EUROPEAN CENTRAL BANK

EUROSYSTEM

EN **ECB-PUBLIC**

OPINION OF THE EUROPEAN CENTRAL BANK

of 21 June 2019

on the governance and financial independence of the Central Bank of Cyprus and on amendments to the Constitution regarding the Central Bank of Cyprus

(CON/2019/24)

Introduction and legal basis

On 20 May 2019 the European Central Bank (ECB) received a request from the Ministry of Finance of the Republic of Cyprus for an opinion on a draft law amending the Law of 2002 on the Central Bank of Cyprus[1] (hereinafter the 'draft law') and a draft amendment to the Constitution of the Republic of Cyprus[2] (hereinafter the 'draft amendment to the Constitution'). The ECB was already consulted on an earlier version of the draft law and provided its observations in Opinion CON/2018/23[3].

This opinion focuses on the amendments to the Law of 2002 on the Central Bank of Cyprus (hereinafter referred to as the 'Law on the CBC') that differ from the earlier version of the draft law on which the ECB provided its observations in Opinion CON/2018/23 and also considers the draft amendment to the Constitution.

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 third indent of Article 2(1) of Council Decision 98/415/EC[4], as the draft law and the draft amendment to the Constitution relate to the Central Bank of Cyprus (CBC). 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 and the draft amendment to the Constitution

1.1 Purpose of the draft law

1.1.1 The draft law introduces amendments to the Law on the CBC in respect of the CBC's governance structure, the independence of the CBC's directors, and the CBC's capital and its alteration.

1.1.2 The Law on the CBC lists the licensing and supervision of authorised credit institutions as one of the CBC's basic tasks, without prejudice to the Law on the business of credit institutions[5].

---

1 Ο περί της Κεντρικής Τράπεζας της Κύπρου Νόμος του 2002 (138(I)/2002).

2 Το Σύνταγμα της Κυπριακής Δημοκρατίας.

3 All ECB opinions are published on the ECB's website at www.ecb.europa.eu.

4 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).

5 Ο Περί Εργασιών Πιστωτικών Ιδρυμάτων Νόμος (66(I)/1997).

The draft law removes the licensing of credit institutions as one of the CBC's basic tasks and makes reference to Council Regulation (EU) No 1024/2013[6].

1.1.3 The draft law removes a provision on which the ECB provided its observations in Opinion CON/2018/23 that provided for different terms of office for the members of the board of directors during a transitional period. More specifically, this provision set out that three out of the five directors appointed for the first time after the entry into force of that draft law would have terms of office of three years. The terms of office of the other two directors would be four years. The draft law also removes the prerequisite that executive and non-executive directors must be citizens of the Republic of Cyprus in order to be appointed[7]. In addition, the draft law has been revised to provide that two members of the executive committee constitute a quorum at any of its meetings[8].

1.1.4 The draft law revises the grounds for dismissal of directors[9]. The position of an executive director may become vacant for the following reasons: (a) in the case of his or her death; (b) upon a director's written resignation; (c) if the director no longer fulfils the conditions required for the performance of his or her duties; (d) if the director has been guilty of serious misconduct. The position of a non-executive director may become vacant for the same grounds as for an executive director, as well as in the case of one of the events taking place that are listed in Article 14 of the Law on the CBC. Article 14 of the Law on the CBC provides that a person cannot be appointed as a director if he or she already holds a position that may create a conflict of interest with his or her capacity as a director, and sets out a number of specific events where such a conflict of interest exists.

1.1.5 In addition, the draft law provides that 'with the exception of the governor and deputy governor', both executive and non-executive directors may be dismissed by a council that is chaired by the president of the Supreme Court and that has been established in accordance with Article 153(8) of the Constitution at the motion *(προσφυγή)* of the Council of Ministers[10]. The grounds for dismissal of the governor and deputy governor set out in Article 18(4) of the Law on the CBC have not been changed[11].

1.1.6 The draft law removes a provision on which the ECB provided its observations in Opinion CON/2018/23, which empowered the Council of Ministers to dismiss any CBC director who acquires an interest in or holds a position in a financial institution during the course of his or her term of office with the CBC.

1.1.7 In the provision conferring upon the board of directors the power to adopt CBC accounting policies and procedures in accordance with international accounting standards, the draft law makes reference to the accounting standards that apply to the European System of Central

6 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). See Article 6(2)(d) of the Law on the CBC, as amended by Article 3 of the draft law.

