EUROPEAN CENTRAL BANK

OPINION OF THE EUROPEAN CENTRAL BANK

of 5 June 2002

at the request of the Irish Department of Finance on a draft Central Bank and Financial Services Authority of Ireland Bill, 2002

(CON/2002/16)

1. On 16 April 2002 the European Central Bank (ECB) received a request from the Irish Department of Finance for an opinion on a draft Central Bank and Financial Services Authority of Ireland Bill, 2002.

2. The ECB's competence to deliver an opinion is based on Article 2 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 legislative proposal contains provisions concerning a national central bank and rules which materially influence the stability of financial institutions. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, this opinion has been adopted by the Governing Council of the ECB.

3. The legislative proposal contains four noteworthy elements. *First,* the Central Bank of Ireland would be reorganised and re-named as the Central Bank and Financial Services Authority of Ireland, which would be the legal entity that would qualify as the central bank of Ireland and be a member of the European System of Central Banks. *Second,* a new 'body' called the Irish Financial Services Regulatory Authority (the 'Regulatory Authority') would be established as a constituent part of the central bank with responsibility for the supervision of virtually all financial institutions and insurance undertakings in Ireland, as well as the protection of consumers of financial services. *Third,* while the decision-making body within the central bank for ESCB-related functions would continue to be solely the Governor, the draft legislation provides for the possible establishment of a committee of the central bank's Board of Directors called the 'Monetary Committee of the Board' (or a similar name) to which the Governor, subject to the requirements of the Treaty establishing the European Community and the ESCB Statute, would be required to provide information about, and with the members of which the Governor may discuss, the performance by the Governor of the central bank's ESCB-related functions. *Fourth,* the central bank's residual functions, including the co-ordination of activities of the constituent parts of the central bank and the exchange of information among those parts,

1 OJ L 189, 3.7.1998, p. 42.

would be vested in a reconstituted board of directors, whose 12 members would include the Governor as Chairperson, six members drawn from the Regulatory Authority (including the Chairperson and Chief Executive of the Regulatory Authority and four members appointed by the Minister for Finance after consulting the Minister for Enterprise, Trade and Employment), the Secretary General of the Department of Finance, the Director General of the central bank and three other directors appointed by the Minister for Finance.

4. The legislative proposal would establish the Regulatory Authority as an autonomous authority that will perform the financial supervision functions previously attributed to the central bank and other residual functions relating to the supervision of the Irish financial sector and of financial intermediaries in particular. The ECB welcomes the fact that the new supervisory authority will remain a constituent part of the central bank. While the ECB's overall assessment of the structure is therefore positive, the ECB has a number of detailed, technical reservations regarding the draft legislation which are set forth in this opinion. These reservations are primarily designed to eliminate any legal risks associated with the independent discharge of the central bank's ESCB-related tasks. The ECB believes that these reservations can be accommodated without disturbing the overall integrity of the Regulatory Authority as an autonomous supervisory authority operating within the legal structure of the central bank of Ireland.

5. In view of the somewhat complex corporate governance structure for the central bank that the establishment of the Regulatory Authority entails, the ECB is concerned that the governance structure of the central bank might not allow for an effective contribution of central banking functions to prudential supervision tasks, which will be conducted in an independent manner by the Regulatory Authority, or indeed that the pursuance of supervisory tasks might prevail over the central banking perspective. In this regard, the ECB welcomes the series of provisions that should safeguard the contribution of central banking functions. *First,* the central bank has the function of contributing to the stability of the financial system. In addition, the pursuance of this objective would also be taken into due consideration by the central bank in promoting the development of the financial services industry. *Second,* the Regulatory Authority has the obligation to consult and obtain the approval of the Governor over matters relating to the stability of the financial system, including the issue, revocation and suspension of a licence or authorisation. In this regard, the Governor, in addition to the Chief Executive of the Regulatory Authority, enjoys crucial powers to authorise central bank employees to investigate the business and carry out on-site inspections of financial institutions. *Third,* the future Board of the central bank is established as the main forum that will allow close co-operation between central banking and supervisory functions within the central bank. *Fourth,* the Governor or the Board of the central bank may issue guidelines to the Regulatory Authority as to the principles and policies that the Regulatory Authority is required to implement in performing the central bank's functions, and the Regulatory Authority would be required to comply with such guidelines. *Fifth,* upon request the Regulatory Authority would be required to provide the

