



EUROPEAN MONETARY INSTITUTE

21 January 1998

OPINION OF THE EUROPEAN MONETARY INSTITUTE

at the request of the United Kingdom under Article 109f(6) of the Treaty establishing the European Community (the “Treaty”) and Article 5.3 of the Statute of the EMI concerning a Bank of England Bill

(CON/97/27)

Introduction

1. On 31 October 1997 the EMI received from the Chief Secretary to H.M. Treasury a request for an opinion on a Bank of England Bill (“the bill”).
2. The EMI’s competence to deliver an opinion is based on Article 1.1, second and fifth indents, of the Council Decision of 22 November 1993 (93/717/EC) (“the Council Decision”) on consultation of the EMI by the authorities of the Member States on draft legislative provisions, as the bill contains inter alia provisions concerning the status and powers of the Bank of England (“the Bank”), instruments of monetary policy and rules applicable to financial institutions in so far as they influence the stability of financial institutions and markets.
3. The EMI has been informed that it may be of assistance to the process of public scrutiny of the bill within the UK if its opinion were to be available before the debate in parliamentary Committee on the bill. Whilst the EMI wishes to be helpful in this regard, it notes the provisions of the Council Decision that Member States shall ensure that the EMI is consulted at an appropriate stage to enable the consulting authority to have the EMI’s opinion before taking its decision on the substance of the draft legislation and that any time limit imposed upon the EMI may not be less than one month. The EMI therefore proposes to issue its general comments in time for the UK parliamentary Committee debate, and to finalise its opinion by the addition of more detailed comments at a later date.
4. Pursuant to notification given by the United Kingdom on 30 October 1997 that it does not intend to move to Stage Three, certain provisions of the Treaty and the ESCB/ECB statute set out in the third protocol to the Treaty (“the Statute”) do not apply to the United Kingdom, including

Article 107 (dealing with the independence of national central banks) and Article 108 (dealing with the compatibility of legislation). In consequence, there is no current legal requirement to ensure that, by the time the ESCB is established, national legislation, including the statutes establishing the Bank, has become compatible with the Treaty and the Statute, nor that the Bank satisfies the requirements for central bank independence.

5. Article 109e(5) of the Treaty provides that during the second stage each Member State shall, as appropriate, start the process leading to the independence of its central bank, in accordance with Article 108. While Article 109e(5) applies to the UK, Article 108 does not. Although the EMI understands that the bill is not intended to comply with the provisions of the Treaty, it considers that the bill is a step in the process towards the independence of the Bank, and welcomes it accordingly.
6. In this opinion the EMI will divide its comments into those which relate to central bank independence, which the EMI hopes may be helpful in clarifying the requirements for central bank independence established in the Treaty, and those which relate more widely to integration within the ESCB, which will be of most relevance if the UK intends to join the single currency.
7. The background to the views of the EMI is set out in its reports on the adaptation of national legislation (in particular the statutes of national central banks) the most recent of which is the report entitled "Legal Convergence in the Member States of the European Union as at August 1997", published on 27 October 1997. The EMI noted in that report that further legislation would be required if the United Kingdom intended to join the single currency. The EMI notes that the bill embodies most of the reforms announced by the Chancellor of the Exchequer on 6 May 1997 and as referred to in the EMI's report.

Central bank independence.

8. The EMI notes that the bill provides for a higher degree of autonomy of the Bank. It welcomes this step. However, the provisions of the bill fall short of the level of independence required by the Treaty.
9. The EMI notes as a general matter that effective central bank independence cannot be restricted to operational aspects. In this regard it notes that, although the priority of the Bank's monetary policy objective is clear, the requirement on the Treasury to set inflation targets and specify what the economic policy of the government is to be taken to be does not necessarily separate monetary policy from political decisions. This would be particularly so if there are frequent revisions of what price stability is to be taken to consist of or of the inflation target in the specification of economic policy. The EMI notes that such specifications are to be made by

the Treasury at least once a year. The EMI would emphasise that account should be taken of the time delay involved in the transmission of monetary policy impulses. The EMI understands that the Bank has traditionally identified a lag of 18 to 24 months before monetary policy becomes fully effective. Any alteration to the inflation target each year (a possibility not excluded by clause 12) might not allow for the existence of such lags. (In this context the EMI understands further that the UK government will monitor the UK's inflation target and inflation measure in the light of the practices of the ECB.) Further assessment in relation to independence (including functional independence) would be required as regards other ESCB-related tasks.