7 See Article 13(1) and (5) of the Law on the CBC, as amended by Article 5(c) and (d) of the draft law, respectively.

8 See Article 17A(6) of the Law on the CBC, as amended by Article 11(b) of the draft law.

9 See Article 13(4) and (5) of the Law on the CBC, as amended by Article 5(a) and (c) of the draft law, respectively.

10 Ibid.

11 There is no need for a motion from the Council of Ministers in this case.

Banks (ESCB) and to the ECB's Guidelines[12]. In addition, the provision of the draft law concerning the appointment of an alternate as a member of the Governing Council has been revised to refer to the Rules of Procedure of the European Central Bank[13].

1.1.8 According to the draft law, the executive committee members have no voting rights at meetings of the board of directors when matters connected with the executive committee's management of the CBC are reviewed[14]. This provision has been redrafted to clarify that this limitation only applies in relation to specific tasks undertaken by the executive committee, namely the carrying out of the CBC's day-to-day activities and the management of its work, the performance of the CBC's objectives and mission as set out in Articles 5, 5A and 6 of the Law on the CBC[15], and the appointment, suspension and dismissal of employees. The draft law clarifies that the oversight of the executive committee's actions in relation to the performance of the CBC's objectives and mission should not concern matters which fall within the ESCB's fields of competence, the ECB's competences pursuant to Council Regulation (EU) No 1024/2013 and the Single Resolution Board's competences pursuant to Regulation (EU) No 806/2014 of the European Parliament and of the Council[16]. Additionally, this provision is without prejudice to the executive committee's independence and competence in the performance of its ESCB-related and other duties.

1.1.9 The draft law introduces a qualification to the provision regarding the legal costs to be paid by the CBC as regards acts of the governor, deputy governor and/or members of the board of directors. This qualification stipulates that the CBC will not pay the legal costs incurred and/or damages awarded in connection with any act or omission of the governor and/or deputy governor and/or members of the board of directors during the exercise of their powers in cases where such an act or omission was committed in bad faith, or constituted fraud or gross negligence[17].

1.1.10 As regards the CBC's capital, the draft law removes a draft provision that the CBC's general reserve should not exceed twice its capital and corrects the amount of the capital by setting it at EUR 150 million[18].

1.2 Purpose of the draft amendment to the Constitution

1.2.1 The draft amendment to the Constitution modifies two Articles concerning the CBC.

---

12 See Article 15(1)(k) of the Law on the CBC, as amended by Article 7 of the draft law.

13 See Article 20(3) of the Law on the CBC, as amended by Article 14 of the draft law.

14 See Article 17(4) of Law on the CBC, as amended by Article 10 of the draft law.

15 Article 5 of the Law on the CBC sets out the CBC's primary objective which is to maintain price stability and, without prejudice to this objective, to support the general economic policies of the State. Article 5A provides that the CBC forms part of and contributes to the performance of the tasks of the ESCB and that it acts within the ESCB's fields of competence. Article 6 provides that the CBC is to perform all tasks required for the achievement of its objectives and lists, without prejudice to the beforementioned, the basic tasks that the CBC may exercise.

16 Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (OJ L 225, 30.7.2014, p. 1).

17 See Article 22 of the Law on the CBC, as amended by Article 15 of the draft law.

18 See Article 56(1) of the Law on the CBC, as amended by Article 17 of the draft law.

1.2.2 The first modification relates to Article 118(4) of the Constitution, which provides for the dismissal of the CBC's governor and deputy governor. In this respect, the CBC's governor and deputy governor may be dismissed by a council established in accordance with Article 153(8) of the Constitution and chaired by the president of the Supreme Court. The draft amendment to the Constitution extends the scope of Article 118(4) to the remaining members of the CBC's executive committee and of the board of directors (i.e. the executive and non-executive directors).

1.2.3 The second modification inserts the words 'unless otherwise determined by law' into paragraphs 1, 2, and 3 of Article 119 of the Constitution, which describe the powers and tasks of the CBC's governor and which, more specifically, provide that the governor is responsible for the CBC's management and exercises all powers and performs all functions and duties within the scope of the CBC's competences, assisted by the deputy governor.

2. Observations

2.1 The ECB welcomes the amendments introduced by the draft law, which reflect a number of suggestions provided by the ECB in Opinion CON/2018/23[19]. The ECB wishes to make the following additional observations in relation to the draft law.

