EUROPEAN CENTRAL BANK

EUROSYSTEM

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OPINION OF THE EUROPEAN CENTRAL BANK

of 26 February 2021

on the reform of Latvijas Banka

(CON/2021/9)

Introduction and legal basis

On 22 December 2020 the European Central Bank (ECB) received a request from the Latvian Ministry of Finance for an opinion on a proposal for a new Law on Latvijas Banka (hereinafter the 'draft law'), together with amendments to 27 other laws (hereinafter 'the draft legislative package').

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 first, second, third, fourth, fifth and sixth indents of Article 2(1) of Council Decision 98/415/EC[1], as the draft legislative package relates to currency matters, means of payment, Latvijas Banka, the collection, compilation and distribution of monetary, financial, banking, payment systems and balance of payment statistics, rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets and the specific tasks conferred on 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 legislative package

On 21 November 2019 the Parliament of the Republic of Latvia adopted amendments to the Law on Latvijas Banka, requiring the Cabinet of Ministers to submit to the Parliament a new draft law on Latvijas Banka that would regulate the governance structure of Latvijas Banka and provide for incorporating Finanšu un kapitāla tirgus komisija (the Latvian Financial and Capital Market Commission - FKTK) into Latvijas Banka. The governance reform and the incorporation of FKTK into Latvijas Banka, constitute the main elements of the draft legislative package. However, given that the current Law on Latvijas Banka was adopted in 1992 and has not been amended very substantially, the draft law also envisages a number of amendments that impact many areas of Latvijas Banka's existing competences, including payment systems, statistics, and the issue and circulation of banknotes and coins. These amendments mainly reflect existing practices at Latvijas Banka, however, where necessary, they add new powers, for example, introducing a sanctioning regime for breaches committed by cash handlers and for breaches of national statistical rules. Once the draft law enters into force the Law on Latvijas Banka and the Law on Financial and Capital Market Commission will be repealed.

1 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).

2. General observations on Latvijas Banka's reform

2.1 Under Article 131 of the Treaty each Member State is required to ensure that its national legislation including the statutes of its national central bank (NCB) is compatible with the Treaties and the Statute of the European System of Central Banks and of the European Central Bank (hereinafter the 'Statute of the ESCB'). When the statute of an NCB, in this case the Law on Latvijas Banka, is amended, the amending law should ensure, in particular, that central bank independence, guaranteed under Article 130 of the Treaty and Articles 7 and 14.2 of the Statute of the ESCB, is fully respected. Compatibility with those provisions is a fundamental aspect of the legal convergence of 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 area[2].

2.2 The ECB welcomes the fact that, as a result of the transfer to Latvijas Banka of FKTK's tasks relating to the prudential supervision of credit institutions, Latvijas Banka will become a national competent authority (NCA) within the framework of the ECB's Single Supervisory Mechanism (SSM) established pursuant to Council Regulation (EU) No 1024/2013[3].

3. Governance reform of Latvijas Banka

3.1 *Change from a two tier governance structure to a single tier governance structure*

3.1.1 *Purpose of the draft law's provisions on a single tier governance structure*

At present Latvijas Banka has a two tier governance structure. The Council of Latvijas Banka, composed of six Members appointed by the Parliament, is the highest decision-making body, while the Board of Latvijas Banka is an executive body appointed by the Council to ensure the efficient management of Latvijas Banka[4]. The Council is chaired by the Governor of Latvijas Banka, who is appointed for a five–year term that may be renewed once. The draft law introduces a single tier governance structure, whereby the sole decision-making body performing tasks related to the European System of Central Banks (ESCB), and whose independence is guaranteed under the Treaty and the Statute of the ESCB, will be the Council. The Council will be composed of seven members. It will be chaired by the Governor, who will have two deputies. The appointment procedure remains unchanged, all Council members, including the Governor and the two Deputy Governors, will be appointed by the Parliament. While it is intended that the draft law will enter into force on 1 January 2023, the switch to the single tier governance structure is intended to take place earlier (when the amendments to the present Law on Latvijas Banka are passed by the Parliament), in order to ensure that the change in the governance structure occurs before FKTK's functions are assumed by Latvijas Banka.

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2 See paragraph 2.1. of Opinion CON/2018/23. All ECB opinions are published on the ECB's website at www.ecb.europa.eu.

3 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).

4 Article 23 of the Law on Latvijas Banka.

3.1.2 *Specific observations on the draft law's single tier governance structure*

The ECB notes that the Treaty and the Statute of the ESCB do not have specific requirements in relation to the levels of governance structure of the NCBs in the ESCB. The members of the Board of Latvijas Banka are employees of Latvijas Banka. The Board of Latvijas Banka manages the operations of Latvijas Banka, implementing the resolutions of the Council of Latvijas Banka. The ECB has already noted that the decision-making body involved in performing ESCB-related tasks in Latvijas Banka is the Council, while the Board of Latvijas Banka is an executive body of Latvijas Banka which merely implements the resolutions of the Council of Latvijas Banka[5]. Against this background, the ECB does not have any observations with regard to the abolition of the Board.

3.2 *Establishment of committees*

3.2.1 *Purpose of the draft law's provisions on establishing committees*

The draft law envisages that Latvijas Banka's Council will establish a number of committees, which would be entitled to adopt binding administrative decisions. According to the draft law, a Supervisory Committee, a Resolution Committee and a Cash Replacement Committee will be established, while a Committee mandated to apply sanctions for breaches of the national statistics regime may be established.

The members of such committees would be prohibited from seeking or taking instructions from the Government of the Republic of Latvia and from other Union Member States, the Union's institutions and other national, foreign or international institutions and their bodies, and these entities would in turn be prohibited from giving instructions or otherwise seeking to influence Latvijas Banka, the members of its Council and the members of the Committees established by the Council.

The Supervisory Committee will be authorised to take decisions stipulated by the laws governing both the financial market and the operations of financial market participants supervised by Latvijas Banka, these include, inter alia, decisions to: a) impose sanctions on and/or b) restrict the rights, obligations and operations of the financial market participants supervised by Latvijas Banka. Latvijas Banka will further elaborate the tasks of the Supervisory Committee. The Council of Latvijas Banka will determine the composition of the Supervisory Committee, which will be chaired by a member of the Council of Latvijas Banka appointed by the Council. No one who is either a member of the Resolution Committee or an employee of Latvijas Banka responsible for Latvijas Banka's tasks in the field of monetary policy formulation and implementation, may be a member of the Supervisory Committee. A decision taken by the Supervisory Committee may be challenged before the Council of Latvijas Banka in line with the procedure stipulated in the Administrative Procedure Law.

The Resolution Committee will be authorised to take decisions stipulated by the laws governing the application of resolution tools and the implementation of the compensation disbursement scheme. Latvijas Banka will further elaborate the tasks of the Resolution Committee. The Committee will be chaired by a member of the Council of Latvijas Banka appointed by the Council. No one who is either a member of the Supervisory Committee or an employee of Latvijas Banka responsible for

5 See paragraph 2.4. of Opinion CON/2019/36.

Latvijas Banka's tasks in the field of monetary policy formulation and implementation may be a member of the Resolution Committee. A decision taken by the Resolution Committee may be challenged before the Council of Latvijas Banka in line with the procedure stipulated in the Administrative Procedure Law.

The Cash Replacement Committee will take decisions on the replacement of damaged and unfit banknotes and coins[6] and apply sanctions on cash handlers who violate the requirements regarding: a) the processing and recirculation of euro banknotes and coins; b) registration; and c) the submission of reports on the handling machines used for processing euro banknotes and coins and the volume of the euro banknotes and coins processed by these machines[7]. The draft law does not provide any further details on the composition of this committee. It is, however, understood that the members of the committee will be employees of Latvijas Banka.

The Council of Latvijas Banka may establish a committee to take decisions imposing sanctions on statistical data providers for failure to comply with the requirements or procedures, in particular the submission deadlines, for preparing or submitting statistical data. The Council of Latvijas Banka will determine the composition of such a committee. The draft law does not provide any further details on the composition of the eventual committee. It is, however, understood that the members of the committee will be employees of Latvijas Banka.

Meetings of the four committees will be valid if more than half of the committee's members participate in the meeting, and decisions will be passed by a majority vote of those present. Latvijas Banka will establish the rules of procedure for the four committees.

The draft law provides that Latvijas Banka may also establish committees in other areas, however, these committees will not be entitled to adopt binding external administrative decisions.

3.2.2 *Specific observations on the draft law's provisions on establishing committees*

All members of an NCB's 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[8]. It is therefore necessary to assess whether the four committees envisaged in the draft law constitute decision-making bodies within the meaning of the Treaties and the Statute.

