EUROPEAN CENTRAL BANK

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OPINION OF THE EUROPEAN CENTRAL BANK

of 19 March 2021

on the mandate and tasks of the Magyar Nemzeti Bank relating to environmental sustainability

(CON/2021/12)

Introduction and legal basis

On 18 December 2020, the European Central Bank (ECB) received a request from the Hungarian Ministry of Finance for an opinion on a draft law amending the Law on the Magyar Nemzeti Bank[1] (hereinafter the 'draft law').

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 (TFEU) and the third indent of Article 2(1) of Council Decision 98/415/EC[2], as the draft law concerns the Magyar Nemzeti Bank (hereinafter the 'MNB'). In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. Purpose of the draft law

1.1 According to the explanatory memorandum accompanying the draft law, which has been prepared by the MNB for the Hungarian Ministry of Finance, the draft law was conceived by the MNB in line with its vision of a green central bank.

1.2 The draft law would amend the Law on the MNB in three respects.

1.3 First, the draft law provides that, without prejudice to its primary objective of achieving and maintaining price stability, as a secondary objective, the MNB supports the government's economic policy and its policy related to environmental sustainability, using instruments at its disposal.

1.4 The explanatory memorandum emphasises that environmental sustainability concerns are expected to have a fundamental impact on price and financial stability, and, therefore, greater emphasis must be placed on these issues by central banks. The explanatory memorandum notes that integrating environmental sustainability considerations has been added to a growing range of central bank activities, including incorporating risks arising from climate change into the various aspects of financial stability, taking into account the risk exposures of financial market participants identified in relation to climate change, and minimising the ecological footprint of central bank operations. Environmental sustainability also has an effect on monetary policy: environmental and

1 A Magyar Nemzeti Bankról szóló 2013. *évi CXXXIX. törvény*.

2 Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions (OJ L 189, 3.7.1998, p. 42).

weather processes can lead to an increase in the volatility of food prices, and the structural transformation of the economy can have an influence on inflation over the longer term. Reference is made in this context to the assessment of inter-relationships between climate change and monetary policy as part of the ECB's strategy review. According to the explanatory memorandum, the MNB is not explicitly entitled by current law to take action in relation to environmental sustainability in the context of monetary policy. Thus, the Hungarian legislator considers it necessary to prescribe in the Law on the MNB that the MNB shall support environmental sustainability with the means at its disposal, without prejudice to its primary objective of achieving and maintaining price stability.

1.5 Second, the draft law enables the MNB to use the revenues from supervisory fees, fines imposed by the MNB and administrative service fees to offset the impact of its activities on the environment, in order to facilitate and support the implementation of environmental objectives. The explanatory memorandum clarifies in this respect that the MNB would like to provide a positive example in the field of environmental protection to institutions under its supervision and other domestic organisations.

1.6 Third, the draft law provides that, as instruments of its monetary policy, the MNB will provide energy efficiency consumer loans and, in relation to this task, the MNB will manage Hungarian forint accounts for consumers. The explanatory memorandum explains that in Hungary residential buildings are responsible for nearly 25 % of the national primary energy consumption, and energy consumption per dwelling is high compared to the European Union average. In addition, the renewal rate of the housing stock is lower than the regional average. The MNB introduced a Green Preferential Capital Requirement Programme[3] in 2019. The programme ensures that credit institutions receive a Pillar II capital requirement reduction on consumer loans serving energy-efficient home purposes if consumers receive an interest rate subsidy. However, up to now banks have not incorporated the beneficial features of green mortgage loans into their lending standards and prices. According to the explanatory memorandum, as the current business models of banks do not incorporate the positive externalities relating to energy efficient mortgages, a central bank programme that enables direct lending to retail clients would be needed. This could spur green residential real estate constructions and renovations, help renew the domestic residential real estate stock, and therefore support cutting greenhouse gas emissions. The programme would also incentivise market participants to provide new green housing loans.