Governor with advice, information and assistance. All these provisions, in the view of the ECB, are fundamental - and should be made the most of in practice – to allow for the continued close involvement of the central banking functions in supervision matters, as is currently the case within the Central Bank of Ireland. Indeed, this involvement is a necessary condition to allow the Eurosystem to contribute adequately to monitoring the risks to financial stability in the euro area. In addition, it also safeguards a smooth co-ordination between the central banking functions exercised at the Eurosystem's level and the supervisory functions carried out at national level. An additional safeguard to ensure that supervisory tasks do not prevail over the central banking perspective, as referred to below with regard to other issues raised in this opinion, would be that the composition of the central bank's Board would not be such that as many as half of the Board directors would also be members of the Regulatory Authority.

6. The legislation would establish a structure that is unique within the Eurosystem for the regulation and supervision of financial institutions by setting-up a statutory body enjoying independent functions, but located within the legal personality of a national central bank. In this regard, the ECB would like to make two general points. *First,* under Article 108 of the Treaty, when exercising the powers and carrying out the tasks and duties conferred upon it by the Treaty and the ESCB Statute, neither a national central bank nor any member of its decision-making bodies shall seek or take instructions from, *inter alia,* any government of a Member State 'or from any other body', which would include a statutory body such as the Regulatory Authority. Having particular regard to the unique structure of the Regulatory Authority as a constituent part of the central bank, the ECB considers that it is of critical importance, as required by Article 108 of the Treaty, that the Regulatory Authority should not seek to influence the Governor, in his capacity as the sole member of the central bank's decision-making body responsible for the performance of the central bank's ESCB tasks. *Second,* there would be no precedent within the Eurosystem for a national central bank to be accountable or liable for acts performed by a constituent part of the central bank (the Regulatory Authority) which would be outside the control of the central bank's key decision-making body responsible for the discharge of its ESCB-related tasks (the Governor). Such a structure could pose a risk to a national central bank's integrity, threatening its overall institutional independence. The potential exposure of a national central bank to liabilities resulting from funding and budgetary decisions for the Regulatory Authority could also be seen as a threat to its financial independence. In addition, the Governor would not have autonomy for staffing decisions in terms similar to those available to the Regulatory Authority. In order to eliminate any legal risks associated with the independent discharge of the central bank's ESCB-related tasks, one of the following two options could be followed. *First,* the Governor could be granted an explicit right to oppose any funding, budgetary and staffing decisions which may have implications for the central bank's independence or which may be deemed otherwise incompatible with the exercise by the Governor of the central bank's ESCB-related functions. *Second,* all funding, budgetary and staffing decisions for the Regulatory Authority could be

made by a restructured Board of Directors, removing the requirement that as many as half of the Board directors would also be members of the Regulatory Authority.

7. With regard to funding, while the Regulatory Authority may be funded by levies and fees paid by financial institutions subject to the Authority's supervision, in the event that the funds raised from such levies and fees prove insufficient the central bank's board of directors may provide funding to the Authority, following approval by the Minister for Finance of the amount of the funds concerned and any conditions to the funding imposed by the central bank's Board. The draft legislation contains some safeguard provisions which are designed to ensure that this does not impede the proper performance of the central bank's ESCB-related tasks. *First,* the Governor, in his capacity as Chairperson of the central bank's Board of Directors, has a platform from which he may seek to protect the central bank's independence with respect to any decisions of the central bank's Board and the Minister for Finance to provide the Regulatory Authority with central bank funds. In practice, however, there may be potential within the central bank's Board for a conflict of interest between the financial interests of the Regulatory Authority and the independence of the central bank in view of the particular composition of the Board, a majority of whose 12 members would include six members of the Regulatory Authority, including the Chairperson and Chief Executive of the Regulatory Authority, and the Secretary General of the Department of Finance, whose Minister would ultimately be responsible for the approval of any funds provided by the central bank to the Regulatory Authority. *Second,* the central bank has a legal obligation to perform its functions in a manner consistent with the Treaty and the ESCB Statute. This legal obligation would necessarily apply to the directors when exercising their statutory responsibilities as members of the central bank's Board of Directors. While the legal risks posed to the central bank's independence would be reduced by these safeguards, it remains unclear from a legal perspective whether the Governor would enjoy a sufficient degree of control over any decisions by the central bank to fund the Regulatory Authority so as to be able to fully protect the central bank's institutional and financial independence.