The Cash Replacement Committee, as well as the committee dealing with statistical sanctions, have specific and narrowly defined mandates, as described above, which do not involve the performance of ESCB-related tasks conferred upon Latvijas Banka by the Treaties and the Statute of the ESCB. Therefore, these Committees do not constitute decision-making bodies within the meaning of the Treaties and the Statute.

6 Article 39(4) of the draft law.

7 Article 43(5) of the draft law.

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

The mandates of the Supervisory and Resolution Committees are confined to supervisory and resolution matters, respectively, and as such do not involve the performance of ESCB-related tasks conferred upon Latvijas Banka by the Treaties and the Statute of the ESCB. Therefore, these Committees do not constitute decision-making bodies within the meaning of the Treaties and the Statute.

3.3 *Appointment criteria and grounds for dismissal of the Governor and Council members of Latvijas Banka*

3.3.1 *Purpose of the draft law's provisions on appointment criteria and grounds for dismissal of the Governor and Council members*

The draft law introduces requirements that a person must comply with in order to be appointed as the Governor of Latvijas Banka and as a member of its Council. A person may become Governor of Latvijas Banka if he/she: (a) is a citizen of the Republic of Latvia; (b) has obtained, as a minimum, a master's degree or an equivalent degree; (c) has adequate experience as the manager of an organisation or in a position directly subordinated to the manager; (d) is competent in issues concerning macroeconomics and financial market analysis; (e) has an unblemished reputation; and (f) meets the legal requirements to be granted the first category personnel security clearance to access official secrets. A person may become a member of the Council of Latvijas Banka if he/she is: (a) a citizen of the Republic of Latvia; (b) has obtained, as a minimum, a master's degree or an equivalent degree; (c) has an unblemished reputation; (d) has adequate professional experience for the position and (e) meets the legal requirements to be granted the first category personnel security clearance to access official secrets.

The draft law clarifies the role and tasks of the Governor of Latvijas Banka, who is the chairperson of the Council of Latvijas Banka and is responsible for organising the work of Latvijas Banka. The draft law provides that in the absence of the Governor his or her duties will be carried out by the Deputy Governor designated by the Governor. In the absence of the Governor and both Deputy Governors, the duties of the Governor will be carried out by a member of the Council of Latvijas Banka designated by the Governor.

According to the draft law a member of the Council of Latvijas Banka may only be relieved of their office before the expiry of the term of the office (five years, renewable once) in the following cases: (a) the member has submitted their resignation; (b) the member no longer fulfils the conditions required for performing their duties within the meaning of Article 14.2 of the Statute of the ESCB; (c) the member has been found guilty of serious misconduct within the meaning of Article 14.2 of the Statute of the ESCB. The draft law further clarifies that the Governor of Latvijas Banka may refer the Parliament's decision to relieve the Governor himself/herself from office to the Court of Justice of the European Union following the procedure stipulated in Article 14.2 of the Statute of the ESCB, while a member of the Council of Latvijas Banka, other than the Governor, may refer the Parliament's decision to relieve him/her from office to the national court in line with the Administrative Procedure Law. If the Governor of Latvijas Banka has been relieved from office before the end of his/her term of office, or his/her term of office has expired before the start of the term of a new Governor, the duties of the Governor – other than the responsibilities of a member of the Governing Council of the ECB – will be carried out by a Deputy Governor designated by the

Parliament, or in his/her absence – by a member of the Council of Latvijas Banka designated by the Parliament.

3.3.2 *Specific observations on the draft law's provisions on appointment criteria and grounds for dismissal of the Governor and Council members*

Regarding the new requirements that a person needs to meet in order to be appointed as the Governor or as an ordinary member of the Council of Latvijas Banka, the ECB recalls that Member States are free to set the conditions required for appointing the members of the decision-making bodies of their NCBs, provided that these conditions do not conflict with the features of central bank independence embedded in the Treaties[9]. The ECB considers that the newly introduced appointment criteria for the Governor and other members of the Council do not conflict with the requirement of central bank independence as laid down in Article 130 of the Treaty and Article 7 of the Statute of the ESCB.

The ECB has given particular consideration to the draft law's requirement[10] that the Governor or the Council member *'*meets the legal requirements to be granted the first category personnel security clearance to access official secrets*'*. In this respect, the ECB understands that the Law on Official Secrets provides that where an official or employee is refused personnel security clearance, or their clearance is cancelled, this represents a sufficient reason for considering that this person no longer fulfils the requirements for the position held/work to be performed, where such position/work is related to the use or protection of an official secret. Therefore, following such a cancellation, the person concerned must be immediately transferred to a position that is not related to an official secret, or, where this is not possible, employment (service) relations must be immediately terminated with him/her.[11] The ECB understands, however, that these provisions of the Law on Official Secrets do not apply to the Governor and other members of the Council of Latvijas Banka because: (a) the draft law contains exclusive grounds for their dismissal; and (b) the relevant provisions of the Law on Official Secrets apply to officials and employees while the Governor and the members of the Council are appointed officials who are not employees of Latvijas Banka and are not in a service relationship with Latvijas Banka.

3.4 *Limiting Council members' term of office*

3.4.1 *Purpose of the draft law's provisions on limiting Council members' term of office*

The draft law provides that the same person may hold the office of a member of the Council for no more than two subsequent terms. According to the explanatory memorandum the intention of the draft law is to introduce a more strict limitation because the provisions of the current Law on Latvijas Banka Law are understood to apply the limitation only with regard to a specific position on the Council, this would mean that a Council member may serve only two consecutive terms of office as an ordinary member of the Council, however he or she could then serve two further terms as Governor. The draft law now proposes to limit the possibility for two consecutive terms of office at Council, irrespective of the position held, whether as an ordinary member, as Deputy Governor

9 See paragraph 2.1 of Opinion CON/2020/19.

10 See Article 12(3)(6) of the draft law.

11 See Article 13(4) of the Law on Official Secrets.

or as Governor. In view of the more restrictive nature of this limitation compared to the law currently in force, the transitional provisions of the draft law specify that the new limitation will apply only to those Council members appointed after the entry into force of the draft law.

3.4.2 *Specific observations on the draft law's provisions on limiting Council members' term of office*

In respect of the new limitations regarding the reappointment of the Council members, the ECB takes note of the fact that the draft law applies the new limitation only to those Council members appointed after the entry into force of the draft law[12].

3.5 *Remuneration of the Governor and Council members*

3.5.1 *Purpose of the draft law's provisions on the remuneration of the Governor and Council members*

The draft law preserves the current legal framework according to which the Council of Latvijas Banka establishes the remuneration system for its members and for the employees of Latvijas Banka. It should be noted, however, that the Law on Latvijas Banka currently in force does not provide any criteria for determining the remuneration. The draft law introduces a formula for determining the salaries of the members of the Council, including the Governor of Latvijas Banka, which must be set based on the average gross monthly salary of employees in the financial and insurance sector for the previous calendar year, applying the following coefficients: (a) 5.44 to the salary of the Governor; (b) 4.91 to the salary of a Deputy Governor of Latvijas Banka; (c) 4.05 to the salary of other members of the Council of Latvijas Banka. The salaries of the Governor, Deputy Governor and other members of the Council will be set on an annual basis, for the period from 1 April of each year to 31 March of the following year. According to the explanatory memorandum this formula for indexing the salaries of the Governor and other members of the Governing Council has already been used in practice by Latvijas Banka for a significant period of time in order to minimise any potential conflicts of interest. Previously the formula had not been laid down by law and was entirely at the discretion of the Governing Council members. The explanatory memorandum states that the formula has been slightly changed to take into account the incorporation of FKTK into Latvijas Banka, by extending the reference remuneration to include remuneration in the insurance sector. In order to ensure that the actual remuneration of the Council members remains unchanged, the coefficients proposed in the draft law have been slightly increased compared with those currently applied in practice.

3.5.2 *Specific observations on the draft law's provisions on the remuneration of the Governor and Council members*

With regard to the remuneration of the members of the Council of Latvijas Banka the ECB notes that Member States may not seek to influence the members of the NCB's decision-making bodies by amending national legislation affecting their remuneration, which, as a matter of principle, should apply only to future appointments.[13] The ECB understands that the impact of the draft law on the actual remuneration of the Governor, Deputy Governor and other members of the Council will be very limited, if any, due to the fact that the coefficients have been calibrated in such a way

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

13 See the ECB Convergence Report 2020, page 24 of the English version.

as to ensure that the remuneration remains largely unaffected. However, given the potential dynamics of the underlying reference value, i.e., the average gross monthly earnings of employees in the financial services and insurance sector, it cannot be excluded that the remuneration of the Governor, Deputy Governor and other Council members will be lower compared with their current remuneration. Against this background the ECB invites the legislator to consider applying the new provisions on the determination of such remuneration only to Governors, Deputy Governors and other Council members appointed after the entry into force of the draft law.