10. *(Clause 1 of the bill)* The arrangements proposed in the bill for the court of directors of the Bank continue to exclude from eligibility those who are in the service of the state. However, the arrangements do not meet the requirements for personal independence that derive from the Treaty and the Statute and which apply to the performance of ESCB-related tasks. Such tasks are not limited to the formulation and implementation of monetary policy. The EMI notes that the tenure of directors other than the Governor and the two Deputy Governors is to be three years, or in some cases even less, where the Treaty requires five; and that the possibility that conflicts of interest might arise is not excluded (indeed, an arrangement is made to resolve them at schedule 1, paragraph 13). The EMI would prefer for bodies making decisions on ESCB-related tasks an arrangement which would preclude any such conflict.
11. *(Clause 7 of the bill)* The power of the Treasury to require the Bank to publish additional information in relation to its accounts may not be consistent with the ESCB's confidentiality regime.
12. *(Clauses 10 and 19 of the bill)* Article 107 of the Treaty prohibits any national central bank or any member of any of their decision-making bodies from seeking or taking instructions from, amongst others, any government. Whilst the bill removes from the Treasury the power to give directions to the Bank in relation to monetary policy, it also establishes a reserve power enabling the Treasury to give the Bank directions for limited periods if such are required in the public interest and by extreme economic circumstances. This would not be compatible with the requirements of the Treaty, in which the prohibition against giving such directions is absolute.
13. *(Clause 13(2) of the bill)* The provisions for the members of the Monetary Policy Committee do not comply with the requirements of the Treaty and the Statute in that their tenure is to be for three years, or in some cases even less, instead of at least five (schedule 3, paragraphs 1 and 2 of the bill).

Integration within the ESCB.

14. The EMI notes that no provision has been made as regards the integration of the Bank into the ESCB.
15. *(Clause 6 of the bill)* The provisions set out in schedule 2 to the bill relating to cash ratio deposits are established as part of the arrangements for financing the Bank. Whilst the EMI acknowledges that they are not intended to be used as a monetary policy instrument, it notes that the holding of minimum reserves might be a monetary policy instrument in Stage Three and that such cash ratio deposits would need to be reviewed accordingly.
16. *(Clause 7 of the bill)* The proposed financial arrangements would have to be modified to take account of the financial provisions of the ESCB as set out in Chapter VI of the Statute.
17. *(Clauses 11 and 12 of the bill)* The Treaty requires that the primary statutory objective of the ESCB shall be the maintenance of price stability. The EMI notes that the bill provides that the primary objective of the Bank shall be to maintain price stability. However, this objective is qualified by relating only to monetary policy and by being subject to the power of the Treasury to specify what price stability is (a point which also affects independence). Whilst the general statement of the objective of price stability represents a welcome move towards the requirement of the Treaty, the EMI notes that the existence of the qualifications and, in particular, the power for the UK government to specify what price stability is would not be compatible with the requirements of the Treaty regarding national central banks becoming an integral part of the ESCB.
18. *(Clauses 11 and 12 of the bill)* The Bank's secondary objective, again only in relation to monetary policy, is to support the economic policy of the UK government, including the government's objectives for growth and employment. These provisions would not be consistent with the secondary objectives required by the Treaty, which include (Article 2 of the Statute) the support of the general economic policies of the Community with a view to contributing to the achievement of the Community's objectives as laid down in Article 2 of the Treaty.
19. *(Clause 13(1) of the bill)* The bill establishes a Monetary Policy Committee which shall have responsibility for formulating monetary policy. All the members of the committee will be in the service of the Bank and will have relevant expertise. However, the existence of this responsibility would not be consistent with the monetary policy competences of the Governing Council of the ECB in Stage Three.
20. *(Clauses 14 and 15 of the bill)* The regime for the publication of information concerning discussions and decisions would not be consistent with the transfer to Community level of control over such publication.

