EUROPEAN CENTRAL BANK

EUROSYSTEM

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OPINION OF THE EUROPEAN CENTRAL BANK

of 25 October 2019

on amendments to the Law on Latvijas Banka

(CON/2019/36)

Introduction and legal basis

On 25 September 2019 the European Central Bank (ECB) received a request from the *Budžeta un finanšu (nodokļu) komisija* (Budget and Finance (Tax) Commission) of the *Saeima* (Parliament) of the Republic of Latvia for an opinion on a draft law containing amendments to the Law on Latvijas 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/EC[2], as the draft law relates to Latvijas Banka and to the specific tasks conferred upon the ECB concerning the prudential supervision of credit institutions pursuant to Article 127(6) of the Treaty. 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 amends the profit distribution provisions of the Law on Latvijas Banka. Within 15 days following the approval of the annual report by the Council of Latvijas Banka and the covering of losses accumulated in the previous years, if any, Latvijas Banka shall transfer part of its profit earned during the reporting year to a State general budget account. That part shall be calculated by applying the tax rate established by the Corporate Income Tax Law (the 'CIT Law')[3] without applying the coefficient which increases the tax base as laid down by the CIT Law.

1.2 The draft law amends the Law on Latvijas Banka by reducing the term of office of the Governor, Deputy Governor and the members of the Council of Latvijas Banka from six to five years. If the Governor, Deputy Governor or any of the members of the Council resign before their term expires, the *Saeima* shall appoint a new Governor, Deputy Governor or member of the Council in their place for a term of five years. As explained by the consulting authority in the letter accompanying the consultation request, decreasing the term of office from six to five years is in accordance with

1 Grozījumi likumā "Par Latvijas Banku".

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 Uzņēmumu ienākuma nodokļa likums.

the general practice and legislation in force, including the Statute of the European System of Central Banks (ESCB) and of the ECB (the 'Statute of the ESCB'). It also aligns the term of office of the Governor, Deputy Governor and members of the Council of Latvijas Banka with the term of office of the Chairman and members of the Council of the *Finanšu un kapitāla tirgus komisija* (FKTK, Latvian Financial and Capital Market Commission).

1.3 The draft law amends the Law on Latvijas Banka to provide that the same person may hold the office of the Governor, the Deputy Governor and a member of the Council of Latvijas Banka for a maximum of two consecutive terms. As explained by the consulting authority, this provision of the draft law is in accordance with the latest international practice on the appointment of heads of institutions.

1.4 The transitional provisions of the draft law provide that the above-mentioned amendments to the Law on Latvijas Banka concerning the terms of office of the Governor, Deputy Governor and the members of the Council of Latvijas Banka shall enter into force upon the resignation of the Governor, Deputy Governor or the members of the Council of Latvijas Banka at the end of the current six-year term, or, in the event that the Governor, Deputy Governor or the members of the Council of Latvijas Banka resign before the expiry of the current six-year term, upon appointment of a new Governor, Deputy Governor or member of the Council of Latvijas Banka. Under the draft law which amends the Law on Latvijas banka, the current Governor, Deputy Governor and/or members of the Council of Latvijas Banka shall continue to perform their duties until the end of their six-year term of office, or until the *Saeima* has relieved them from office.

1.5 The draft law amends the Law on Latvijas Banka by providing that the Governor, Deputy Governor and a member of the Council of Latvijas Banka may be relieved from office by the *Saeima* if he/she (i) has submitted a resignation, or (ii) has been found guilty of serious misconduct or no longer fulfils the conditions required for the performance of his/her duties in accordance with Article 14.2 of the Statute of the ESCB.

1.6 The draft law amends the Law on Latvijas Banka by reducing the number of members of the Board of Latvijas Banka from six to four persons. The transitional provisions of the draft law provide that the above provision shall apply from 1 March 2020.

1.7 Finally, the transitional provisions of the draft law provide that by 31 October 2020 the Government shall submit to the *Saeima* a draft law on Latvijas Banka providing for its governance framework and operation and for the incorporation of the FKTK into Latvijas Banka while respecting the independence of its monetary policy functions and its functions as the finance and capital market supervisor and resolution authority.