8. With regard to the budget, the Regulatory Authority would be required to prepare an annual statement setting out estimates of its income and expenditure, and the Minister for Finance would be empowered, following consultation of the central bank's Board, to approve the statement. As noted in the 1998 European Monetary Institute (EMI) Convergence Report, where third parties, and particularly the government, are in a position, directly or indirectly, to exercise influence on the determination of a national central bank's budget, the relevant statutory provisions should contain a safeguard clause to ensure that this does not impede the proper performance of the national central bank's ESCB-related tasks. Although both the Minister for Finance and the Regulatory Authority are clearly in a position, directly or indirectly, to exercise influence on the determination of that portion of the central bank's budget that relates to the Regulatory Authority, the relevant statutory provisions contain some safeguard clauses which are designed to ensure that this does not impede the proper

performance of the central bank's ESCB-related tasks. *First,* in the case of the Regulatory Authority's budgetary powers, these safeguards include (a) a required consultation of the Governor of the estimates insofar as they affect the carrying out of the central bank's obligations with respect to the Irish State's financial stability or the performance of the central bank's ESCB-related functions; and (b) the Governor's power, with respect to the exercise of his functions, to issue guidelines as to policies and principles with which the Regulatory Authority would be required to comply. *Second,* in the case of the Minister for Finance's budgetary powers, these safeguards include (a) a required consultation of the central bank's Board, of which the Governor is Chairperson, before approving the estimates; and (b) a specific legal obligation of the Minister to have regard to the central bank's functions under the Treaty and the ESCB Statute, which are exclusively vested in the Governor, when approving the estimates. While the legal risks posed to the central bank's independence would be reduced by these safeguards, it remains unclear from a legal perspective whether the Governor would enjoy a sufficient degree of control over budgetary decisions taken by the Regulatory Authority and the Minister for Finance so as to be able to fully protect the central bank's institutional and financial independence.

9. With regard to staffing, the central bank's Board of Directors would be responsible for administering the staff of the central bank and its constituent parts and for administering the provision of accommodation and office equipment with a view to enabling the central bank and its constituent parts to perform their respective functions. However, while the central bank's Board would be required to appoint such employees of the central bank as it considers necessary for the effective performance of the functions of the central bank and each of its constituent parts, the Regulatory Authority and its Chief Executive would have the same power as the Board to appoint employees of the central bank. In fixing the conditions of employment of such central bank employees appointed by the Chief Executive of the Regulatory Authority the central bank's Board would be required to obtain the concurrence of the Regulatory Authority or its Chief Executive. While the legal risks posed to the central bank's operational independence would be reduced by certain safeguards, such as the Governor's power to issue guidelines and the Regulatory Authority's legal obligation to perform its functions in a way that is consistent with the Treaty and the ESCB Statute, it remains unclear from a legal perspective whether the Governor would enjoy a sufficient degree of control over staffing decisions taken by the Regulatory Authority and its Chief Executive so as to be able to fully protect the central bank's operational independence. This risk would cease to exist if the Governor were to be granted comparable staffing powers as the Regulatory Authority and its Chief Executive.

10. The ECB considers that the significant role that the Governor would have with respect to financial stability issues eliminates any legal risks resulting from the separation between the decision-making power and the central bank's legal accountability with respect to those decisions of the Regulatory Authority which have financial stability implications. However, the ECB notes that provision is made for the appointment within the Regulatory Authority, and

therefore as a constituent part of the central bank, of a Registrar of Credit Unions responsible for the registration and supervision of credit unions. The Registrar would not be subject to the control or direction of the Regulatory Authority. While the Regulatory Authority would be required to issue guidelines to the Registrar with respect to consultation and co-operation with the Governor, it is unclear whether the Governor would enjoy a sufficient degree of control over the supervisory decisions of the autonomous Registrar in order to protect the central bank's independence. The legislation should explicitly clarify that the supervisory decisions of the Registrar of Credit Unions, as a constituent part of the central bank, would be subject to the same degree of financial stability oversight by the Governor as is proposed for the Regulatory Authority.

