EUROPEAN CENTRAL BANK

**OPINION OF THE EUROPEAN CENTRAL BANK**

**of 27 January 2006**

**at the request of the Central Bank of Cyprus**
**on a draft law amending the Central Bank of Cyprus Laws of 2002 and 2003**

**(CON/2006/4)**

On 30 November 2005 the European Central Bank (ECB) received a request from the Central Bank of Cyprus (CBC) for an opinion on a draft law amending the Central Bank of Cyprus Laws of 2002 and 2003 (hereinafter the 'draft law').

The ECB's competence to deliver an opinion is based on the first, third, fourth and fifth indents of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions[1], as the draft law relates to currency matters, a national central bank (NCB), the collection of statistics and payment and settlement systems. 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 General remarks

1.1 The ECB welcomes the draft law, the main objective of which is to make the Central Bank of Cyprus Laws of 2002 and 2003 (hereinafter the 'CBC Law') compatible with the Treaty establishing the European Community and the Statute of the European System of Central Banks and of the European Central Bank, thereby laying a firm foundation for the legal integration of the CBC into the Eurosystem when Cyprus adopts the euro.

## 2 Audit Office and Auditor General

2.1 Section 52 of the draft law amends Section 60(1) of the CBC Law ('Audit of the annual financial statements') to provide that '[t]he annual financial statements of the Bank shall be audited by independent external auditors, in accordance with the provisions of Article 27 of the Statute'. Article 27 of the Statute provides that the accounts of NCBs of the Member States that have adopted the euro (hereinafter the 'Eurosystem NCBs') shall be audited by auditors that are: (i) independent; and (ii) external. These requirements mean that the auditors must be independent

1 OJ L 189, 3.7.1998, p. 42.

from and external to: (i) the ECB; and (ii) the NCBs and their shareholders. The established practice is to appoint private auditors or firms of auditors as external auditors for Eurosystem NCBs with a specific independent audit mandate for a certain period of time.

2.2 The ECB understands that the CBC's annual financial statements are currently audited by the Cypriot Auditor General and that, in accordance with Article 116(4) of the Cypriot Constitution, the Auditor General's annual report on the exercise of his functions and duties is submitted to the Cypriot President, who causes it to be laid before the House of Representatives. The ECB notes that under Article 115 of the Cypriot Constitution, the Audit Office is an independent public authority, and the Auditor General is not to retire or to be removed from office except on the same grounds and in the same manner as a judge of the Supreme Court. Pursuant to Article 116(1) of the Cypriot Constitution, the Auditor General's task is to control, *on behalf of the Republic*, 'all disbursements and receipts and audit and inspect all accounts of moneys and other assets administered, and of liabilities incurred, by or under the authority of the Republic...'. It follows that notwithstanding the Auditor General's independence as enshrined in the Cypriot Constitution, the Audit Office is not an external auditor within the meaning of Article 27.1 of the Statute, but rather an independent Cypriot public authority.

2.3 In the light of the above, a party other than the Audit Office will need to be appointed as the CBC's external auditor in the future. However, this will not prevent the Audit Office from continuing to perform a control function, provided that its auditing activities: (i) do not interfere with the review of European System of Central Banks (ESCB) related tasks of the CBC to be undertaken by the CBC's independent external auditors to be approved by the Council of the European Union in accordance with Article 27 of the Statute; and (ii) do not jeopardise the CBC's independence[2]. The ECB notes in this regard that certain Eurosystem NCBs are currently subject to such additional external auditing outside the scope of Article 27 of the Statute.

## 3 Application of minimum reserve requirements to cooperative credit societies

3.1 The draft law amends Section 2 of the CBC Law ('Interpretation') by, *inter alia*, inserting a new definition of the term 'credit institution' that includes cooperative credit societies, banks and electronic money institutions. The ECB welcomes this extended definition of 'credit institution' which is consistent with a number of recent ECB opinions[3], and is designed to already at this time allow for the future incorporation of Cypriot cooperative credit societies, which have been granted

2 Cf. paragraphs 5 to 7 of ECB Opinion CON/2002/22 of 2 September 2002 at the request of the Swedish Ministry of Finance on a draft legislative proposal establishing the National Audit, including proposed amendments to the Sveriges Riksbank Act (1988:1385) .

3 Cf. paragraph 15 of ECB Opinion CON/2005/35 of 10 October 2005 at the request of the Central Bank of Cyprus on a draft directive on the maintenance of minimum reserves with the Central Bank of Cyprus and paragraphs 10 to 14 of ECB Opinion CON/2005/8 of 1 April 2005 at the request of Lietuvos bankas on certain draft rules on minimum reserve requirements for credit institutions.

a derogation from the application of the Consolidated Banking Directive[4] until 31 December 2007[5], into the CBC's minimum reserve regime. This amendment is also reflected in the proposed revision of Section 41(1) of the CBC Law. The incorporation of cooperative credit societies into the CBC's minimum reserve regime would smoothen their transition to the Eurosystem's minimum reserve framework.

## 4 Monetary financing safeguards

4.1 Section 46(3) of the CBC Law ('Deposits') provides that the CBC is entitled to grant advances or loans to banks against adequate collateral for fixed periods and for purposes which the CBC may designate. The ECB understands that the purpose of this provision is to provide for the possibility of emergency liquidity assistance. The ECB notes that, while similar provisions can be found in the statutes of several NCBs, a proviso should be added to Section 46(3) that such advances or loans should be provided without prejudice to the requirements derived from the participation of the CBC in the ESCB. Besides, compliance with the prohibition on monetary financing laid down in Article 101 of the Treaty must be ensured.