2. Observations

2.1 Distribution of Latvijas Banka's profits

2.1.1 Under the existing provisions on profit distribution of the Law on Latvijas Banka, within 15 days following the approval of the annual report by the Council of Latvijas Banka and the covering of losses accumulated in the previous years, if any, Latvijas Banka transfers the following to a State

general budget account: (i) a part of its profit earned during the reporting year, which shall be calculated by applying the tax rate established by the Law on Corporate Income Tax[4]; and (ii) payments for the usage of State capital amounting to 50 % of the profit earned during the reporting year. The Council of Latvijas Banka may reduce the amount of dividends payable into the State budget if required for an increase of Latvijas Banka's reserve capital due to financial risks affecting Latvijas Banka in the execution of its tasks[5].

2.1.2 The ECB understands that the draft law only amends the first component of the twofold calculation of the amount payable by Latvijas Banka into the State budget under point (i) above. This technical amendment is intended to take into account the new corporate income tax regime under the CIT Law, which entered into force on 1 January 2018. In particular, the CIT Law provides that the basis of corporate income tax, which is applied at the statutory rate of 20 % instead of the previous rate of 15 %, is the amount of distributed dividends divided by a coefficient of 0.8 meaning that the actual corporate income rate amounts to 25 % of the total amount of distributed dividends[6]. Although Latvijas Banka is not subject to corporate income tax[7], the change in the corporate income tax regime is relevant for the calculation of the first component of the twofold calculation of the amount payable by Latvijas Banka into the State budget. In this respect, the draft law clarifies that this first component shall be calculated by applying the tax rate established by the CIT Law without applying the coefficient 0.8 which increases the tax base. This effectively means that Latvijas Banka will, under the first component, transfer into the State budget account 20 % of the profits earned during the reporting year, instead of the 15 % payable based on the old Law on Corporate Income Tax and also in lieu of the 25 % that would be payable if the coefficient 0.8 under the new CIT Law was to be included in the calculation.

2.1.3 The ECB notes that the amendments to the first component of the twofold calculation of the amount payable by Latvijas Banka into the State budget enter into force retroactively, from 1 January 2018. The ECB understands that the retroactive application of the amendments would not result in a recalculation of the amount payable by Latvijas Banka into the State budget for the year 2018.

2.1.4 The ECB understands that the second component of the twofold calculation of the amount payable by Latvijas Banka into the State budget remains unchanged so that Latvijas Banka is obliged to make a further payment of 50 % of those profits, in addition to the payment of 20 % of the profits earned during the reporting year. However, as noted above, under the draft law the Council of Latvijas Banka retains discretion to reduce the amount of dividends payable into the State budget if

4 Likums "Par uzņēmumu ienākuma nodokli".

5 Article 18 of the Law on Latvijas Banka (likums "Par Latvijas banku").

6 Articles 4(2) and 4(9) of the CIT Law (Uzņēmumu ienākuma nodokļa likums).

7 Latvijas Banka does not fall under the definition of corporate income tax payers provided by Article 2(1)(1) of the CIT Law. Moreover, paragraph I(2)(3) of the annotation to the draft law states that in the future Latvijas Banka will not be bound by other provisions of the CIT Law apart from the 20 % tax rate (without applying the 0.8 % coefficient increasing the tax base).

required to increase Latvijas Banka's reserve capital in the event of financial risks affecting Latvijas Banka in the execution of its tasks.

2.1.5 Under the principle of financial independence under the Treaty, a national central bank (NCB) must have available to it sufficient financial resources to fulfil its mandate, i.e. to perform its ESCB-related tasks and its national tasks[8]. An NCB's statutes may prescribe how its profits are to be allocated. However, profits may only be transferred to the State budget after any accumulated losses from previous years have been covered and financial provisions deemed necessary to safeguard the real value of the NCB's capital and assets have been created[9]. Against this backdrop, notwithstanding the 5 % increase in the level of profits to be transferred by Latvijas Banka to the State budget, the ECB welcomes that profits will continue to be transferred to the State budget after the covering of losses accumulated in the previous years and that the Council of Latvijas Banka will retain discretion to reduce the amount of dividends payable into the State budget if required to increase Latvijas Banka's reserve capital in the event of financial risks affecting Latvijas Banka in the execution of its tasks.