11. The draft legislation facilitates the possible establishment by the central bank's Board of Directors of a committee of the Board called the 'Monetary Committee of the Board' (or a similar name) consisting of those Board members who are not members of the Regulatory Authority, to whom the Governor, subject to the requirements of the Treaty and the ESCB Statute, would be required to provide information about, and with whom the Governor may discuss, the performance of the central bank's ESCB-related functions. In this regard, the ECB takes particular note that the draft legislation would not authorise the Board to delegate any function that must be performed by the Governor. Given that the Governor's ESCB-related tasks include monetary policy, one might question whether the statutory characterisation of a board committee as a 'Monetary Committee' might create the misleading impression that such a committee enjoys an advisory role with respect to the performance by the Governor of the central bank's monetary policy tasks. The ECB would therefore like to express its clear understanding that the members of such a 'Monetary Committee' would, in practice, enjoy no role with respect to the performance of the central bank's ESCB-related functions. As is clarified in the EMI's 1998 Convergence Report, dialogue between the Governor, in his capacity as the sole decision-making body of the central bank responsible for the performance of the central bank's ESCB-related tasks, and the members of such a 'Monetary Committee', even when based on such statutory obligations to provide information and exchange views, would not be incompatible with the Treaty, provided that (a) this does not result in interference with the independence of the Governor; (b) the ECB's competences and accountability at the Community level as well as the special status of the Governor as a member of the ECB's decision-making bodies are respected; and (c) confidentiality requirements resulting from the ESCB Statute are respected.

12. As is currently the case, the Director General of the central bank would be required to carry out the responsibilities of the Governor for the performance of the central bank's ESCB-related functions whenever the Governor is unable to carry out those responsibilities, while any one of the central bank directors may be appointed to act as Governor to carry out the other non-ESCB related responsibilities of the Governor. It is therefore necessary to explicitly clarify that where the Governor is unable to carry out certain responsibilities which are vested in the Governor in

order to ensure the proper performance of the central bank's ESCB-related functions, these responsibilities would be carried out by the Director General, in his capacity as the central bank's substitute decision-making body for the performance of ESCB-related tasks. These responsibilities include all of the Governor's powers and functions in connection with (a) the financial stability of the State's financial system; (b) the issuance to the Regulatory Authority of guidelines as to the policies and principles that the Authority is required to implement; (c) decisions by the central bank to fund the Regulatory Authority; (d) the establishment of the Regulatory Authority's annual estimates of its income and expenditure; (e) requests for advice, information and assistance from the Regulatory Authority; and (f) the Governor's responsibility to ensure that the resources of the central bank allocated for carrying out the central bank's ESCB-related responsibilities are used effectively, efficiently and economically.

13. The ECB notes that the explicit clarification in the draft legislation of the Governor's responsibilities in connection with the holding and managing the foreign reserves held by the central bank is consistent with the exclusive vesting of the central bank's ESCB-related functions in the Governor, since the basic tasks to be carried out through the ESCB under Article 105(2) of the Treaty include the holding and management of the official foreign reserves of the Member States. In a similar manner, the ECB welcomes the provisions of the draft legislation whereby the Governor is responsible for promoting the efficient and effective operation of payment and settlement systems as reflecting the ESCB's related function regarding clearing and payment systems provided for in the Treaty and the Statute. Regarding the identification in the draft legislation of the objectives of the central bank in performing its ESCB functions, two drafting points are noted. *First,* under Article 105(5) of the Treaty the ESCB's required contribution to the stability of the financial system does not contain any geographical connotations, and the specific reference to the stability of the 'European' financial system should be amended accordingly. *Second,* under Article 105(1) of the Treaty the ESCB's objective of supporting the general economic policies in the Community is stated to be 'without prejudice to' (rather than 'without affecting') the objective of price stability. These two drafting points are adequately addressed in the existing wording of Section 6(2) and (6) of the Central Bank Act, 1942, as amended.