2. Explicit reference in the MNB's objectives to support of environmental sustainability

2.1 The ECB welcomes the proposed amendment of the MNB's mandate, which provides that, without prejudice to its primary objective of achieving and maintaining price stability, the MNB shall support, as a secondary objective, the government's policy related to environmental sustainability. The ECB understands that the purpose of the draft law is to emphasise the role of environmental sustainability amongst the MNB's secondary objectives.

3 'MNB introduces a green preferential capital requirement programme', press releases 2019, available on the MNB's website at www.mnb.hu

2.2 The ECB notes that supporting the general economic policies of the government, without prejudice to its primary objective of achieving and maintaining price stability, is already part of the mandate of the MNB. Policies contributing to a high level of environmental protection that have an economic dimension or qualify as general economic policies of the government are implicitly covered by the current mandate of the MNB. Hence, the ECB understands that the draft law does not aim at introducing a substantial reform of the MNB's mandate, but rather at clarifying the MNB's existing mandate by explicitly specifying environmental sustainability as a secondary objective of the MNB.

2.3 The proposed change to the MNB's mandate provided for in the draft law is compatible with the Treaties. In accordance with Articles 119(2), 127(1) and 282(2) of the TFEU the primary objective of the European System of Central Banks (ESCB) is to maintain price stability. Without prejudice to the objective of price stability, the ESCB supports the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union as laid down in Article 3 of the Treaty on the European Union (TEU). The ESCB acts in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 119 TFEU. Article 3(3) TEU in turn provides that the Union must, inter alia, work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment. In addition, Article 11 TFEU provides that environmental protection requirements must be integrated into the definition and implementation of the Union's policies and activities, in particular with a view to promoting sustainable development. In the same vein, Article 37 of the Charter of Fundamental Rights of the European Union stipulates that a high level of environmental protection and the improvement of the quality of the environment must be integrated into the policies of the Union and ensured in accordance with the principle of sustainable development.

2.4 Climate change can specifically impact central banks, and the manner in which they discharge their mandates. Physical risks and transition risks associated with climate change can potentially cause abrupt changes in prices and thereby threaten price stability[4]. Although methodologies to assess the magnitude of climate-related risks for banks and financial stability are still being developed, available estimates suggest that the impact of these risks is likely to be significant[5]. This, in turn, could impair the transmission mechanism of monetary policy. The Network of Central Banks and Supervisors for Greening the Financial System (hereinafter the 'NGFS'), an international group of 87 central banks and supervisors, including most ESCB central banks, recommends, therefore, that central banks consider the possible effects of climate change on the economy. The NGFS argues that these effects may be relevant to monetary policy even if they only materialise beyond the conventional three- to five-year policy horizon[6].

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4 See Christine Lagarde, 'Climate change and central banking', ILF conference on Green Banking and Green Central Banking, Frankfurt am Main, 25 January 2021, available on the ECB's website at www.ecb.europa.eu.

5 See Isabel Schnabel, 'Never waste a crisis: COVID-19, climate change and monetary policy', virtual roundtable on 'Sustainable Crisis Responses in Europe', INSPIRE Research Network, 17 July 2020, available on the ECB's website at www.ecb.europa.eu.

6 See 'Climate change and monetary policy: initial takeaways, technical document, June 2020, available on the Network of Central Banks and Supervisors for Greening the Financial System's website at www.ngfs.net. f

3. Offsetting the MNB's carbon footprint

The ECB welcomes the MNB's initiative to offset its carbon footprint as a complementary measure to the accomplishment of its other institutional environmental objectives. While many central banks in the ESCB seek to offset their carbon footprint as part of good corporate governance, it is relatively rare for central banks' activities in this area to be specifically mandated by law. In this respect, the ECB understands that this specific provision in the draft law is introduced to make the MNB's spending on the offsetting of its carbon footprint transparent, and that the draft law does not authorise the MNB to use its revenues to facilitate and support the implementation of environmental objectives generally, but rather only to avoid, reduce and offset the impact of the MNB's own activities on the environment.

