statute of the ESCB concerning central bank independence must be ensured on accession to the Union. Compatibility with Article 130 of the Treaty and Article 7 of the Statute of the ESCB is a fundamental aspect of the legal convergence in a Member State, which is examined in the convergence reports required by Article 140(1) of the Treaty to assess a country's readiness to join the euro area⁸.
- 2.2 The ECB notes the establishment of an executive committee and the restructuring of the CBC's decision-making structure. The introduction of a collegiate decision-making process aims at strengthening the quality of the CBC internal deliberations with respect to the exercise of its tasks and is comparable with the regimes applicable in other jurisdictions across the EU. The ECB therefore understands that the establishment of a new collegiate decision-making body serves the purpose of greater responsibility-sharing.
- 2.3 The ECB welcomes the amendments introduced into the CBC Law clarifying the division of competences between the decision-making bodies of the CBC, in line with past ECB opinions on the CBC's governance⁹. The ECB understands that the executive committee will be exclusively responsible for carrying out all of the CBC's tasks and exercising all of the CBC's powers under the Treaty and the Statute of the ESCB. The ECB further understands that the executive committee will be responsible for carrying out the CBC's tasks in relation to the supervision of, but not the granting of licenses to, credit institutions, without prejudice to the provisions of the SSM Regulation¹⁰. In this respect the ECB recommends that Article 6(2)(d) of the CBC Law be amended so as to remove the licensing of credit institutions as one of the tasks of the CBC and to note that the supervision of credit institutions is without prejudice to the SSM Regulation.
- 2.4 With respect to the provision of the draft law on the limited voting rights of members of the executive committee (see paragraph 1.2.5 above), the ECB understands that this provision applies only to the CBC's day-to-day activities and management of its work under the newly amended Article 17A(1)(a) of the CBC Law and that it will not, in any case, affect the independence and

⁸ See paragraph 3.1 of Opinion CON/2010/56.

⁹ See paragraphs 2.3 and 2.4 of Opinion CON/2013/41 and paragraph 4 of Opinion CON/2013/78.

¹⁰ Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

powers of the executive committee to carry out its ESCB-related and other tasks. For the sake of legal certainty it is suggested to reformulate this provision to reflect this understanding.

- 2.5 The ECB understands that under Article 119 of the Constitution of the Republic of Cyprus¹¹ the governor is responsible for the management of the CBC and exercises all powers and performs all functions and duties within the scope of the CBC's competences, assisted by the deputy governor. The ECB therefore understands that given that the draft law confers on the executive committee all ESCB-related competences and on the board of directors all residual competences, the draft law and Article 119 of the Constitution may need to be aligned¹². In such an event, the ECB would like to remind the consulting authority of the obligation to consult the ECB on any relevant draft legislation.
- 2.6 The ECB notes the amendments in relation to the appointment, suspension and dismissal of the CBC employees and understands that the removal of the provisions relating to the personnel committee will facilitate the internal functioning of the CBC¹³.
- 2.7 As regards the provision of the draft law which confers upon the board of directors the power to adopt the accounting policies and procedures of the CBC in accordance with international accounting standards¹⁴, the ECB understands that for the purpose of Eurosystem financial reporting the CBC adheres to the Eurosystem accounting and financial reporting framework as set out in Guideline (EU) 2016/2249 of the European Central Bank (ECB/2016/34)¹⁵.
- 2.8 The ECB notes that the provision of the draft law concerning the appointment of an alternate as a member of the Governing Council of the ECB should be in line with Article 10.2 of the Statute of the ESCB and with the relevant provisions of the Rules of Procedure of the ECB. The provisions stipulate, inter alia, that, if a member of the Governing Council is prevented from voting for a prolonged period (i.e. more than one month), he/she may appoint an alternate as member of the Governing Council.