14. The ECB notes that the list of enactments and regulations under which the Regulatory Authority is to perform functions of the central bank should not include any ESCB-related functions vested in the Governor, such as certain of the functions of the central bank under (a) section 18 of the Central Bank Act, 1971, as amended, which, *inter alia,* facilitates the collection by the ECB, assisted by the central bank, of the necessary statistical information directly from economic agents in order to undertake the tasks of the ESCB, in accordance with Article 5 of the ESCB Statute; and (b) Section 23 of the Central Bank Act, 1971, as amended, which, *inter alia,* facilitates the application by the central bank of the ECB's requirements that credit institutions hold minimum reserves on accounts with the ECB and national central banks in pursuance of monetary policy objectives, in accordance with Article 19.1 of the ESCB

Statute. It is recognised that the Regulatory Authority must be able to exercise the central bank's functions under Section 18 in order to collect information and under Section 23 in order to apply specified ratios for purposes of the exercise of the Regulatory Authority's own functions.

15. The ECB notes the proposed repeal of section 7(1)(mm) of the Central Bank Act, 1942, under which it is stated to be lawful for the central bank to transfer assets, income or liabilities to the ECB where required under the ESCB Statute. This repeal should not affect the obligations of the central bank under Chapter VI of the ESCB Statute regarding the financial provisions of the ESCB.

16. While the draft legislative proposal does not propose to repeal Section 11 of the Central Bank Act, 1998, pursuant to which the central bank's accounts may be audited in accordance with Article 27 of the ESCB Statute, the proposed repeal of the related Section 19 of the Central Bank Act, 1989 would appear to have rendered Section 11 of the 1998 Act redundant. It is therefore suggested that a new section be inserted in the provisions of the draft legislative proposal which restate Section 19 of the 1989 Act to clarify that the central bank's accounts may, in addition to being audited by the Comptroller and Auditor General, be audited by independent external auditors recommended by the ECB in accordance with Article 27 of the ESCB Statute. A corresponding revision to the provisions permitting the disclosure of information concerning matters arising in connection with performance of the central bank's functions to such independent external auditors would also be necessary.

17. Finally, the ECB notes that the draft legislative proposal contains a good deal of restatement and reordering of existing Irish legislation relating to the central bank's functions and powers. While the ECB welcomes this partial consolidation of Ireland's central bank statutes, and most particularly the Central Bank Act, 1942, the ECB notes that the provisions of Irish law relating to the basic structure of Ireland's central bank and the performance of its ESCB-related tasks would, following enactment of the draft legislative proposal, be contained in a number of different laws, including the draft legislative proposal, the surviving provisions of the original Central Bank Act, 1942, a number of provisions in the Central Bank Acts, 1971 and 1989, the surviving provisions of the Central Bank Act, 1998, a number of provisions of the Economic and Monetary Union Act, 1998 (as amended by the Finance Act, 2002), as well as a number of additional laws concerning currency matters. The lack of a consolidated central bank statute creates a structure for Ireland's central bank that is somewhat lacking in transparency. Legal clarity and transparency would suggest that at the first suitable opportunity the Irish Government should undertake a consolidation exercise. In addition, a full consolidation of Ireland's central bank statutes would greatly assist the ECB in fulfilling its ongoing task of responding to consultations from the Irish authorities on draft legislation within the ECB's field of competence, as well as of ensuring that Irish legislation, including the statutes of Ireland's central bank, are compatible with the Treaty and the ESCB Statute. In this regard it is noted that

Ireland's central bank statutes are the only central bank statutes in the Eurosystem which have not been consolidated.

18. The ECB would appreciate being provided, for information purposes, with any amendments affecting any of the issues addressed in this opinion. In addition, the ECB stands ready to provide further comments on the draft legislation prior to enactment by the Oireachtas.

Done at Frankfurt am Main on 5 June 2002.

The President of the ECB

[signed]

Willem F. DUISENBERG