3.6 *Establishment of an Audit Committee*

3.6.1 *Purpose of the draft law's provisions on establishing an Audit Committee*

An Audit Committee will be established to oversee the preparation of the financial statements and the operation of the internal control system, internal audit and external auditors of Latvijas Banka. The Audit Committee will consist of at least three members and a majority of its members must be independent in the discharge of their professional duties. According to the explanatory memorandum, this means that at least one member of the Audit Committee may be an employee of Latvijas Banka. The members of the Audit Committee will be appointed by the Council of Latvijas Banka. It is envisaged that the Audit Committee will become operational by 31 October 2021.

3.6.2 *Specific observations on the draft law's provisions on establishing an Audit Committee*

The ECB welcomes the establishment of an independent Audit Committee by Latvijas Banka, which should further contribute to the good governance of Latvijas Banka.

3.7 *Consultative Financial Market Council*

3.7.1 *Purpose of the draft law's provisions on a Consultative Financial Market Council*

The draft law provides for the establishment of a Consultative Financial Market Council to facilitate the involvement of financial market participants under Latvijas Banka's supervision in matters of direct relevance for them. The Consultative Financial Market Council will consist of three representatives from Latvijas Banka and delegated representatives from every professional association representing the financial market participants under Latvijas Banka's supervision. Its composition will be approved by the Governor of Latvijas Banka.

The main tasks of the Consultative Financial Market Council will be: (a) providing recommendations with regard to Latvijas Banka's draft regulations on supervision, resolution and investor protection; (b) providing an opinion on Latvijas Banka's planned annual expenditure on regulation and supervision of the financial market and the operation of its participants, application of resolution tools and implementation of compensation disbursement schemes; and (c) evaluating the results of accumulating the compensation disbursement scheme resources and disbursements of compensation under those schemes. Latvijas Banka will also have the right to consult the Consultative Financial Market Council on other issues related to the implementation of Latvijas Banka's tasks.

3.7.2 *Specific observations on the draft law's provisions on the Consultative Financial Market Council*

It is noted that a Consultative Financial Market Council already exists under the current legal framework and is consulted on similar matters by FKTK. This body has a strictly consultative character and its opinions are not binding on FKTK. Under the current legal framework, however,

FKTK is obliged to provide explanations in the minutes of the Consultative Financial Market Council meeting as to why it is not following the Council's recommendations[14]. There is no similar requirement in the draft law. However, the ECB understands that Latvijas Banka is under a legal obligation to provide such explanations pursuant to the Administrative Procedure Law and the jurisprudence of the Constitutional Court.

The ECB understands that the Consultative Financial Market Council will be a purely consultative body whose main tasks will be to issue opinions and recommendations to Latvijas Banka in its fields of competence. The Consultative Financial Market Council will not, under any circumstances, be able to directly or indirectly intervene in the decision-making processes of Latvijas Banka. In the past the ECB has broadly welcomed the establishment of similar consultative bodies, which should provide wide-ranging expertise to Latvijas Banka, which will be useful in exercising its new responsibility for supervising the financial market[15]. Many supervisory authorities hold regular consultations with market participants on supervisory matters to maintain a feedback loop which informs the authority of the consequences of its past or intended actions with respect to supervised entities. From a governance perspective, such consultations can help to maintain high and consistent supervisory standards. The submission of individual supervisory decisions to the Consultative Financial Market Council would raise serious concerns from a confidentiality perspective, however, the ECB understands that it is not envisaged that the Consultative Financial Market Council would be consulted prior to the adoption of individual binding administrative decisions addressed to market participants.

4. Financial independence of Latvijas Banka

4.1 *Purpose of the draft law's provisions on Latvijas Banka's financial independence*

Under the draft law the financial reporting and accounting rules of Latvijas Banka remain largely unchanged compared to the current Law on Latvijas Banka.

The nominal capital of Latvijas Banka remains as it is – EUR 100 million. Latvijas Banka will maintain its own independent budget approved by the Council of Latvijas Banka. In addition, the draft law grants Latvijas Banka the right to determine the price list for the services that it provides. According to the explanatory memorandum this is particularly relevant with regard to charges for payment services and participation in payment systems, as well as services related to the circulation of cash. This provision does not apply to the supervisory fees of the financial market participants as those will continue to be collected under the relevant sectoral laws.

The draft law maintains the current legal framework regarding Latvijas Banka's accounting procedures and financial statements. Latvijas Banka will continue to draw up its financial statements in accordance with the ECB's legal acts on accounting and financial statements. Without prejudice to the ECB's requirements, Latvijas Banka remains entitled to issue internal rules establishing additional requirements for the preparation of its financial statements.

14 See Article 21(2) of the Law on FKTK.

15 See paragraph 7 of Opinion CON/2005/39.

The draft law in principle maintains the current legal framework regarding the distribution of Latvijas Banka's profits, adding an explicit clarification that any profit earned during the reporting year is calculated after covering losses accumulated in previous years and that losses are covered from Latvijas Banka's profit carried forward in situations where both the reserve capital and nominal capital are insufficient. The Council of Latvijas Banka retains the right to reduce the payment for the using State capital, comprising 50 % of the profit earned during the reporting year after covering the losses accumulated in previous years, if any, where this reduction is necessary to increase Latvijas Banka's reserve capital in relation to the financial risks Latvijas Banka is exposed to when carrying out its tasks. Profits are to be distributed to the State budget within 3 days of the approval of the annual report by the Council of Latvijas Banka.

4.2 *Specific observations on the draft law's provisions on Latvijas Banka's financial independence*

The ECB welcomes the provisions of the draft law that, while maintaining the current legal framework regarding Latvijas Banka's accounting procedures, financial statements and, in substance, profit distribution, further strengthen Latvijas Banka's financial independence by adding an explicit clarification that any profit earned during the reporting year is calculated after covering losses accumulated in previous years and that losses are covered from Latvijas Banka's profit carried forward in situations where both the reserve capital and nominal capital are insufficient. Nonetheless, the ECB notes that the mechanism for carrying Latvijas Banka's profit forward could also be applied after Latvijas Banka's reserve capital has been used for the purpose of covering the losses. In this manner Latvijas Banka's nominal capital would not need to be used as a loss offsetting mechanism.

The ECB welcomes the liability regime introduced by the draft law, which ensures that Latvijas Banka is only liable for the consequences of the decisions taken independently by Latvijas Banka. In this respect, Latvijas Banka is insulated from any losses arising from claims against FKTK for decisions taken before its incorporation into Latvijas Banka[16].

5. Incorporation of FKTK into Latvijas Banka

5.1 *Purpose of the draft law's provisions on incorporating FKTK into Latvijas Banka*

5.1.1 *Draft law's conferral of new tasks on Latvijas Banka*

The draft law provides for the transfer of all of FKTK's functions to Latvijas Banka and for FKTK's liquidation, effective on 1 January 2023. FKTK is responsible for: (1) the supervision of the whole financial sector – credit institutions, insurers, insurance intermediaries, reinsurers, reinsurance intermediaries, private pension funds, regulated market organisers, depositories, investment brokerage companies, investment management companies, credit unions, external credit assessment institutions (rating agencies), alternative investment fund managers, payment institutions and e-money institutions; (2) the administration of compensation schemes; and (3) the resolution of credit institutions and investment firms. The existing scope and regulation of supervision, implementation of resolution and the administration of compensation schemes

16 For more details see paragraph 5.1.4. of this Opinion.

remains unchanged. Furthermore, financial market participants will continue to bear all costs necessary for the regulation and supervision of the financial market and its participants, the implementation of resolution and the administration of compensation schemes after the transfer of these tasks to Latvijas Banka. Latvijas Banka will assume all of FKTK's liabilities, however, the draft law provides for several layers of protection that aim to insulate Latvijas Banka from any financial consequences.

It is envisaged that the following new tasks will therefore be conferred upon Latvijas Banka as a result of incorporating FKTK: (a) supervision of all regulated financial and capital market participants, including their compliance with the Law on the Prevention of Money Laundering and Terrorism and Proliferation Financing and with the requirements of the Law on International Sanctions and national sanctions of the Republic of Latvia with respect to financial restrictions; (b) the resolution of credit institutions and investment firms; (c) the management of the deposit guarantee fund, the fund for the protection of insured and of disbursement to investors under the investor protection scheme.

5.1.2 *Draft law's transitional provisions*

The Council of Latvijas Banka, in cooperation with FKTK's Council, will establish a Commission to deal with matters concerning the incorporation of FKTK into Latvijas Banka. Both institutions will be represented on this Commission on a parity basis. The Commission will be chaired by an official of Latvijas Banka, while an FKTK official will act as the chairperson's deputy. This Commission will serve as a forum to address in detail the practical issues related to incorporating FKTK into Latvijas Banka. The Commission will draw up and implement a plan for incorporating FKTK into Latvijas Banka. This plan will be adopted by the Council of Latvijas Banka in close cooperation with FKTK's Council.