3. Specific observations

3.1 Central bank independence

Personal independence

- 3.1.1 The personal independence of the CBC would be at stake if the same rules for the security of tenure and grounds for dismissal of governors did not also apply to other members of the decision-making bodies of NCBs involved in the performance of ESCB-related tasks. As the draft law entrusts the executive committee with the performance of the CBC's ESCB-related tasks, then the same rules must be applicable to the executive directors of the CBC.
- 3.1.2 With regard to security of tenure, the draft law ensures that all board members have a term of office

11 Το Σύνταγμα της Κυπριακής Δημοκρατίας.

12 See paragraph 3.4.2 of Opinion CON/2017/17.

13 See paragraph 1 of Opinion CON/2016/9 where it was noted that the CBC could not recruit permanent staff or promote, dismiss or suspend employees when there was a vacant position on its personnel committee.

14 See Article 15(1)(k) of the draft law.

15 Guideline (EU) 2016/2249 of the ECB of 3 November 2016 on the legal framework for accounting and financial reporting in the European System of Central Banks (ECB/2016/34) (OJ L 347, 20.12.2016, p. 3).

of five years. There is, however, a transitional period in which the term of office of three of the five members appointed for the first time after the entry into force of the draft law would be three years and the term of office of two members would be four years. The ECB understands that the transitional period would be applicable only in relation to the non-executive directors of the CBC, since members of the executive committee must have a term of office of five years. The ECB notes that the reasons for the different periods of appointment for members of the board of directors and the relevant criteria for appointing some members for three years and others for four years are not clear¹⁶.

- 3.1.3 As noted in the ECB Convergence Reports, NCB statutes must ensure that governors are not dismissed for reasons other than those mentioned in Article 14.2 of the Statute of the ESCB, that is, where they no longer fulfil the conditions required for the performance of their duties or have been guilty of serious misconduct. This principle also applies to other members of NCB decision making-bodies involved in the performance of ESCB-related tasks, especially where a governor is 'first among equals' with colleagues with equivalent voting rights, or where other such members are involved in the performance of ESCB-related tasks¹⁷. With respect to the governor and the deputy governor, the current version of the CBC Law is in line with Article 14.2 of the Statute of the ESCB. The introduction under the draft law of new grounds for the dismissal of executive committee members, including for the governor and the deputy governor, raises concerns as these are not aligned with Article 14.2 of the Statute of the ESCB. In the light of this, the ECB would support using the current wording of the CBC Law in respect of members of the executive committee. It is also noted that on the basis of Article 14.2 of the Statute of the ESCB, a decision to relieve a Governor from office may be referred to the Court of Justice by the Governor concerned or the ECB Governing Council on grounds of infringement of the TFEU or of any rule of law relating to its application.
- 3.1.4 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 have 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 bodies¹⁸. The ECB therefore welcomes the new provisions on the eligibility criteria for the appointment of individuals to

¹⁶ It is recalled that Article 13(3) of the CBC Law previously gave the Council of Ministers the right to appoint a member to the board of directors for a term of less than five year. This provision was removed following a recommendation in the ECB Convergence Report of December 2006 that the relevant provision needed to comply with Article 14.2 of the Statute of the ESCB. The ECB Convergence Report of May 2007 confirmed the removal of the aforementioned incompatibility.

¹⁷ See paragraph 2.2 of Opinion CON/2014/51.

¹⁸ See page 24 of the ECB Convergence Report of June 2016.

the positions of executive director, deputy governor and governor of the CBC, which aim to strengthen the independence of these posts. These new provisions reinforce the current provisions of the CBC Law which require the executive directors, the deputy governor and the governor to perform their duties full-time and not to take up any other employment¹⁹. In addition, and considering that the board of directors is comprised of five non-executive directors, the ECB understands that the obligation imposed by the draft law on the executive committee to provide the board of directors with detailed information required for the exercise of the board's powers would not compromise the independence of the governor and the rest of the executive committee.