2.2 The ECB welcomes the revisions introduced as regards the grounds for dismissal of the members of the executive committee as these are now aligned with Article 14.2 of the Statute of the ESCB and reinforce the independence of these members. As noted in the ECB Convergence Reports[20], NCB statutes must ensure that governors are not dismissed for reasons other than those mentioned in Article 14.2 of the Statute of the ESCB, i.e. where they no longer fulfil the conditions required for the performance of their duties or have been guilty of serious misconduct. This principle also applies to other members of NCB decision-making bodies involved in the performance of ESCB-related tasks, especially where a governor is 'first among equals' with colleagues with equivalent voting rights, or where other such members are involved in the performance of ESCB-related tasks[21]. The ECB also notes that these revisions go a step further by providing that the same procedure for the dismissal of the governor and deputy governor also applies with regard to the dismissal of non-executive directors. From a technical drafting perspective, the added wording referred to in paragraph 1.1.5 seems redundant as the governor and deputy governor cannot be considered to be executive or non-executive directors.

2.3 The ECB understands the deletion of the provision stipulating that the acquisition of an interest or holding of a position by a director in a financial institution during the course of his or her term would result in his or her dismissal by the Council of Ministers to be a technical amendment,

19 See paragraphs 2.3, 2.4, 2.7, 2.8, 3.1.2, 3.1.3, 3.1.6 and 3.1.7 of Opinion CON/2018/23.

20 See for example the ECB's Convergence Report of May 2018, page 24.

21 See paragraph 2.2 of Opinion CON/2014/51.

which has been introduced in view of the introduction of a conflict of interest as a ground for dismissal for the non-executive directors[22].

2.4 The ECB welcomes the amendment to the provision that limits the voting rights of the members of the executive committee at the meetings of the board of directors. This provision aims to clarify the matters over which such a limitation would apply. It might also be useful to clarify the basis on which the board of directors may exercise oversight (*ανασκόπηση*) of the executive committee's performance by identifying which of the tasks of the board of directors set out in Article 15 of the Law on the CBC[23] capture the task of oversight (*ανασκόπηση*) of the executive committee's performance referred to in Article 17(4) of the Law on the CBC[24]. The ECB also welcomes the added qualification that this provision is without prejudice to the independence and competence of the executive committee in the performance of its ESCB-related and other duties.

2.5 In relation to the amendments introduced regarding the CBC's capital and its alteration, the ECB reiterates its understanding that according to the draft law, the CBC will be entitled to be automatically recapitalised up to the level of the prescribed capital referred to in the Law on the CBC as amended by the draft law[25].

2.6 The ECB welcomes the provision of the draft law conferring powers on the board of directors to determine the level of 'maximum provisions and reserves' that the CBC can maintain in the medium term[26]. In this respect, the ECB reiterates its understanding that this provision intends to address financial buffers comprising general reserves, capital and financial risk provisions[27]. The ECB furthermore reiterates its understanding that the 'maximum provisions and reserves' exclude: (a) specific provisions against already incurred losses; and (b) any amounts recorded by the CBC on revaluation accounts, and that the profit to be distributed by the CBC to the general government account is determined following the establishment of adequate 'maximum provisions and reserves'.

2.7 Finally, the ECB welcomes the objective of the draft amendment to the Constitution to guarantee legal certainty by ensuring that the draft law is in line with the provisions of the Constitution. In particular, the ECB welcomes the extension of the scope of Article 118(4) of the Constitution on the grounds of dismissal to cover the CBC's executive directors, putting them on an equal footing with the governor and deputy governor, and notes that the draft amendment to the Constitution goes a step further by providing that the same procedure for the dismissal of the governor and deputy governor also applies with regard to the dismissal of non-executive directors. As regards the modifications to Article 119 of the Constitution, the ECB understands that these modifications aim to bring legal certainty as regards the performance of the powers

22 See paragraphs 1.1.4 and 1.1.6.

23 See Article 7 of the draft law.

24 See Article 10 of the draft law.

25 See Article 56(2) and (3) of the Law on the CBC as amended by Article 17 of the draft law and paragraph 3.1.8 of Opinion CON/2018/23.

26 See Article 59 of the Law on the CBC, as amended by Article 18 of the draft law.

27 See paragraph 3.1.9 of Opinion CON/2018/23.

and tasks of the executive committee, which would otherwise be inconsistent with the powers and tasks of the governor, assisted by the deputy governor.

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

Done at Frankfurt am Main, 21 June 2019

[signed]

The President of the ECB

Mario DRAGHI