EUROPEAN CENTRAL BANK

OPINION OF THE EUROPEAN CENTRAL BANK

of 23 February 2006

at the request of Latvijas Banka
on draft amendments to the Regulation on calculating and fulfilling the minimum reserve requirements for banks

(CON/2006/11)

1. On 30 January 2006 the European Central Bank (ECB) received a request from Latvijas Banka for an opinion on draft amendments to the Regulation on calculating and fulfilling the minimum reserve requirements for Banks (hereinafter the 'Regulation'). Latvijas Banka is the national authority that will adopt the draft amendments.

2. The ECB's competence to deliver an opinion is based on Article 105(4) of the Treaty and the sixth indent 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 provisions[1], as the legislative proposal contains provisions concerning rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets. In addition, under Article 2(2) of Decision 98/415/EC, the authorities of Member States other than participating Member States are obliged to consult the ECB on any draft legislative provisions on the instruments of monetary policy. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the European Central Bank has adopted this opinion.

3. The main objective of the draft amendments is to broaden the reserve base for the minimum reserve requirement in view of accelerating domestic lending growth and to contain credit expansion. The draft amendments also intend to harmonise the Regulation with the Law on credit institutions and Latvijas Banka's Regulation on compiling the monthly financial position report of monetary financial institutions and its appendices.

General observations

4. The ECB notes that, although non-participating Member States retain their powers in the field of monetary policy, it is nevertheless beneficial to gradually achieve consistency with Eurosystem standards so that credit institutions operating in their territory can already become acquainted with the minimum reserve requirements that will apply once the euro has been introduced in Latvia.

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1 OJ L 189, 3.7.1998, p. 42.

5. The legal framework underlying the Eurosystem's minimum reserve system is laid down in: (i) Article 19 of the Statute of the European System of Central Banks and the European Central Bank; and (ii) Council Regulation (EC) No 2531/98 of 23 November 1998 concerning the application of minimum reserves by the European Central Bank[2]; and (iii) Regulation ECB/2003/9 of 12 September 2003 on the application of minimum reserves[3]. The purpose of these legal acts, that are directly applicable to and binding on credit institutions in the euro area, is to ensure that the terms and conditions for the Eurosystem's minimum reserve system are uniform throughout the euro area. Taking into account the abovementioned legal framework for the Eurosystem's reserve requirements, the ECB comments as follows on the draft amendments.

6. First, in the course of preparing for the introduction of the euro in Latvia, Latvijas Banka will need to examine whether the Eurosystem's requirements can be fulfilled effectively and whether the necessary measures have been adopted in Latvia to ensure that the authorities have the requisite powers, under Latvian law, to assist and cooperate with the ECB to collect and verify the information necessary for the Eurosystem's minimum reserve system.

7. Second, because the Eurosystem's minimum reserve system is highly dependent on the Eurosystem's statistical reporting requirements and because any changes to the statistical reporting requirements will have a direct influence on the size of minimum reserve holdings, a key element for achieving consistency between the Latvian minimum reserve system and that of the Eurosystem is the introduction into Latvian law of statistical reporting requirements corresponding to those of the Eurosystem.

Specific observations

8. The ECB welcomes the broadening of the reserve base as it contributes to aligning Latvian reporting requirements with those of the Eurosystem. Paragraph 3.2 of the current Regulation excludes from the reserve base deposits with a fixed maturity of more than two years, deposits redeemable at notice with a notice period of more than two years, irrevocable (irredeemable before maturity) debt securities with an original maturity of more than two years and repo transactions. The draft amendments delete paragraph 3.2, thus including the abovementioned liabilities in the reserve base. The ECB notes that this is consistent with Article 3 of Regulation ECB/2003/9.

9. Draft amendments also insert a new paragraph 4.2 into the Regulation enabling Latvijas Banka to establish a different reserve ratio for each category of liabilities included in the reserve base. This provision does not necessarily differ from Article 4 of Regulation ECB/2003/9 that applies a fixed reserve ratio of 0% to deposits with agreed maturity over two years, deposits redeemable at notice over two years, repos and debt securities issued with an agreed maturity over two years, and a fixed reserve ratio of 2% to all other liabilities. However, according to the consultation letter, the applied

2 OJ L 318, 27.11.1998, p. 1.
3 OJ L 250, 2.10.2003, p. 10.

reserve ratio for liabilities with an original maturity of over two years would be larger than zero. Indeed, Latvijas Banka's Council is authorised to set the level of required reserves as appropriate. The ECB notes that this measure does not contribute to further bringing into line the Latvian reserve requirement level with that of the Eurosystem.

10. The ECB also welcomes the introduction of a list of entities subject to minimum reserve requirements as it aligns the Regulation with Article 2 of Regulation ECB/2003/9. However, according to Article 2 of the Regulation ECB/2003/9, all credit institutions located in the euro area are subject to a minimum reserve requirement, while in Latvia currently neither electronic money institutions nor credit unions are covered by minimum reserve requirements. These differences between the Eurosystem and Latvia will need to be eliminated on Latvia's accession to the euro area, as further explained in the paragraphs below.

11. Article 2(1) of Regulation ECB/2003/9 subjects the following categories of institutions to minimum reserve requirements: (a) credit institutions as defined in the first subparagraph of Article 1(1) of the Consolidated Banking Directive[4], other than participating national central banks (NCBs); and (b) branches, as defined in Article 1(3) of the Consolidated Banking Directive, of credit institutions as defined in the first subparagraph of Article 1(1) of the same Directive, other than participating NCBs. Article 1(1) of the Consolidated Banking Directive defines a credit institution as (a) 'an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account'; or (b) an electronic money institution within the meaning of Directive 2000/46/EC of the European Parliament and of the Council of 18 September 2000 on the taking up, pursuit and prudential supervision of the business of electronic money institutions[5].