From July 2021 Latvijas Banka may provide support functions to FKTK. FKTK will reimburse Latvijas Banka for the costs associated with the provision of these services. The detailed rules regarding the provision of support functions and the reimbursement of costs will be set out in a cooperation agreement between Latvijas Banka and FKTK. This approach will allow for a timely integration of support functions, provide additional time for employees to adapt to new internal processes and IT solutions, and enable the smooth integration of part of FKTK's support staff into Latvijas Banka.

The employment relationships with employees executing basic (i.e., non-support) functions within FKTK (sections A and B according to the Eurosystem's Functions Grid) will be transferred to Latvijas Banka. Since it is not possible to ensure the transfer of the existing departments and job titles of FKTK into the structure of Latvijas Banka without any changes being made, the Commission will prepare a proposal for the integration of FKTK's basic functions into the structure of Latvijas Banka and will prepare a list of employees executing basic functions whose employment relationship is to be transferred to Latvijas Banka.

Latvijas Banka will already take over FKTK's task of promoting financial literacy and the acquisition of economic knowledge on 1 January 2022.

The draft law provides that each institution will bear its own costs arising from the process of incorporation.

5.1.3 *Draft law's provisions on preventing conflicts of interest*

Taking into account risks and risk mitigation measures identified in the assessment report of 20 May 2020, the draft law stipulates that Latvijas Banka must ensure the operational separation of monetary policy, supervisory and resolution functions. This includes establishing an internal structure whereby these tasks are carried out by separate departments with separate reporting lines and a clear specification of the powers of the decision-making bodies and their members. Two separate committees will be established for supervisory and resolution matters. Each of these committees will be chaired by a different Council member. The members of the Supervisory Committee may not also be members of the Resolution Committee and vice versa. Furthermore, employees responsible for Latvijas Banka's monetary policy function may not be members of either of these two committees. Finally, the draft law provides that the supervisory and resolution functions must be carried out in such a way that they neither interfere with, nor are determined by, the tasks relating to the Eurosystem's monetary policy. Supervisory tasks must not interfere with or affect monetary policy tasks, i.e. the performance of monetary policy tasks must not be affected by the needs of the supervisory task.

5.1.4 *Draft law's financial arrangements for FKTK's incorporation into Latvijas Banka*

Latvijas Banka will take over the property and financial assets of FKTK and will be the legal successor to its rights and obligations. The draft law contains detailed provisions regarding the use of the net assets of FKTK as at the moment of its incorporation into Latvijas Banka:

1) With regard to any positive net assets a reserve to cover eventual losses related to litigation and claims against FKTK will be established;
2) The remaining net assets, if positive, will be used to reduce Latvijas Banka's expenses, which are covered by financial market participants' contributions;
3) If the remaining net assets are negative or become negative after establishing the reserve to cover eventual losses related to litigation and claims against FKTK, the financial market participants' contributions will be increased.

Any losses arising from claims against FKTK in relation to decisions taken before its incorporation into Latvijas Banka, and for which no reserve was established at the time of the incorporation, will be covered from the State budget.

With regard to the forward-looking financing of expenses for supervision, resolution and the management of deposit guarantee and investor and insurance protection schemes, the draft law provides that any such expenses will be collected from financial market participants. Finally, the draft law changes the liability regime to which Latvijas Banka is subject for losses incurred by a third party as a result of actions performed by a member of the Council of Latvijas Banka, an employee of or a person authorised by Latvijas Banka, when performing his/her official (work) duties from a standard based on regular negligence to a standard based on the commission of deliberate unlawful acts or gross negligence.

5.2 *Assessment of the conferral of new tasks on Latvijas Banka against the prohibition of monetary financing*

5.2.1 *New tasks conferred on Latvijas Banka*

As noted above, an extensive range of new tasks will be conferred on Latvijas Banka as a result of incorporating FKTK, these include: (a) the supervision of all regulated financial and capital market participants, including credit institutions; (b) the resolution of credit institutions and investment firms; and (c) the management of the deposit guarantee fund, the fund for the protection of insured and of disbursements to investors under the investor protection scheme. It may appear from the drafting of the transitional provisions that there is another new task conferred on Latvijas Banka, namely promoting financial literacy and the acquisition of economic knowledge. However, this is not a genuinely new task, as Latvijas Banka has spent decades working on providing information and educational facilities to the general public[17]. Consequently, it is not necessary to assess whether promoting financial literacy and the acquisition of economic knowledge task complies with the prohibition of monetary financing[18].

5.2.2 *Criteria for assessing the conferral of new tasks of ESCB NCBs against the prohibition of monetary financing*

The ECB emphasises that a proposed conferral of new tasks on an NCB participating in the ESCB must be assessed against the prohibition on monetary financing under Article 123 of the Treaty. For the purposes of that prohibition, Article 1(1)(b)(ii) of Council Regulation (EC) No 3603/93[19] defines 'other type of credit facility' as, inter alia, 'any financing of the public sector's obligations vis-à-vis third parties'.

Ensuring that Member States implement a sound budgetary policy is one of the key objectives of the prohibition on monetary financing, which may not be circumvented. Therefore, the task of financing measures, which are normally the responsibility of the Member States, and which are financed from their budgetary sources rather than by the NCBs, must not be entrusted to NCBs. To decide what constitutes financing of the public sector's obligations vis-à-vis third parties – which may be interpreted as providing central bank financing outside the scope of central bank tasks – it is necessary to carry out, on a case-by-case basis, an assessment on whether the task to be undertaken by an NCB is a central bank task or a government task, i.e. a task within the responsibility of the Member States. In other words, adequate safeguards must be in place to ensure that the objective of the prohibition on monetary financing, which is to that Member States maintain a sound budgetary policy, is not circumvented.

As part of its discretion in the exercise of its duty – on the basis of Article 271(d) of the Treaty and Article 35.6 of the Statute of the ESCB – to ensure that NCBs honour the obligations laid down by the Treaty, the Governing Council has endorsed safeguards in the form of criteria for determining

17 Regarding the specific activities of Latvijas Banka in this context please see pages 55-57 of Latvijas Banka's Annual Report 2019.

18 See the ECB Convergence Report 2020, footnote 72.

19 Council Regulation (EC) No 3603/93 of 13 December 1993 specifying definitions for the application of the prohibitions referred to in Articles 104 and 104b (1) of the Treaty (OJ L 332, 31.12.1993, p. 1).

what may be considered as falling within the scope of 'the public sector's obligations vis-à-vis third parties' within the meaning of Article 1(1)(b)(ii) of Regulation (EC) No 3603/93 or, in other words, what constitutes a government task, as follows:

First, central bank tasks are, in particular, those tasks that are related to the tasks that have been conferred upon the ECB and the NCBs by the Treaty and the Statute of the ESCB. These tasks are mainly defined in Article 127(2), (5) and (6), and Article 128(1) of the Treaty, as well as in Article 22 and Article 25.1 of the Statute of the ESCB.

Second, pursuant to Article 14.4 of the Statute of the ESCB NCBs may perform 'functions other than those specified in [the Statute of the ESCB]', new tasks, i.e. tasks that are not related to tasks that have been conferred upon the ECB and the NCBs, are not precluded per se. However, new tasks that are undertaken by an NCB and which are atypical of NCB tasks or which are clearly discharged on behalf of, and in the exclusive interest of the government or of other public sector entities, should be considered government tasks.

Third, an important criterion for qualifying a new task as an atypical NCB task, or as being clearly discharged on behalf of and in the exclusive interest of the government or other public sector entities, is the impact of the task on the institutional, financial and personal independence of the NCB concerned.

In particular, the following aspects should be taken into account:

(a) whether the performance of the new task creates conflicts of interest with existing central bank tasks which are not adequately addressed, and its performance does not necessarily complement those existing central bank tasks. If a conflict of interest arises between existing and new tasks, sufficient safeguards to mitigate that conflict should be in place. The complementarity between a new task and existing central bank tasks should not be interpreted broadly so that it could lead to the creation of an indefinite chain of ancillary tasks. Such complementarity should be examined in relation to the financing of those tasks;

(b) whether without new financial resources the performance of the new task is disproportionate to the NCB's financial or organisational capacity, and may have a negative impact on the capacity to properly perform the existing central bank tasks;

(c) whether the performance of the new task fits into the institutional set-up of the NCB in the light of central bank independence and accountability considerations;

(d) whether the performance of the new task harbours substantial financial risks;

(e) whether the performance of the new task exposes the members of the NCB decision-making bodies to political risks that are disproportionate and may also have an impact on their personal independence and, in particular, on the guarantee of term of office set out in Article 14.2 of the Statute of the ESCB.