4. The MNB's new task to provide energy efficiency loans to consumers

4.1 The draft law confers a new task on the MNB by requiring the MNB, as part of the instruments of its monetary policy, to provide energy efficiency loans directly to consumers in order to support green residential real estate developments.

4.2 In accordance with Article 42.2 of the Statute of the ESCB, the central banks of Member States with a derogation, including Hungary, retain their powers in the field of monetary policy according to national law. This notwithstanding, the explanatory memorandum accompanying the draft law argues that the current business models of banks do not incorporate positive externalities relating to energy efficient mortgage loans and therefore a central bank programme that enables direct lending to retail clients is needed. In this respect, the explanatory memorandum does not convincingly reason that such lending is linked to the primary objective of monetary policy to maintain price stability, which would qualify such intervention as a monetary policy measure. Moreover, direct residential real estate lending to consumers is not expressly among the instruments of monetary policy envisaged for the ECB and the NCBs by the TFEU and the Statute of the ESCB. Monetary operations within the ESCB are typically conducted via the banking sector, by setting lending or borrowing conditions which are transmitted to consumers and businesses, or via open market operations that affect financing conditions. Such operations pursue a monetary policy objective, unlike the direct provision of energy efficiency loans to consumers, which pursue an objective that can be better served by government agencies or credit institutions. Against this backdrop, the ECB emphasises that a proposed conferral of new tasks on a national central bank (NCB) participating in the ESCB, including the MNB, must be assessed against the prohibition of monetary financing laid down in Article 123(1) TFEU. For the purposes of that prohibition, Article 1(1)(b)(ii) of Council Regulation (EC) No 3603/93[7] defines 'other type of credit facility' as, inter alia, 'any financing of the public sector's obligations vis-à-vis third parties'.

4.3 Ensuring that Member States maintain 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

7 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).

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 can be translated as the provision of central bank financing outside the scope of central bank tasks – it is necessary to carry out, on a case-by-case basis, an assessment of 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 circumventions of the objective of the prohibition on monetary financing, which is to maintain sound budgetary policy by Member States, do not take place.

4.4 As part of its discretion in the exercise of its duty – on the basis of Article 271(d) TFEU and Article 35.6 of the Statute of the European System of Central Banks and of the European Central Bank (hereinafter the 'Statute of the ESCB') – to ensure that NCBs honour the obligations laid down by the TFEU, the Governing Council has endorsed safeguards in the form of criteria for determining 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 TFEU and the Statute of the ESCB. These tasks are mainly defined in Article 127(2), (5) and (6), and Article 128(1) TFEU, as well as in Article 22 of the Statute of the ESCB.

Second, as Article 14.4 of the Statute of the ESCB allows NCBs to 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 atypical of an 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 that NCB.

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.

4.5 *Tasks related to the tasks conferred upon the ECB and the NCBs by the TFEU and the Statute of the ESCB*

As previously noted, direct residential real estate lending to consumers is not expressly among the instruments of monetary policy envisaged for the ECB and the NCBs by the TFEU and the Statute of the ESCB. Moreover, it is not clear from the explanatory memorandum that such lending is linked to the primary objective of monetary policy to maintain price stability.

4.6 *Tasks which are atypical of central bank tasks*

Direct residential real estate lending to consumers is atypical of central bank tasks. With the exception of lending by some ESCB central banks to their staff, no central bank in the ESCB currently engages in direct lending to consumers. In certain Member States the provision of financial support to subsidise energy efficiency loans to consumers in order to support green residential real estate developments is conducted directly by the State,[8] or State-owned entities such as development banks[9], funds[10] or foundations[11], also under co-funded Union schemes[12]. As previously noted, monetary operations within the ESCB are typically conducted via the banking sector, by setting lending or borrowing conditions which are transmitted to consumers and businesses, or via open market operations that affect financing conditions. Such operations pursue

8 For example, in Austria, financial subsidies for housing projects are granted and administered by competent departments of the regional governments. In France, the Ministry of Finance in collaboration with the Agency for Environment and Energy Management (ADEME) promotes an eco-loan to facilitate energy renovation, granted by commercial banks with a financial ceiling, but regardless of income conditions.