4.2 Section 49(1) of the CBC Law ('Prohibition of credit facilities to the Government') provides for the prohibition on monetary financing, without, however, referring to the relevant provisions of Community law. The CBC Law should state that the prohibition on monetary financing derives from Article 101 of the Treaty and that the definitions for the application of this prohibition are specified by the Council of the European Union in accordance with the Treaty[6]. Alternatively, this Section could be deleted, since the relevant provisions of Community law, namely Article 101 of the Treaty and Regulation (EC) No 3603/93, are directly applicable in the Member States.

## 5 Technical comments

5.1 *Statistical reporting requirements*

The draft law amends Section 64 of the CBC Law ('Obligation to report data for the purpose of balance of payments') by, *inter alia*, inserting a proviso recognising the priority to be accorded to

4 Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions, OJ L 126, 26.5.2000. Directive as last amended by Directive 2004/39/EC (OJ L 145, 30.4.2004, p. 1.)

5 Cf. Annex VII to the Act concerning the conditions of accession of the Czech Republic the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, The Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Slovak Republic and the adjustments to the Treaties on which the European Union is founded (OJ L 236, 23.9.2003, p. 819) entitled 'List referred to in Article 24 of the Act of Accession: Cyprus', which provides under Title 2 (Freedom to Provide Services) as follows: 'In Cyprus, Directive 2000/12/EC shall not apply to the Cooperative Credit and Savings Societies, in so far as they are not in conformity with the provisions of this Directive, until 31 December 2007. As from the date of accession and until the end of the above period the Cypriot authorities shall inform the Commission at the beginning of each year about the number of non-conforming Cooperative Credit and Savings Societies which continue to be excluded, as well as the market share that they represent.'

6 See Article 103(2) of the Treaty and 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.

the ECB's statistical reporting requirements under Article 5 of the Statute. The ECB takes the view that this general proviso may instead be inserted into Section 63 of the CBC Law ('Obligation to report data to the Bank'), as the priority for ECB statistical reporting requirements relates not only to balance of payment statistics and to the financial accounts of the individual sectors of the economy, but also to the entire range of statistical information in which the ECB has an interest and which is covered by Section 63 of the CBC Law. For the rest, the ECB agrees with the proposed changes to the CBC's statistical reporting requirements.

5.2 *Payment and settlement systems*

5.2.1 The ECB notes that although the draft law abolishes the Cypriot Monetary Policy Committee and provides that the CBC's Governor has the exclusive competence to carry out the tasks and to exercise the powers conferred upon the CBC by the Treaty and the Statute, it does not expressly provide where the Monetary Policy Committee's current powers with regard to the oversight of payment and settlement systems will vest when Cyprus adopts the euro. In the interests of transparency and legal certainty, the ECB would therefore invite the CBC to consider expressly vesting the power to oversee payment and settlement systems in the CBC's Governor or its Board of Directors.

5.2.2 The draft law amends Section 6(2)(g) of the CBC Law to state that one of the CBC's main tasks is the promotion, regulation and oversight of the smooth functioning of payment and settlement systems. For reasons of clarity, the ECB suggests that this provision should refer to clearing systems in addition to payment and settlement systems.

5.3 *Monetary policy instruments*

5.3.1 The draft law inserts a new Section 42 into the CBC Law providing that '[t]he Bank may issue securities for the purpose of intervening in the money market'. The ECB notes that the issuance of debt instruments for monetary policy purposes by individual NCBs *after* their Member States have adopted the euro is subject to the Eurosystem's rules on monetary policy instruments and procedures, something which the CBC Law should clearly reflect.

5.3.2 Regarding Section 41 of the CBC Law ('Requirement of banks to maintain assets with the Bank'), as amended by the draft law, the ECB would invite the CBC to consider: (i) referring only to 'minimum reserves' in the proposed new text in the interests of consistency and legal certainty, as Section 35 of the draft law currently uses the terms 'minimum reserves' and 'mandatory reserves' interchangeably; and (ii) inserting a reference to Article 19 of the Statute or otherwise amending the wording of the new Section 41 of the CBC Law in the interests of legal certainty, as the proposed wording of Section 36 of the draft law is too generic and does not specify the source of the rules to which it refers.

5.4 *References to the Cyprus pound*

The draft law amends Section 28 of the CBC Law to replace references in the CBC Law to the Cyprus pound with references to the 'euro'. The ECB considers that this provision is unnecessary as all references in Cypriot legal acts and other legal instruments to the Cypriot national currency will automatically be understood as references to the single currency from the date that Cyprus adopts the euro in accordance with Article 3 of Council Regulation (EC) No 974/98 of 3 May 1998 on the introduction of the euro[7].

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

Done at Frankfurt am Main, 27 January 2006.

[signed]

*The President of the ECB*

Jean-Claude TRICHET

7 OJ L 139, 11.5.1998, p. 1. Regulation as amended by Regulation (EC) No 2596/2000 (OJ L 300, 29.11.2000, p. 2). This conclusion is also reinforced by the wording of recital 7 to Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro, OJ L 162, 19.6.1997, p. 1. Regulation as amended by Regulation (EC) No 2595/2000 (OJ L 300, 29.11.2000, p. 1).