5.2.3 *Assessment of the conferral of new tasks on Latvijas Banka against the prohibition of monetary financing*

Based on the criteria set out above, the following paragraphs assess whether Latvijas Banka's new tasks are in line with the prohibition of monetary financing.

a) *Tasks related to the tasks conferred upon the ECB and the NCBs by the Treaty and the Statute of the ESCB*

Pursuant to Article 127(5) of the Treaty and Article 3.3 of the Statute of the ESCB, the ESCB must contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system. Pursuant to Article 127(6) of the Treaty and Article 25.2 of the Statute of the ESCB, the Council may confer specific tasks upon the ECB concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings. On this basis, the Council has conferred tasks upon the ECB concerning the prudential supervision of credit institutions pursuant to Regulation (EU) No 1024/2013.

As a result of the transfer to Latvijas Banka of FKTK's tasks relating to the prudential supervision of credit institutions, Latvijas Banka will become an NCA within the framework of the SSM established pursuant to Regulation (EU) No 1024/2013. The remaining tasks to be transferred from FKTK to Latvijas Banka concerning the supervision of other financial market participants, the resolution of credit institutions and investment firms and the management of deposit guarantee and investor and insurance protection schemes are not directly related to the tasks conferred upon the ECB and the NCBs by the Treaty and the Statute of the ESCB.

b) *Tasks which are atypical of central bank tasks*

Latvijas Banka's new tasks in the fields of the supervision and resolution of credit institutions and other financial market participants and the management of deposit guarantee and investor and insurance protection schemes are not atypical central bank tasks.

Supervisory tasks, and tasks relating to supervisory tasks, are among the tasks which central banks exercise[20]. Thirteen out of the nineteen NCAs participating in the SSM are NCBs. The ECB has consistently favoured the involvement of NCBs in prudential supervision. Past ECB opinions on draft national legislation reforming the institutional framework for prudential supervision in Member States have noted that NCBs have traditionally been closely involved in the prudential supervision of credit institutions due to their pivotal role in the financial system, in particular regarding implementing monetary policy and ensuring the proper functioning of payment systems[21].

In the past the ECB has also taken the position that the extension of an NCB's supervisory tasks to non-banking supervision is compatible with ESCB tasks. Faced with the increased blurring of traditional borders between the banking, securities and insurance sectors and the resulting new challenges to prudential supervision and the stability of the financial system, an NCB with overall responsibility for the financial markets is likely to cope better than

20 See the ECB Convergence Report 2020, page 32 of the English version.

21 See paragraph 2.1.2. of Opinion CON/2006/15.

several supervisors, whose supervisory competences are limited to a particular financial sector[22].

Resolution *tasks* may be considered to be central banking tasks, provided that they do not undermine an NCB's independence in accordance with Article 130 of the Treaty[23]. Administrative resolution tasks are considered to be tasks related to those referred to in Article 127(5) of the Treaty, based on the understanding that administrative resolution tasks and supervisory tasks complement each other. The ECB has already opined that if an NCB's resolution-related responsibilities are extended to other financial institutions forming part of a banking group, such new tasks may also be considered to be related to tasks under Article 127(5) of the Treaty, by analogy with the complementarity of an NCB's resolution tasks in respect of credit institutions with its existing supervisory and financial stability tasks. A number of Member States have conferred on their NCBs a significant role in the resolution of credit and financial institutions, either as the resolution authority itself or as a competent supervisory authority. The ECB has generally accepted the allocation of such tasks to NCBs provided they do not interfere financially and operationally with the performance of the NCB's ESCB-related tasks[24].

The ECB understands that resolution financing arrangements in Latvia remain unchanged and continue to be governed by the relevant provisions of the Law on the Restoration and Resolution of Credit Institutions and Investment Brokerage Companies[25]. Accordingly, Latvijas Banka will be responsible for ensuring the accumulation and management of funds in the national resolution fund from entities subject to resolution. Latvijas Banka will also be entitled to use alternative sources of financing and enter into loan or other support agreements with investment brokerage companies, financial institutions or other third parties if the funds in the resolution fund are not immediately available or insufficient to cover losses, costs or other expenses[26]. Finally, Latvijas Banka will be entitled to request a loan from the resolution financing mechanisms of other Member States[27].

In this context the ECB notes that the financing by an ESCB NCB of any resolution fund or financial arrangement is not in line with the monetary financing prohibition under Article 123 of the Treaty. Where an NCB acts as resolution authority, it should not, under any

22 See paragraph 2.3. of Opinion CON/2011/46.

23 See paragraph 3.2.3 of Opinion CON/2016/28.

24 With respect to resolution, the ECB notes that Article 3(3) of Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 82/891/EEC, and Directives 2001/234/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1309/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12.6.2014, p. 190) provides that authorities which are also competent authorities for banking supervision purposes may only exceptionally be designated as resolution authorities, and only subject to adequate structural arrangements being in place to ensure operational independence and avoid conflicts of interest between the supervision function and other functions of the authority concerned.

25 Articles 121 to 127 of the Law on the Restoration and Resolution of Credit Institutions and Investment Brokerage Companies.

26 Article 121.3 of the Law on the Restoration and Resolution of Credit Institutions and Investment Brokerage Companies.

27 Article 121.4 of the Law on the Restoration and Resolution of Credit Institutions and Investment Brokerage Companies.

circumstances, assume or finance any obligation of either a bridge institution or an asset management vehicle. To this end, national legislation should clarify that the NCB will not assume or finance any of these entities' obligations[28].

The ECB has recognised that the management of deposit guarantee and investor and insurance protection schemes are tasks that are complementary to an NCB's supervisory tasks[29]. In Latvia, this is clear from the fact that these tasks have been performed by FKTK ever since its creation in 2001.

c) *Tasks clearly discharged on behalf of and in the exclusive interest of the government*

For the same reasons as described in point b), the tasks conferred upon Latvijas Banka by the draft law in relation to the supervision and resolution of credit institutions and other financial market participants and the management of deposit guarantee and investor and insurance protection schemes are not tasks discharged on behalf of and in the exclusive interest of the government.

d) *Extent to which the performance of the new tasks creates conflicts of interest with existing central bank tasks*

The draft law provides for the operational separation of monetary policy, supervisory and resolution functions. This includes the establishment of an internal structure whereby these tasks are carried out by separate departments with separate reporting lines and a clear specification of the powers of the decision-making bodies and their members. Two separate committees will be established for supervisory and resolution matters. Each of these committees will be chaired by a different Council member. The members of the Supervisory Committee may not also be members of the Resolution Committee and vice versa. Finally, the draft law provides that the supervisory and resolution functions must be carried out in such a way that they neither interfere with, nor are determined by, the tasks relating to the Eurosystem's monetary policy. These provisions clearly insulate the supervisory and the resolution tasks from creating conflicts of interest with existing central bank tasks[30].

e) *Extent to which the performance of the new tasks is disproportionate to Latvijas Banka financial or organisational capacity*

National legislation which requires an NCB to take over the liabilities of a previously independent public body, as a result of a national reorganisation of certain tasks and duties, for example, in the context of a transfer to the NCB of certain supervisory tasks previously carried out by the State or independent public authorities or bodies, without fully insulating the NCB from all financial obligations resulting from the prior activities of such a body, would be incompatible with the monetary financing prohibition[31]. The draft law's transitional provisions contain detailed rules regarding the use of the net assets of FKTK as at the

28 See the ECB Convergence Report 2020, page 34 of the English version.

29 See Opinion CON/2016/6.

30 With respect to prudential supervision, the ECB notes that the provisions on the separation between monetary policy and supervision under Article 25 of Council Regulation (EU) No 1024/2013 apply directly to the ECB, not to national competent authorities.

31 See the ECB Convergence Report 2020, page 34 of the English version.

moment of its incorporation into Latvijas Banka (see paragraph 5.1.4). Any losses arising from claims against FKTK in relation to decisions taken before its incorporation into Latvijas Banka, and for which no reserve was established at the time of the incorporation, will be covered from the State budget. The ECB welcomes this provision as it clearly insulates Latvijas Banka from FKTK's financial obligations thus ensuring compliance with the monetary financing prohibition. With regard to the forward-looking financing of expenses arising out of Latvijas Banka's new supervisory, resolution and deposit guarantee and investor and insurance protection schemes management tasks, the draft law provides that any such expenses will be collected from financial market participants. Finally, the transitional provisions also provide for the transfer of all employees executing the basic (i.e., non-support) functions of FKTK to Latvijas Banka.