9 For example, in Germany, depending on the financial support chosen, either the state-owned promotional bank KfW provides a subsidised loan at favourable conditions or the Federal Office for Economic Affairs and Export Control (*Bundesamt für Ausfuhrkontrolle* BAFA) pays State subsidies. In Greece, such financial support in connection with energy-efficient housing projects is granted through the Hellenic Development Bank (HDB). In Latvia, a state-owned development finance institution ALTUM is mandated to provide financial aid for energy efficiency improvement measures.

10 For example, in Croatia the 2003 Law on the Fund for Environmental Protection and Energy Efficiency set up the Environmental Protection and Energy Efficiency Fund as a legal entity with public authority for collecting and investing extra budgetary resources in programmes and projects supporting environmental and nature protection, energy efficiency and the use of renewable energy sources.

11 For example, in Estonia the KredEx foundation was set up by the Ministry of Economic Affairs and Communications inter alia with the aim of increasing the energy performance of residential buildings in Estonia.

12 For example, in Ireland the Better Energy Warmer Homes Scheme (BEWHS) is operated by the Sustainable Energy Authority of Ireland (SEAI) and co-funded by the Irish Government and the Union through the European Regional Development Fund.

a monetary policy objective, unlike the direct provision of energy efficiency loans to consumers, which pursue an objective that can be better served by government agencies or credit institutions.

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

As noted above, in those Member States where financial support is provided to subsidise energy efficiency loans to consumers in order to support green residential real estate developments, this support is provided directly by the State, or by State-owned entities such as development banks, funds or foundations.

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

As indicated above, central bank operations in the ESCB are conducted with credit institutions and other market participants with a view to maintaining the primary objective of price stability. While the ESCB has a duty, without prejudice to the objective of price stability, to support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union, including working for a high level of protection and improvement of the quality of the environment, it may be questioned whether direct residential real estate lending to consumers to support green residential real estate developments would be in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, or if any interference with this principle could be justified by the central bank in accordance with proportionality standards. Mortgage lending to consumers is typically undertaken by credit institutions in an open market economy where credit institutions compete with one another for mortgage lending business, subject to supervision by the public authorities responsible for the prudential supervision of credit institutions (in Hungary, the MNB) and the protection of consumers. In principle, the entry by a central bank into this market would distort the market, and raise questions as to how the activities of the central bank would be overseen or supervised. It would seem that credit institutions would be better positioned than central banks to price mortgage loans. Moreover, given that central banks are not the primary actors when it comes to economic or environmental policies, if the Hungarian authorities perceive that there is a need for State intervention in the mortgage lending market for green residential real estate developments, it would seem incumbent on the authorities to explore options other than direct lending to consumers by central banks, such as government subsidies or appropriate lending arrangements financed through development or other State-owned banks. It would otherwise not be apparent that the departure from the principle of an open market economy could be justified by the central bank in accordance with proportionality standards. It should also be noted that an arrangement whereby the central bank is tasked by law to perform certain non-standard tasks stands in stark contrast to one where the central bank has the freedom to undertake operations, which could be seen as diminishing central bank independence. The MNB's competence to independently decide on conducting operations with its monetary counterparts via regular instruments of monetary policy, which may support the Hungarian government's policy relating to environmental sustainability, should not be prejudiced.

4.9 *Extent to which the performance of the new tasks is disproportionate to MNB's financial or organisational capacity*

The principle of financial independence requires NCBs to have sufficient means to carry out not only their ESCB-related tasks but also their national tasks, both from an operational and financial perspective[13]. To perform its new task under the draft law, the MNB would be obliged to dedicate substantial additional human and financial resources to manage its new consumer lending portfolios. Mortgage lending is a demanding commercial banking business, requiring extensive due diligence on the part of lenders, including assessing the creditworthiness of large numbers of individual borrowers in the general population, valuing real estate in different urban and rural locations, mobilising collateral in the form of security interests over residential real estate which may need to be foreclosed in the event of borrower default, ensuring that the borrower has appropriate life and property insurance arrangements in place, attending to any relevant consumer protection issues, and so on. Central banks do not have a particular operational expertise in this intricate business. The performance of these extensive new tasks would therefore appear to be disproportionate to the MNB's existing financial and organisational capacity, in the absence of supplementary means being granted to the MNB.

