EUROPEAN CENTRAL BANK

OPINION OF THE EUROPEAN CENTRAL BANK

of 23 August 2006

at the request of the Cypriot Cooperative Societies' Supervision and Development Authority on a draft regulatory decision on the terms and conditions of affiliation of cooperative credit institutions with the Cooperative Central Bank

(CON/2006/42)

Introduction and legal basis

On 19 July 2006 the European Central Bank (ECB) received a request from the Cypriot Cooperative Societies' Supervision and Development Authority (hereinafter the 'YEASE') for an opinion on a draft regulatory decision on the terms and conditions for the affiliation of cooperative credit institutions with the Cooperative Central Bank (hereinafter the 'draft decision').

The ECB's competence to deliver an opinion is based on 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 rules contained in the draft decision materially influence the stability of financial institutions and markets. 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 decision

1.1 The purpose of the draft decision, adopted by the YEASE in accordance with Section 41Z of the Cooperative Societies Law of 1985 to (No 3) 2005 (hereinafter the 'Cooperative Societies Law'), is to harmonise the domestic legal framework governing the establishment and operation of cooperative credit institutions (CCIs) with the Directive on the taking up and pursuit of the business of credit institutions[2] (the 'recast Banking Directive'), that will apply to CCIs from 1 January 2008[3]. The ECB notes that, whilst the recast Banking Directive does not elaborate on the

1 OJ L 189, 3.7.1998, p. 42.

2 Directive 2001/12/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), recently recast as Directive 2006/48/EC (OJ L 177, 30.6.2006, p. 1).

3 See Annex VII to the Act concerning the conditions of accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Slovak Republic and the adjustments to the Treaties on which

procedure for the affiliation of cooperative societies with their respective central bodies, Article 3 of the recast Banking Directive exempts, subject to certain conditions, credit institutions affiliated to a central body from some of their Community banking law obligations[4]. In accordance with Article 3(1) of the recast Banking Directive as implemented by the Cooperative Societies' Law, CCIs will be entitled to pursue their business either on a stand-alone basis or through affiliation with the Cooperative Central Bank (hereinafter the 'SKT')[5] as the central body.

1.2 In line with its stated purpose, the draft decision *inter alia* lays down (i) the procedure for the affiliation of CCIs with the SKT[6]; and (ii) the implications of such affiliation; and (iii) the conditions and procedures for terminating the affiliation of CCIs to the SKT; and (iv) the framework for the the SKT to instruct its affiliated CCIs.

2. General observations

2.1 CCIs are autonomous, mutually owned entities engaging providing core banking services to their members and specialising in mortgage lending and small retail loans. According to the information provided by the consulting authority, CCIs represent a quantitatively important component of the domestic financial system, jointly accounting for about one third of the total loans and deposits in local currency. The subdivision of the domestic banking sector into a commercial banking and a cooperative credit sub-sector resulted in a parallel regulatory and supervisory regime for CCIs, based on the Law on Cooperative Societies, the YEASE being the independent authority responsible for the authorisation, prudential supervision and regulation of CCIs. The CCIs' sector is

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the European Union is founded (OJ L 236, 23.9.2003, p. 819) entitled 'List referred to in Article 24 of the Act of Accession: Cyprus', which provides under Title 2 (FREEDOM TO PROVIDE SERVICES) as follows: 'In Cyprus, Directive 2000/12/EC shall not apply to the Cooperative Credit and Savings Societies, in so far as they are not in conformity with the provisions of this Directive, until 31 December 2007. As from the date of accession and until the end of the above period the Cypriot authorities shall inform the Commission at the beginning of each year about the number of non-conforming Cooperative Credit and Savings Societies which continue to be excluded, as well as the market share that they represent'.

4 Under Article 3 of the recast Banking Directive, credit institutions situated in the same Member State and permanently affiliated to a central body which supervises them and which is established in that same Member State may be exempted from the requirements of Articles 7 and 11(1) of the recast Banking Directive. Moreover such affiliated credit institutions may also be exempted from the provisions of Articles 9 and 10 and also Title V, Chapter 2, Sections 2 to 6 and Chapter 3 of the Directive provided that, without prejudice to the application of those provisions to the central body, the whole as constituted by the central body together with its affiliated institutions is subject to those provisions on a consolidated basis. In case of exemption, Articles 16, 23 to 25, Article 26(1) to (3), and Articles 28 to 37 apply to the whole as constituted by the central body together with its affiliated institutions.