Taking into account the new responsibilities of Latvijas Banka within the framework of the SSM, the ECB notes that Article 4(4) of Directive 2013/36/EU of the European Parliament and of the Council[32] requires Member States to ensure that the competent authorities have the expertise, resources, operational capacity, powers and independence necessary to carry out the functions relating to prudential supervision, investigations and penalties set out in that Directive and in Regulation (EU) No 575/2013 of the European Parliament and of the Council[33]. According to the recommendations of the Basel Core Principles for Effective Banking Supervision[34] the supervisor is to have adequate resources for the conduct of effective supervision and oversight. In view of the responsibilities of Latvijas Banka within the framework of the SSM, and also considering Latvijas Banka's resources, the Latvian authorities should take into account the SSM's need for NCA staff on joint supervisory teams and inspection teams and the more intense supervision expected for less significant institutions[35].

Against this background, it does not appear that the performance of the new tasks conferred upon Latvijas Banka would be disproportionate to Latvijas Banka's financial or organisational capacity, and should not affect the resources Latvijas Banka currently allocates for the performance of its monetary policy and other existing central banking tasks.

f) Extent to which performance of the new tasks fits into Latvijas Banka's institutional set-up, in the light of central bank independence and accountability considerations

The allocation of the new tasks to Latvijas Banka relating to the supervision and resolution of credit and financial institutions and the management of deposit guarantee and investor and insurance protection schemes will be accompanied by the establishment of two new committees that will deal with supervisory and resolution matters respectively. The rules of

32 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

33 Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

34 Available on the Bank for International Settlements website at www.bis.org.

35 See also paragraph 2.2. of Opinion CON/2018/6.

procedure adopted by Latvijas Banka's Council will determine which decisions these committees are primarily responsible for. The Council will be the appeal body for binding decisions taken by the committees. While the members of the committees, who are not also members of the Council, will only benefit from institutional independence guarantees, all Council decisions, irrespective of whether they concern ESCB-related tasks or supervisory and resolution tasks, benefit from the same independence guarantees and are subject to the same accountability regime. Finally, the draft law's provisions on avoiding conflicts of interest, as described in paragraph 5.1.3., sufficiently insulate the performance of ESCB tasks by Latvijas Banka from the performance of the new tasks proposed to be allocated to Latvijas Banka.

Against this background the ECB considers that the allocation of the new tasks to Latvijas Banka is unlikely to conflict with the institutional set-up of Latvijas Banka.

g) *Extent to which the performance of tasks could incur substantial financial risks*

With regard to Latvijas Banka's liability regime the draft law provides that the liability for actions performed by a member of Latvijas Banka's Council, or an employee or an authorised person of Latvijas Banka, when performing his/her official duties is limited to the commission of deliberate unlawful acts or gross negligence. Under the current legal framework the liability of FKTK's decision-making bodies and staff is broader and is not confined to gross negligence. The draft law thus considerably mitigates financial risks that could arise from the conferral of the new supervisory and resolution tasks on Latvijas Banka.

h) *Extent to which the performance of the new tasks exposes members of Latvijas Banka's decision-making bodies to disproportionate political risks and has an impact on their personal independence*

The performance of the new tasks conferred on Latvijas Banka by the draft law does not expose the members of Latvijas Banka's decision-making bodies to any disproportionate political risk and has no impact on their personal independence.

Conclusion

The new tasks conferred by the draft law on Latvijas Banka relating to the supervision and resolution of credit and financial institutions and the management of deposit guarantee and investor and insurance protection schemes can be considered to be central bank tasks. With regard to the prudential supervision of credit institutions, Latvijas Banka's tasks complement the ECB's prudential supervisory tasks within the framework of the SSM. The remaining tasks are not atypical of central bank tasks, and have been conferred upon a number of other ESCB NCBs. The financial risks facing Latvijas Banka as a result of the assumption of these new tasks have been limited by the draft law. Financial market participants will continue to bear all costs necessary for the regulation and supervision of the financial market and its participants, the implementation of resolution and the management of deposit guarantee and investor and insurance protection schemes after the transfer of these tasks to Latvijas Banka. Any losses arising from claims against FKTK for decisions taken before its incorporation into Latvijas Banka, and for which no reserve was established at the time of the incorporation, will be covered from the State budget. Expenses

incurred by Latvijas Banka when performing its new tasks will be covered by contributions from financial market participants. The liability of Latvijas Banka will be limited to deliberate unlawful acts and gross negligence. Care has been taken in the draft law to ensure that the new tasks fit into Latvijas Banka's new institutional framework, and to appropriately manage conflicts of interest which might arise in the performance of Latvijas Banka's tasks in the fields of central banking, supervisory, resolution, deposit guarantee and investor and insurance protection schemes.

6. Payment and financial instrument settlement systems

6.1 *Purpose of the draft law's provisions on payment and financial instrument settlement systems*

Under the draft law Latvijas Banka's task of promoting the smooth functioning of payment and financial instrument settlement systems is regulated in greater detail than under existing law. The draft law provides that the promotion of the smooth functioning of payment and financial instrument settlement systems includes the oversight of payment systems in order to assess their efficiency and security. Latvijas Banka oversees payment and financial instrument settlement systems together with the other Eurosystem central banks, in accordance with the Eurosystem's oversight policy framework. This oversight covers all payment and financial instrument settlement systems operating in Latvia. The draft law clarifies that the task of promoting the smooth functioning of payment and financial instrument settlement systems also includes promoting the development of means of payment. Latvijas Banka ensures the participation of Latvian financial market participants in TARGET2-Latvia in accordance with the ECB's legal framework, including ECB guidelines, and in the electronic clearing system maintained by Latvijas Banka.

6.2 *Specific observations on the draft law's provisions on payment and financial instrument settlement systems*

The ECB welcomes the provisions of the draft law providing a more robust legal basis for Latvijas Banka's existing tasks relating to the smooth functioning of payment and financial instrument settlement systems, including the oversight of payment systems, in order assess their efficiency and security.

7. Issue and circulation of euro banknotes and coins

7.1 *Purpose of the draft law's provisions on the issue and circulation of euro banknotes and coins*

7.1.1 The draft law empowers Latvijas Banka to organise the production and delivery of euro banknotes and issue euro banknotes pursuant to the Statute of the ESCB and the ECB's legal acts. Latvijas Banka organises the design, production and delivery of euro circulation coins, including euro commemorative coins, and collector coins, and issues the above coins in compliance with the Union's legal acts and according to the volume of euro coin issuance approved by the ECB. Latvijas Banka processes euro banknotes and coins, replaces them and withdraws them from circulation in compliance with the Union's legal acts, including those of the ECB.

In order to facilitate the availability of euro cash in Latvia, Latvijas Banka is tasked with: (a) monitoring, analysing and estimating the future circulation of cash in Latvia; (b) preparing a report on cash circulation and availability in Latvia; and (c) cooperating with the legal entities involved in

cash circulation in Latvia, to develop and implement measures to ensure euro cash circulation in Latvia.

7.1.2 The draft law provides that Latvijas Banka withdraws from circulation unfit euro banknotes and coins submitted to it and replaces them with fit ones pursuant to the Union's legal acts, including those of the ECB. In line with this legal framework, Latvijas Banka may refuse to replace damaged and unfit euro banknotes or coins submitted to Latvijas Banka if their appearance, in Latvijas Banka's opinion, has been altered intentionally or by a process that could reasonably be expected to have such an effect. The draft law mandates Latvijas Banka to lay down the requirements and procedure for the acceptance, identification and replacement of damaged and unfit banknotes and coins. The draft law further mandates Latvijas Banka's Council to establish a committee empowered to take decisions on the replacement of damaged and unfit banknotes or coins accepted for identification.

7.1.3 The draft law mandates Latvijas Banka to withdraw from circulation counterfeit banknotes and coins and illegal reproductions of euro banknotes and coins submitted to Latvijas Banka, pursuant to the Union's legal acts, including those of the ECB. The draft law further provides that in the cases stipulated by the Union's legal acts, including those of the ECB, Latvijas Banka must provide a written confirmation of the legality of the euro banknote or coin reproduction if so requested. The draft law mandates Latvijas Banka to lay down the requirements and procedure for the acceptance and identification of banknotes and coins that are suspected of being counterfeit.

7.1.4 The draft law codifies existing arrangements by designating Latvijas Banka as the competent authority performing the functions of the National Analysis Centre and the Coin National Analysis Centre in the Republic of Latvia in line with Articles 4 and 5 of Council Regulation (EC) No 1338/2001[36].

7.1.5 The draft law mandates Latvijas Banka to replace euro banknotes and coins fit for circulation and to lay down the requirements and procedure for the replacement of euro banknotes and coins fit for circulation.

7.1.6 The draft law establishes a regime for Latvijas Banka's interaction with cash handlers. In particular, Latvijas Banka is mandated to establish: (a) the requirements for the processing and recirculation of euro banknotes and coins; (b) the requirements and procedure for the registration and operation control of cash handlers; and (c) the requirements for submitting reports on the handling machines used for the processing of euro banknotes and coins and on the volume of the euro banknotes and coins processed by these machines.