2.1.6 As previously noted by the ECB, under the current twofold calculation of the amount payable by Latvijas Banka into the State budget, amendments to the CIT Law result in changes to Latvijas Banka's total contribution to the State budget. While in principle this is acceptable, the ECB reiterates that, for the sake of legal certainty, and to better safeguard Latvijas Banka's financial independence, the maximum contribution of Latvijas Banka to the State budget should be determined by a single fixed rate of Latvijas Banka's annual profits, set out in the Law on Latvijas Banka. Alternatively, if the current twofold calculation of the total rate of Latvijas Banka's profit distribution is maintained, in view of Latvijas Banka's obligations under the Treaty and the Statute of the ESCB, the ECB recommends that any changes to its financial obligations towards the State should be decided in cooperation with the Council of Latvijas Banka, taking into account its specific tasks[10].

2.2 *Term of office of the Governor, Deputy Governor and members of the Council of Latvijas Banka*

2.2.1 In accordance with Article 14.2 of the Statute of the ESCB, the statutes of an NCB shall, in particular, provide that the term of office of a Governor of an NCB shall be no less than five years. Personal independence would be jeopardised if the rules relating to security of tenure and grounds for dismissal of Governors were not to apply to members of the decision-making bodies of NCBs involved in the performance of ESCB-related tasks. In addition, various provisions of the Treaty and of the Statute of the ESCB require comparable security of tenure[11]. If an NCB's statutes are amended, the amending law must safeguard the security of tenure of the Governor and of other

8 See the ECB's Convergence Report 2018, 2.2.3.

9 See the ECB's Convergence Report 2018, 2.2.3.

10 See paragraph 3.3 of Opinion CON/2009/53. All ECB Opinions are published on the ECB's website at www.ecb.europa.eu.

11 See the ECB's Convergence Report 2018, 2.2.3.

members of decision-making bodies who are involved in the performance of ESCB-related tasks[12]. Against this backdrop, the ECB welcomes the transitional provisions of the draft law, which ensure that the current Governor, Deputy Governor and members of the Council of Latvijas Banka will remain in office until the end of their original six-year terms (or until the *Saeima* has relieved them from office) in accordance with the requirements of the Treaty and the Statute of the ESCB.

2.2.2 In relation to the provision of the draft law which provides that the same person may not hold the office of the Governor, Deputy Governor and the members of the Council of Latvijas Banka for more than two consecutive terms, the ECB understands that this requirement does not apply in respect of terms served before the draft law comes into effect. This implies that the current and past members of the Council of Latvijas Banka would be able to serve two consecutive terms in the future, and that terms served in the past are not included and do not count towards the calculation of the two consecutive- term limit. The ECB welcomes this clarification from the perspective of legal certainty[13].

2.3 Grounds for relieving the Governor, Deputy Governor and members of the Council of Latvijas Banka from office

2.3.1 The Law of Latvijas Banka[14] currently provides that the Governor, Deputy Governor and a member of the Council of Latvijas Banka may be relieved from office by the *Saeima* if: (i) he/she has submitted a resignation, (ii) he/she has been found guilty of serious misconduct[15] in accordance with Article 14.2 of the Statute of the ESCB, or (iii) if other grounds of dismissal stipulated by Article 14.2 of the Statute of the ESCB apply. The ECB understands that the draft law is merely amending points (ii) and (iii) to combine them into a single provision that states that the Governor, Deputy Governor and the members of the Council of Latvijas Banka may be relieved from office by the *Saeima* if he/she has been found guilty of serious misconduct or no longer fulfils the conditions required for the performance of his/her duties according to Article 14.2 of the Statute of the ESCB.

2.3.2. The ECB welcomes this technical amendment. As noted above, in accordance with Article 14.2 of the Statute of the ESCB, a Governor may be relieved from office only if he no longer fulfils the conditions required for the performance of his duties or if he has been found guilty of serious misconduct. The principles underpinning the conditions under which a Governor may be relieved from office are autonomous concepts of Union law[16]. The application and interpretation of these principles do not depend on national context, irrespective of whether such concepts are also embedded in the draft law. Therefore, the provision of the draft law relating to relieving the

12 See paragraph 2.1 of Opinion CON/2014/51 and the ECB's Convergence Report 2018, 2.2.3.

13 See paragraph 3.3.3 of Opinion CON/2018/17.

14 Article 22(4) of the Law on Latvijas Banka.

15 Article 22(5) of the Law on Latvijas Banka provides that in a situation referred to in point 2 of Article 22(4) of the Law on Latvijas Banka, the *Saeima* may decide to relieve the Governor, the Deputy Governor and members of the Council of Latvijas Banka from office after a court decision with a guilty verdict becomes effective.