5 To enjoy certain exceptions from the recast Banking Directive several cumulative conditions of permanent affiliation of the credit institution to its central body need to be fulfilled. First, both the central body and affiliated credit institution supervised by that body are to be placed in the same Member State. Second, the national law of that Member State must provide that (1) the commitments of the central body and affiliated institutions are joint and several liabilities or the commitments of its affiliated institutions are entirely guaranteed by the central body; (2) the solvency and liquidity of the central body and of all the affiliated institutions are monitored as a whole on the basis of consolidated accounts; and (3) the management of the central body is empowered to issue instructions to the management of the affiliated institutions.

6 The framework underlying such affiliation has already been defined by the Cooperative Societies' (Amending) Rules of 2004 (Regulatory Act No 874/2004, *Episimi Efimerida tis Dimokratias* No 3940, 31.12.2004), adopted pursuant to Section 53 of the Cooperative Societies Law.

currently undergoing a consolidation process to help the merged entities improve their efficiency and the quality of their services.

2.2 The ECB welcomes the draft decision as a further step towards full conformity between the regime governing the establishment and operation of CCIs and the harmonised framework for the pursuit of the business of credit institutions, noting that the Cypriot authorities have already addressed other aspects of the on-going harmonisation of CCIs with Community law[7].

3. Specific observations

3.1 Section 6.2 of the draft decision provides that the SKT must guarantee in full the repayment of all liabilities of its affiliated CCIs, including all off-balance-sheet liabilities and commitments excluding, subject to conditions, liabilities secured by charges on a CCI's assets. The draft decision regulates in detail the scope and limits of such guarantee, which will be activated at the Commissioner's initiative. Moreover, the fifth recital to the draft decision and Section 6.8(a) and (b) thereof refer to the parallel establishment, by a YEASE regulatory decision, and operation of a 'solidarity' or 'support fund' to supplement the SKT's intervention in any CCI and in general to support all the SKT's activities[8]. Furthermore, the draft decision provides that the Deposit Protection Fund[9] may be also activated for the protection of deposits with CCIs and the SKT.

3.2 First, the ECB understands that, when established, the solidarity fund would be made up of contributions from the CCIs only, thus avoiding any cross-sector subsidisation by other credit institutions that are not CCIs. Second, an appropriate involvement of the Central Bank of Cyprus (CBC) in decisions on the SKT's support of CCIs might be warranted, considering both its role as the SKT's supervisory authority and the need to assess the possible financial stability implications of any intervention. This would require providing for an adequate exchange of information mechanism between the CBC and the YEASE.

3.3 As stated above, Section 6.2 of the draft decision provides that the SKT must guarantee in full the repayment of all liabilities of its affiliated CCIs, including all off-balance-sheet liabilities and commitments excluding, subject to conditions, liabilities secured by charges on a CCI's assets. Section 11.1 of the draft decision provides that the operation of the SKT guarantee shall be no substitute for the company law obligations of the affiliated CCIs' committee, secretary, management and staff. In the interests of legal certainty, the relationship between these two provisions should be clarified.

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7 See draft law amending the Law on the Central Bank of Cyprus of 2002 to 2003 *inter alia* providing for the incorporation of CCIs into the Central Bank of Cyprus' minimum reserve regime on which the ECB adopted Opinion CON/2006/4 of 27 January 2006 at the request of the Central Bank of Cyprus on a draft law amending the Central Bank of Cyprus Laws of 2002 and 2003.

8 See Section 6.3 of the draft decision, read in conjunction with proviso (1) to Section 6.8(b)(iii) thereof, where the solidarity fund is expressly mentioned.

9 The Deposit Protection Fund established under the terms of the Cooperative Societies' (Establishment and Operation of the Deposit Protection Scheme) Rules of 2000 and 2004.

3.4 Sections 6.8(a) and (b)(ii) of the draft decision *inter alia* provide that the SKT shall provide affiliated CCIs services, facilities and support, in its capacity as 'central banker and lender of last resort of all CCIs'. The ECB understands that the SKT's role and powers under Sections 6.8(a) and (b)(ii) are without prejudice to the role and powers of the CBC in this regard, under the terms of the Laws on the Central Bank of Cyprus of 2002 and 2003 and of the Laws on banking of 1997 to (No 2) 2004. Some further clarification in this regard is thus warranted.

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

Done at Frankfurt am Main, 23 August 2006.

[signed]

The President of the ECB

Jean-Claude TRICHET