7.1.7 Finally, the draft law mandates Latvijas Banka to issue a warning or impose a penalty ranging from EUR 1 000 to 10 000 on cash handlers violating the requirements for: (a) the processing and recirculation of euro banknotes and coins; (b) the registration of cash handlers; or (c) submitting reports on the handling machines used for the processing of euro banknotes and coins and on the volume of the euro banknotes and coins processed by these machines. The right to apply sanctions to cash handlers is new as it is not foreseen in the legal framework currently in force.

36 Council Regulation (EC) No 1338/2001 of 28 June 2001 laying down measures necessary for the protection of the euro against counterfeiting (OJ L 181, 4.7.2001, p. 6).

Such sanctioning powers are in line with Regulation (EC) No 1338/2001 and Regulation (EU) No 1210/2010 of the European Parliament and of the Council[37]. It is envisaged that decisions on the application of these sanctions would be adopted by a committee established by the Council of Latvijas Banka.

7.2 *Specific observations on the draft law's provisions on the issue and circulation of euro banknotes and coins*

7.2.1 The ECB understands that the draft law aims to contribute to the availability of cash to a satisfactory extent throughout Latvia. The ECB welcomes the objective of strengthening the position of cash as a means of payment and a store of value accessible to all groups of the population. As previously noted by the ECB, although electronic payment instruments are increasingly used and the use of cash is declining, cash in general is still an established means of payment providing for the immediate settlement of debts. Furthermore, the ability to pay in cash remains particularly important for certain groups in society that, for various legitimate reasons, prefer to use cash rather than other means of payment, or who are unable to use digital technology. Cash could play an important role in the event of a disruption affecting payment systems, even though cash machines and other service points may also be affected as these are dependent on interaction with the account holding institutions[38]. It is important that all Member States take appropriate measures to ensure that credit institutions and branches operating within their territories provide adequate access to cash services, in order to facilitate the continued use of cash[39].

Against this background, the ECB would like to suggest clarifying the draft law by explicitly stating that Latvijas Banka, in cooperation with the legal entities involved in the circulation of cash in Latvia, will develop and implement measures to ensure that there is ***sufficient*** euro cash circulating in Latvia[40]. With regard to the provision mandating Latvijas Banka to prepare a report on cash circulation and availability in Latvia the ECB understands that the preparation of this report is a regular/on-going activity, and recommends that this is clarified in the draft law by introducing details regarding the intervals at which the report will be prepared.

7.2.2 The wording of the draft law[41] needs to be strengthened in order to align it with Article 3(3)(a) of Decision ECB/2013/10 of the European Central Bank[42], as this legal act does not provide for any discretion, where NCBs know or have sufficient reason to believe that genuine euro banknotes have been intentionally damaged, they must refuse to exchange and must withhold the euro banknotes, in order to avoid the return of such euro banknotes into circulation or to prevent the applicant from presenting them to another NCB for exchange. Decision ECB/2013/10 provides that the only exception to this obligation is when the applicant's good faith is known or provable. The

37 Regulation (EU) No 1210/2010 of the European Parliament and of the Council of 15 December 2010 concerning authentication of euro coins and handling of euro coins unfit for circulation (OJ L 339, 22.12.2010, p. 1).

38 See paragraph 9.2.1 of Opinion CON/2020/13.

39 See paragraph 9.2.3 of Opinion CON/2020/13.

40 See Article 38(5) 3 of the draft law.

41 See Article 39(1) of the draft law.

42 Decision ECB/2013/10 of the European Central Bank of 19 April 2013 on the denominations, specifications, reproduction, exchange and withdrawal of euro banknotes (OJ L 118, 30.4.2013, p. 37).

ECB understands that the scope of this provision of the draft law[43] is limited to rules applicable to the exchange of unfit and damaged banknotes. It should be ensured that any decisions on the replacement of damaged or unfit banknotes, which the draft law mandates a committee nominated by Latvijas Banka to take, are taken in accordance with the Union's legal acts, including those of the ECB in particular Decision ECB/2013/10.

7.2.3 With regard to the reproduction of euro banknotes the ECB would like to draw attention to the fact that Decision ECB/2013/10 was amended at the end of 2020. In line with the relevant amendments the wording of the draft law should be updated to ensure that it is in line with Decision ECB/2013/10, for example, the ECB does not confirm the legality of a reproduction of euro banknotes, but rather consents to exempt a reproduction of a euro banknote based on the outcome of an analysis. Furthermore, the ECB understands that the requirements and procedure for the acceptance and identification of suspected counterfeit banknotes and coins[44] will be set by Latvijas Banka in line with the Union's legal acts, including those of the ECB. Moreover, the competences to exempt a reproduction in line with Article 2(5) of Decision ECB/2013/10 should be clarified to take into account cases where a reproduction is not produced in the territory of Latvia.

7.2.4 With regard to Latvijas Banka's mandate to replace euro banknotes and coins fit for circulation the ECB understands that this provision is not intended to create an absolute right for members of the general public to request and receive any denominations, and would suggest that this interpretation be reflected in the draft law.

7.2.5 In relation to the draft law's provisions on Latvijas Banka's interaction with cash handlers, the ECB understands that the requirements for the processing and recirculation of euro banknotes and coins and for submitting reports on the handling machines used for the processing of euro banknotes and coins and on the volume of euro banknotes and coins processed by these machines will be set by Latvijas Banka in line with the Union's legal acts, including those of the ECB.

7.2.6 Finally, the ECB welcomes the new sanctioning powers of Latvijas Banka for potential breaches of cash handlers violating requirements for: (1) the processing and recirculation of euro banknotes and coins; (2) the registration of cash handlers; (3) submitting reports on the handling machines used for the processing of euro banknotes and coins and the volume of euro banknotes and coins processed by these machines.

8. Statistics

8.1 *Purpose of the draft law's provisions on statistics*

8.1.1 The collection of statistics is currently a task allocated to both Latvijas Banka and FKTK. While Latvijas Banka benefits from an exemption under the Law on Statistics, FKTK is currently designated as one of the statistical authorities, subject to the requirements of the Law on Statistics. Following the incorporation of FKTK into Latvijas Banka, the statistics until now covered by FKTK will come under the exemption from the Law on Statistics. Therefore, the draft law provides for a

43 See Article 39 of the draft law.

44 See Article 40(4) of the draft law.

comprehensive statistical framework that complies with the basic principles of the two statistical systems at the European level – of the ESCB and of the European Statistical System composed of Eurostat and the statistical authorities of the Member States.

8.1.2 The draft law mandates Latvijas Banka to collect, store and process statistical data as well as develop, compile, analyse and disseminate statistics to ensure the fulfilment of its tasks of, inter alia, assisting the ECB in providing the statistics required for executing ESCB tasks and supervising credit institutions and assisting the Union institutions and bodies responsible for the supervision of financial market participants, financial market infrastructures, the application of resolution tools, ensuring compensation disbursement schemes or the promotion of the stability of the financial system.

8.1.3 The draft law further provides that Latvijas Banka must establish the requirements and procedures for preparing and submitting statistical data and specifying the submission deadline as well as the persons obliged to provide statistical data (i.e., the statistical data providers) for monetary and financial statistics, banknote and coin statistics, payment and payment system statistics, external statistics (including balance of payments and international investment position statistics), financial account statistics, resolution and compensation disbursement scheme statistics, financial stability statistics, supervisory statistics as well as other statistics required for carrying out Latvijas Banka's tasks.

8.1.4 The draft law provides that Latvijas Banka obtains the statistical data directly from statistical data providers or indirectly from administrative data sources (registers, databases, information systems and other information sources). Upon receiving a reasoned request from Latvijas Banka, the holder of an administrative data source is obliged to provide statistical data to Latvijas Banka free of charge.

8.1.5 The draft law limits the use of statistical data by Latvijas Banka to the fulfilment of its tasks as defined by the draft law. The draft law requires Latvijas Banka to anonymise personal data immediately after their receipt, verification and joining with other statistical data, except where the personal data are required to ensure the statistical information necessary to fulfil Latvijas Banka's tasks, and the personal identification data must be stored separately from the anonymised statistical data.

8.1.6 The draft law provides that the duration for storing statistical data is to be established by Latvijas Banka. Latvijas Banka must take measures to prevent unauthorised access to statistical data, their distortion or dissemination and their unintentional or unauthorised destruction.

8.1.7 The draft law allows for the use of statistics for research or analytical purposes, for developing conceptual recommendations or performing impact assessments of statistical data enabling the indirect identification of the statistical data provider or any other person.