4.10 *Extent to which performance of the new tasks fits into the MNB's institutional set-up, in the light of central bank independence and accountability considerations*

Mortgage lending is a matter of great interest to the general public, as a mortgage loan counts among the most significant financial commitments undertaken by the individual citizen. The MNB would therefore assume the reputational risk of being held accountable by the general public and, indeed, the institutions of government for any perceived shortcomings in the performance of its new consumer lending activities. This new task, therefore, does not appear to smoothly fit into the MNB's existing institutional set-up.

4.11 *Extent to which the performance of tasks harbours substantial financial risks*

The MNB's proposed lending activities would mean that the MNB would assume substantial credit risks on its balance sheet. Based on the nature of such loans, credit risks would remain on the balance sheet of the central bank for a prolonged period of time, possibly extending to decades. As with any mortgage lending portfolio, which is susceptible to fluctuations in real estate prices and general economic developments, this activity could potentially expose the MNB to substantial financial risks. This is different from central banks providing credit to their monetary policy counterparts against marketable mortgage-related collateral, where financial risks for the central bank are limited through adequate risk management measures such as minimum credit ratings, valuation haircuts which are marked to market and margin calls. Similar risk management measures would be impossible to implement for direct lending to consumers. Furthermore, while central bank credit through monetary policy operations is provided on the same conditions to all counterparties, for direct lending to consumers the creditworthiness of the individual borrowers would impact their eligibility to obtain a mortgage loan, the principal amount of the loan, and in some cases also the interest rate.

4.12 *Conclusion*

13 See the ECB's 2016 Convergence Report, p. 25.

The ECB supports the provision of energy efficiency loans, which is a reality across the Union already and needs to be expanded. The ECB also understands the wish of the Hungarian authorities to reach an acceleration of this kind of lending in Hungary. However, the new task proposed to be conferred on the MNB to provide energy efficiency loans directly to consumers in order to support green residential real estate developments is a task which can be more appropriately performed by private or state-owned credit institutions or development banks, rather than central banks. Within the framework of the ESCB, direct residential real estate lending to consumers is not among the instruments of monetary policy expressly envisaged for the ECB and the NCBs by the TFEU and the Statute of the ESCB. This task is atypical of central bank tasks. With the exception of lending by some ESCB central banks to their staff, no central bank in the ESCB currently engages in direct lending to consumers. In certain Member States the provision of financial support to subsidise energy efficiency loans to consumers in order to support green residential real estate developments is conducted directly by the State, or state-owned banks or development banks. Against this backdrop, it is suggested that such a task would be discharged on behalf of and in the exclusive interest of the government. Given the substantial operational challenges of the mortgage lending business, this task would, in the absence of further means being granted to the MNB, be disproportionate to the MNB's financial and organisational capacity, and could leave the MNB vulnerable to substantial financial risks. The performance of this task would also entail reputational risks for the MNB, and would not fit smoothly into the MNB's institutional set-up. The performance of this task would therefore be classified as a government, rather than a central banking task for the purposes of the prohibition of monetary financing, and would, accordingly, have to be entirely conducted by the State, rather than with central bank resources. Also, the MNB's competence to independently decide on conducting operations with its monetary counterparts via regular instruments of monetary policy should not be prejudiced. In conclusion, the ECB notes that central banks can independently decide on conducting operations with their monetary counterparts via regular instruments of monetary policy, which may support the government's policy relating to environmental sustainability. However, for the reasons indicated above, the Hungarian authorities are strongly encouraged not to allocate to the MNB the task of providing energy efficiency loans directly to consumers.

This opinion will be published on EUR-Lex.

Done at Frankfurt am Main, 19 March 2021.

[signed]

The President of the ECB

Christine LAGARDE