Financial independence

- 3.1.5 The independence of an NCB, as required under Article 130 of the Treaty and Article 7 of the Statute of the ESCB, would be at stake if it could not autonomously avail itself of sufficient financial resources to fulfil its mandate (i.e. the performance of ESCB-related tasks required under the Treaty and the Statute of the ESCB)²⁰. The principle of financial independence requires an NCB to have sufficient means not only to perform its ESCB-related tasks but also its own national tasks, e.g. financing its administration and own operations. Therefore, a Member State may not put its NCB in a position where it has insufficient financial resources and inadequate net equity to carry out its tasks. For these reasons, financial independence implies that an NCB should always be sufficiently capitalised²¹. In particular, 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 over²². Any such situation may negatively impact on the NCB's ability to perform both its national tasks and its ESCB-related tasks. Moreover, such a situation may affect the credibility of the Eurosystem's monetary policy. Therefore, where an NCB's net equity is less than its statutory capital or even negative the respective Member State must provide the NCB with sufficient financial means to raise the net equity level at least up to that of the statutory capital within a reasonable period of time so as to avoid compromising the principle of financial independence.
- 3.1.6 In light of this, the ECB welcomes the provision of the draft law providing that the CBC will be recapitalised to the level prescribed under the CBC Law whenever the net equity of the CBC falls below this level. The CBC must have, at all times, sufficient financial resources and adequate net equity for the performance of its ESCB-related tasks²³. In this context, the ECB takes note of the proposed increase of the CBC's capital from EUR 30 million to EUR 90 million and of the fact that the current capital of the CBC amounts to EUR 150 million. The ECB understands that the capital of the CBC has been raised to its current level by a decision of the board of directors pursuant to Article 56(2) of the CBC Law. The ECB understands that the proposed increase of the capital under the draft law will not impact the current level of the CBC's capital. In view of this, the difference between the capital referred to under the draft law and the actual capital of the CBC could result in uncertainty and will, therefore, require further clarification.

19 See Articles 17A(2) and 19(1) of the CBC Law.

20 See paragraph 2.3 of Opinion CON/2017/17.

21 See, e.g., page 25 of the ECB Convergence Report of June 2016.

22 See paragraph 2.5 of Opinion CON/2016/55.

23 See paragraph 3.3.7 of Opinion CON/2017/17.

- 3.1.7 Furthermore, clarifications may be needed in respect of the requirement in the draft law that the general reserve of the CBC should not exceed twice its capital, in particular, whether this requirement refers to the amount of the capital proposed under the draft law or of the actual capital of the CBC. The ECB also wishes to emphasise that the CBC is best positioned to assess the risks involved in its operations and what financial precautions need to be taken to guard against these risks, including the establishment of the necessary level of general reserves within the limits set by the legislator or any other types of appropriate financial buffers. In addition, it should be considered whether the power to define the level and the limit of the general reserves should be conferred only on the board of directors, which has the overall responsibility for the financial soundness of the CBC.
- 3.1.8 With regard to the alteration of the capital, the ECB understands that according to the newly inserted provisions of the draft law, the CBC will be entitled to be automatically recapitalised up to the level of the prescribed capital referred to in the CBC Law (as amended by the draft law).
- 3.1.9 Under the principle of financial independence, an NCB, in the performance of its tasks, can independently assess the risks involved and has the power to decide on any necessary precautions to take. An NCB is best placed to make these assessments and must have the necessary tools to evaluate the relevant circumstances and to make forecasts²⁴. In particular, the ECB is of the view that the higher the level of capital, reserves and provisions against financial risks, the higher the safeguards will be against future losses²⁵. Consequently NCBs should be given the ability to safeguard the real value of their capital and assets by being free to independently create adequate financial buffers. The ECB therefore welcomes the provision of the draft law conferring powers on the board of directors to determine the level of “maximum reserves” and understands that this provision intends to address financial buffers comprising general reserves, capital and financial risk provisions. The ECB furthermore understands that the “maximum reserves” exclude (i) specific provisions against already incurred losses and (ii) any amounts recorded by the CBC on revaluation accounts, and that the profit to be distributed by the CBC to the general government account is determined following the establishment of adequate “maximum reserves”.

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

Done at Frankfurt am Main, 11 May 2018.

[signed]

The President of the ECB

Mario DRAGHI

²⁴ See paragraph 2.3 of Opinion CON/2017/17.

²⁵ See paragraph 3.1 of Opinion CON/2013/96.