12. Article 1 of the Latvian Law on credit institutions mirrors the definition of a credit institution contained in Article 1(1) of the Consolidated Banking Directive and covers: (a) banks – capital companies whose business is to receive deposits or other repayable funds from an unrestricted circle of clients, to grant credits for their own account and to provide other financial services; and (b) electronic money institutions – capital companies that issue and service electronic money and that are not banks. However, electronic money institutions are excluded from the scope of application of the Regulation as the Regulation outlines the procedure for calculating and fulfilling the minimum reserve requirements only for banks and branches of foreign banks registered in Latvia.

13. The ECB notes that credit unions established in Latvia are not subject to the Law on credit institutions and that they are expressly excluded from the scope of application of the Consolidated

4 Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions (OJ L 126, 26.5.2000, p. 1), as last amended by Directive 2004/69/EC (OJ L 125, 28.4.2004, p. 44).

5 OJ L 275, 27.10.2000, p. 39.

Banking Directive under the Accession Treaty[6]. However, as made clear in ECB Opinion CON/2005/8 on 1 April 2005 at the request of Lietuvos bankas on draft rules on minimum reserve requirements for credit institutions[7] the fact that 'credit unions are exempt for prudential supervision purposes from the scope of application of the Consolidated Banking Directive does not automatically imply that they will also be exempt from the Eurosystem's reserve requirements established for monetary policy purposes. Indeed, the ECB considers that in order to apply the Eurosystem's reserve requirements it is necessary to carry out a material test as to whether an institution fulfils the criteria laid down in the first subparagraph of Article 1(1) of the Consolidated Banking Directive (i.e. whether its business is to receive deposits or other repayable funds from the public and to grant credits for its own account).'

14. The exemption of Latvian credit unions from the EU banking supervisory regime is irrelevant to the application of Eurosystem minimum reserve requirements due to the very different purposes served by banking supervisory and minimum reserve requirements. The legal basis for the imposition of minimum reserve requirements contained in Article 19.1 of the ESCB Statute clarifies that the ECB may require credit institutions established in Member States to hold minimum reserve on accounts with the ECB and national central banks 'in pursuance of monetary policy objectives.' The first key function of the minimum reserve system is to stabilise money market interest rates. Its second important function is enlargement of the banking system's structural liquidity shortage. The need for credit institutions to hold reserves with central banks contributes to increasing the demand for central bank refinancing which, in turn, makes it easier for the ECB to steer money market rates through regular liquidity-providing operations. Thus, the range of credit institutions that are within the ambit of minimum reserve requirements differs from the category of credit institutions that fall within the scope of prudential supervision. In the area of minimum reserve requirements the term 'credit institution' is clearly meant to denote all financial market operators whose activities are relevant for the growth of monetary aggregates. Consistent with this, Regulation ECB/2003/9 establishes a very specific exemption regime unrelated to the exemption regime under the Consolidated Banking Directive. In this respect, it is noted that Article 5(2) of Regulation ECB/2003/9 grants to each institution an allowance of EUR 100 000 to be deducted from the amount of minimum reserves, subject to conditions.

15. Under Article 2 of the Latvian Law on credit unions, credit unions may provide a variety of financial services to their members, including receiving their deposits and other repayable funds and providing loans to them, as well as other appropriate activities.

16. Regarding the issue as to whether credit unions in Latvia receive deposits from the 'public' within the meaning of the Consolidated Banking Directive's definition of a credit institution, the concept

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6 Technical adaptations to Article 2(3) of the Consolidated Banking Directive under Chapter 3 of Annex II to the Accession Treaty 2003.

7 Paragraph 10.

of the 'public' encompasses any natural or legal person other than a credit or financial institution, while those entities that fund themselves only in the interbank markets are excluded from the concept of the 'public' for this purpose. It is clear that a Latvian credit union may receive deposits from the 'public'. In particular, a Latvian credit union may receive deposits from members that may include natural persons and their spouses, local governments, trade unions and other bodies. The fact that admission to membership of a Latvian credit union is restricted to persons sharing a common place of residence in the territory of the same local government or are otherwise linked to the specific local government (e.g. as owners of immovable property) or to persons employed by the same employer, or to persons sharing membership of a particular organisation, such as a professional association, trade union or public sports organisation, is irrelevant for this purpose. The key issue is that Latvian credit unions may receive deposits from persons other than credit or financial institutions. Therefore Latvian credit unions receive deposits 'from the public' within the meaning of the Consolidated Banking Directive.

17. In the light of the above, the ECB considers that credit unions established in Latvia will fall under the definition of a credit institution subject to Eurosystem minimum reserve requirements within the meaning of Regulation ECB/2003/9 on the introduction of the euro. It is also noted that subjecting the electronic money institutions and credit unions to the Eurosystem minimum reserve requirement should not present practical difficulties from a statistical perspective as both types of institutions are already included in the list of monetary and financial institutions produced by Latvijas Banka.

18. Finally, the ECB may consider introducing certain transitional arrangements for the application of the Eurosystem's minimum reserve system on the introduction of the euro in Latvia[8]. This would involve a transitional maintenance period for credit institutions located in Latvia.

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

Done at Frankfurt am Main, 23 February 2006.

[signed]

The President of the ECB

Jean-Claude TRICHET

8 As in the case of Regulation ECB/2000/11 of 2 November 2000 concerning transitional provisions for the application of minimum reserves by the European Central Bank following the introduction of the euro in Greece (OJ L 291, 18.11.2000, p. 28) and as stated in Opinions CON/2005/35 and CON/2005/8.