8.1.8 The draft law enables Latvijas Banka to release certain types of statistical data for exchange within the feedback loop as prescribed by Regulation 2016/867 of the European Central Bank

(ECB/2016/13)[45]. Currently the national legal framework does not allow credit institutions that provide Latvijas Banka with the relevant granular credit data to benefit from Regulation 2016/867 (ECB/2016/13) by receiving granular credit data from other Member States' statistical data providers for the purposes of the AnaCredit project. The draft law entitles Latvijas Banka to determine the procedures for implementing exchanges with statistical data providers of granular credit data available within the AnaCredit feedback loop.

8.1.9 The draft law regulates the sanctions that Latvijas Banka is entitled to apply for violations of the provision, use and protection of statistical data, as well as the procedural rules for the application of these sanctions. The draft law makes it clear that these sanctioning powers are without prejudice to the ECB's right to impose sanctions under directly applicable Union legal acts, including those of the ECB. The sanctioning regime provided for in the draft law concerns only those sanctions that Latvijas Banka may impose for breaches of requirements in the field of statistics that are not covered by the Union's legal acts, including those of the ECB. The explanatory memorandum further clarifies that infringements related to supervisory statistical data sanctions will be imposed in accordance with the requirements of the sectoral laws governing the activities of the respective financial market participants. The adoption of decisions on the imposition of sanctions in the field of statistics may be delegated to a committee established by the Council of Latvijas Banka.

8.2 *Specific observations on draft law's provisions on statistics*

8.2.1 The ECB understands that Latvijas Banka establishes requirements and procedures for preparing and submitting statistical data, the submission deadlines and the statistical data providers without prejudice to the ECB's regulatory powers in accordance with the primacy of the EU law.

8.2.2 With regard to the right of Latvijas Banka to establish the duration for storing statistical data, the consulting authority is invited to follow developments in this regard at the ESCB level, as the duration for storing statistical data has not yet been decided. The ECB understands that in accordance with the primacy of the EU law the duration for storing statistical data established by Latvijas Banka may not be shorter than any period determined by the ECB.

8.2.3 Regarding the duty of Latvijas Banka to take measures to prevent unauthorised access to statistical data, their distortion or dissemination, as well as accidental destruction, the ECB understands that this will be performed in accordance with Article 8(3) of Regulation (EC) No 2533/98[46].

8.2.4 With regard to the use of statistical data enabling the indirect identification of a statistical data provider or any other person for research purposes, the relevant provisions of Regulation (EC) No 2533/98 grant such access only to scientific research bodies and with the explicit prior consent of the authority which provided the information. The ECB understands that the procedures of Latvijas Banka to be determined regarding access to such statistical data for scientific research purposes will be aligned with Article 8(1) (c) of Regulation (EC) No 2533/98.

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45 Regulation (EU) 2016/867 of the European Central Bank of 18 May 2016 on the collection of granular credit and credit risk data (ECB/2016/13) (OJ L 144, 1.6.2016, p. 44).

46 Council Regulation (EC) No 2533/98 of 23 November 1998 concerning the collection of statistical information by the European Central Bank (OJ L 318, 27.11.1998, p 8).

8.2.5 The ECB welcomes that the draft law grants Latvijas Banka the right to release certain types of statistical data for exchange within the feedback loop prescribed by Regulation 2016/867 (ECB/2016/13). The ECB understands that the procedures for such exchange will be consistent with the requirements of Article 11 of this Regulation and with the relevant provisions of Guideline (EU) 2017/2335 of the European Central Bank[47].

8.2.6 The ECB welcomes the provisions of the draft law that entitle Latvijas Banka to apply sanctions for any provision, use or protection of statistical data that violates statistical requirements which are not covered by the Union's legal acts, including those of the ECB. This further strengthens the statistical reporting framework. The ECB takes this opportunity to note that NCBs are under an obligation to inform and consult with the ECB regarding the application of the ECB's sanctioning procedures. Consideration should be given to reflecting this duty to cooperate when applying ECB sanctions in the draft law.

9. Macroprudential policy

9.1 *Purpose of the draft law's provisions on macroprudential policy*

9.1.1 Latvijas Banka is currently a macroprudential authority which conducts macroprudential policy in collegial cooperation with FKTK and the Ministry of Finance, including within a mutually established framework for cooperation through the Macroprudential Council. The Ministry of Finance, as the leading State administrative authority in the financial sector, implements the policy of the financial sector and develops regulatory requirements in the financial sector. Following the incorporation of FKTK into Latvijas Banka, Latvijas Banka will undertake macroprudential policy decisions in cooperation with the Ministry of Finance, while the Ministry of Finance will continue to implement financial sector policy.

9.1.2 The draft law defines the objective of macroprudential policy, which is to promote the stability of the financial system as a whole, including by strengthening the financial system's resilience to shocks and by limiting the build-up of systemic risks, thereby ensuring the sustainable support of the economy by the financial system. The draft law mandates Latvijas Banka to both define and implement macroprudential policy. While defining and implementing macroprudential policy Latvijas Banka must: (a) analyse and assess the overall stability of Latvia's financial system as well as identify, monitor and assess its systemic risks; (b) prepare a report on financial stability containing an assessment of the financial system stability; and (c) implement the macroprudential policy measures provided for in the legal acts of the Union and Latvia and to apply regulatory requirements to the financial market and its participants in order to mitigate systemic risks and strengthen the resilience of Latvia's financial system to shocks.

47 Guideline (EU) 2017/2335 of the European Central Bank of 23 November 2017 on the procedures for the collection of granular credit and credit risk data (ECB/2017/38) (OJ L 333, 15.12.2017, p. 66).

9.1.3 When defining and implementing macroprudential policy, Latvijas Banka may issue recommendations on the measures needed to strengthen the resilience of the financial system to shocks and limit the build-up of systemic risks. The draft law also enables Latvijas Banka to establish financial system sustainability promoting measures addressed to financial market participants and aimed at limiting the build-up of systemic risks and strengthening the resilience of the financial system to shocks.

9.2 *Specific observations on the draft law's provisions on macroprudential policy*

9.2.1 The ECB welcomes the clarification of Latvijas Banka's macroprudential mandate. As a national macroprudential authority, Latvijas Banka is already responsible for monitoring the development of Latvia's financial system as a whole, and identifies and evaluates potential systemic risks to financial stability, analyses the resilience of financial institutions to withstand these risks, and recommends and assists in introducing the necessary macroprudential measures to promote financial stability. The draft law does not confer genuinely new tasks on Latvijas Banka in this area, but rather clarifies Latvijas Banka's macroprudential mandate. Also, as a result of the incorporation of FKTK into Latvijas Banka, Latvijas Banka becomes a designated national authority, responsible for implementing macroprudential measures that are harmonised at Union level, e.g., determining the countercyclical capital buffer and systemic risk buffer. Consequently, it is not necessary to assess whether the conferral of new tasks on an NCB complies with the prohibition of monetary financing.

9.2.2 From a financial stability perspective, the ECB welcomes the implementation of a legislative framework for borrower-based measures in all euro area countries[48]. Some examples of macroprudential tools, which are outside of the Union's legal framework, and thus can be applied only where national law provides a specific legal basis, include a levy on non-stable funding, a loan-to-deposit ratio, and borrower based measures, such as a loan to value ratio, loan to income ratio, limits on the maximum duration of a loan, requirements related to the loan repayment calculation method, and other instruments aimed at safeguarding the stability of the financial system as a whole, strengthening its resilience and preventing and mitigating systemic risks[49].

9.2.3 The draft law does not specify a comprehensive macroprudential tool kit. The ECB understands that measures of a macroprudential character have been taken by FKTK based on Article 34.2 (4) and Article 55 of the Law on Credit Institutions and that Latvijas Banka, as the successor to all rights and obligations of FKTK, will be able to adopt such measures in the future. Furthermore, point 3) of Article 46(1) of the draft law entitles Latvijas Banka to apply regulatory requirements to the financial market and its participants in order to mitigate systemic risks and to strengthen the resilience of Latvia's financial system to shocks. In this respect, by empowering Latvijas Banka to

48 See paragraph 2.3 of Opinion CON/2017/11 and the Governing Council's statement on Macroprudential Policies of 15 December 2016, which is available on the ECB's website at www.ecb.europa.eu.

49 See paragraph 3.11 of Opinion CON/2020/10, Recommendation ESRB/2013/1 of the European Systemic Risk Board of 4 April 2013 on intermediate objectives and instruments of macro-prudential policy (OJ C 170, 15.6.2013, p. 1) and he European Systemic Risk Board handbook on operationalising macroprudential policy in the banking sector, which is available on the ESRB's website at www.esrb.europa.eu.

apply such regulatory requirements to the financial market and its participants, Latvijas Banka is equipped with ample flexibility to effectively define and implement macroprudential policy.

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

Done at Frankfurt am Main, 26 February 2021.

[signed]

The President of the ECB

Christine LAGARDE