16 See, also, the opinion of Advocate General Kokott delivered on 19 December 2018, *Rimšēvičs v Latvia*, C-202/18, ECLI:EU:C:2018:1030, paragraph 77.

Governor of Latvijas Banka from office is compatible with the Statute of the ESCB insofar as it replicates the wording of Article 14.2 of the Statute of the ESCB[17].

2.3.3 All members of the NCBs' decision-making bodies must exercise their powers and carry out the tasks and duties conferred upon them by the Treaties and the Statute of the ESCB independently[18]. Personal independence would be jeopardised if the rules relating to security of tenure and grounds for dismissal of Governors were not to apply to members of NCB decision-making bodies involved in the performance of ESCB-related tasks, especially where a governor is 'first among equals' with colleagues and with equivalent voting rights, or where such members are involved in the performance of ESCB-related tasks[19]. Given that not only the Governor but also the Deputy Governor and the other member of the Council of Latvijas Banka are involved in the performance of ESCB-related tasks, the ECB welcomes that the provisions of the draft law regarding security of tenure apply not only to the Governor, but also to the other members of the Council of Latvijas Banka in order to safeguard their independence.

2.4 *Reduction of number of members of Latvijas Banka's Board*

The Board of Latvijas Banka is an executive body appointed by the Council of Latvijas Banka to ensure the efficient management of Latvijas Banka[20]. The members of the Board of Latvijas Banka are employees of Latvijas Banka's central apparatus. The Board of Latvijas Banka manages the operations of Latvijas Banka, implementing the resolutions of the Council of Latvijas Banka[21]. The Chairperson of the Board manages Latvijas Banka by implementing the decisions adopted by the Council and the Board of Latvijas Banka. The Chairperson of the Board is entitled to participate in the meetings of the Latvian Government when authorised by the Governor or in his/her absence and to represent the interests of Latvijas Banka[22]. The ECB understands that it is the Council of Latvijas Banka which is Latvijas Banka's decision-making body involved in the performance of its ESCB-related tasks[23]. The Board of Latvijas Banka is an executive body of Latvijas Banka which merely implements the resolutions of the Council of Latvijas Banka. Therefore the ECB has no comments on the provision of the draft law which reduces the number of members of the Board of Latvijas Banka from six to four persons.

2.5 *Proposed legislation providing for a new governance framework of Latvijas Banka and the incorporation of FKTK into Latvijas Banka*

The ECB understands that the draft law requires the Latvian Government to submit a draft law to the *Saeima* providing for a new governance framework of Latvijas Banka and the incorporation of

17 See paragraphs 2.1.3 and 2.1.4 of Opinion CON/2019/19.

18 Article 130 TFEU and Article 7 of the Statute of the ESCB.

19 See paragraph 2.2 of Opinion CON/2014/51, paragraph 3.1.3 of CON/2018/23, paragraph 2.2 of Opinion CON/2019/19 and the ECB's Convergence Report 2018, 2.2.3.

20 Article 23 of the Law on Latvijas Banka.

21 Article 27 of the Law on Latvijas Banka.

22 Article 29 of the Law on Latvijas Banka.

23 Article 26 of the Law on Latvijas Banka provides that the Council of Latvijas Banka shall adopt decisions on behalf of Latvijas Banka that are necessary to ensure the implementation of the tasks of Latvijas Banka, including the tasks of the European System of Central Banks.

the FKTK into Latvijas Banka by 31 October 2020. The ECB understands that the Latvian authorities will in due course, pursuant to Article 127(4) of the Treaty, consult the ECB on this draft legislation, which falls within the ECB's fields of competence.

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

Done at Frankfurt am Main, 25 October 2019.

[signed]

The President of the ECB

Mario DRAGHI