Collection of statistical information.

21. (*Clause 17 of the bill*) The Bank's power to obtain information mentions some but not all categories included in the reference reporting population as set out in Article 2 of the draft EU Council Regulation concerning the collection of statistical information by the ECB. Thus the category of (non-monetary) financial institutions included in Article 2(a) of the draft regulation is wider than in clause 17(3) of the bill; the bill does not mention economic entities holding cross-border positions, undertaking cross-border transactions, and issuing pre-paid cards. Moreover, the bill at 17(4) empowers the Treasury to determine which "financial affairs" of an undertaking should be reported on and at 17(5) to amend the categories of undertaking to which clause 17 applies. In particular, it should be noted that the EMI/ECB is not listed among the organisations which the Treasury must consult before doing so. This omission may be inconsistent with Article 5 of the Statute, which applies to the United Kingdom (whether or not it joins the single currency).

Stability of financial institutions and markets.

22. (*Part III of the bill*) The EMI notes that the bill foresees a change in the organisation of prudential supervision. Parts III and IV of the bill concern inter alia rules applicable to financial institutions which influence the stability of financial institutions and markets. The EMI notes the proposed transfer of supervisory responsibility to the Financial Services Authority and trusts that the process of reorganisation will not affect the stability of the banking system and the financial markets. In this context the EMI notes that the Bank of England has already been party to a Memorandum of Understanding negotiated with the Treasury and the Financial Services Authority which accompanies the process of reorganisation of prudential supervision and in which the prudential supervisory functions in the new regime are explained. The EMI notes that the Bank will continue to be concerned with the stability of the banking system and that the Deputy Governor of the Bank responsible for financial stability will be an ex officio member of the Deposit Protection Board (clause 29 (2) (c) of the bill). The EMI considers these arrangements to be in conformity with Article 3.3 of the Statute, which states that the ESCB shall contribute to the smooth conduct of policies relating to the prudential supervision of credit institutions and the stability of the financial system.
23. The EMI recalls that this is the general part of its opinion, and that more detailed comments are to be added at a later date. The EMI has no objection to this part of its opinion being made public.

On 10 November 1997 the EMI issued the first part of its opinion, containing the general comments it wished to make. This second and final part of the EMI's opinion repeats above without amendment the first part and supplements it with the addition of the more detailed comments set out below.

Central bank independence.

24. *(Schedules 1 and 3 of the bill)* Schedule 1, paragraph 3 and schedule 3, paragraph 2 respectively provide that a person appointed in place of a person who ceases to hold office before the end of the term for which he or she was appointed shall be appointed only for the remainder of that person's term of office. The EMI notes that this may result in appointments of a very short length, in consequence of which the independence of those so appointed may be subject to influence which affects the level of independence required by the Treaty and Statute.

Integration within the ESCB.

25. *(Clause 18 of the bill)* As noted at paragraph 20 above, the regime for publication of information concerning the discussions and decisions of the Monetary Policy Committee would not be consistent with the Treaty and Statute. In particular, the publication on a quarterly basis by the Bank of a report which contains a review of monetary policy decisions and an indication of the expected approach to meeting monetary and economic policy objectives in the future could, depending on the content of the report, be incompatible with the information provisions contained in the Statute and, possibly, with Article 10.4 of the Statute which states that the proceedings of the ECB Governing Council shall be confidential and that the ECB Governing Council may decide to make the outcome of its deliberations public.
26. The EMI has no objection to the totality of its opinion being made public.

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