EUROPEAN CENTRAL BANK

OPINION OF THE EUROPEAN CENTRAL BANK

of 15 October 2003

at the request of the Finnish Ministry of Finance
on a draft government proposal to amend the Suomen Pankki Act and other related acts

(CON/2003/22)

Introduction

1. On 15 September 2003 the European Central Bank (ECB) received a request from the Finnish Ministry of Finance for an opinion on a draft government proposal to amend the Suomen Pankki Act (*Laki Suomen Pankista (214/1998)*) of 27 March 1998, the Suomen Pankki Officials Act (*Laki Suomen Pankin virkamiehistä (1166/1998)*) of 30 December 1998, and the Financial Supervision Act (*Laki Rahoitustarkastuksesta (587/2003)*) of 27 June 2003 (hereinafter the 'legislative proposal').

2. The ECB's competence to deliver an opinion is based on the second indent of Article 105(4) of the Treaty establishing the European Community and the third indent of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the ECB by national authorities regarding draft legislative provisions[1], as the legislative proposal relates to the national central bank (NCB) of Finland (Suomen Pankki). In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council of the ECB has adopted this opinion.

3. The legislative proposal addresses a number of matters directly related to policy issues of great importance to the Eurosystem. This opinion focuses on proposed measures affecting Suomen Pankki's financial position and provisions relating to its power to issue norms.

General assessment of the proposed measures affecting Suomen Pankki's independence

4. Article 109 of the Treaty provides that the Member States must ensure that their national legislation, including the NCBs' Statutes, is compatible with the Treaty and the Statute of the European System of Central Banks and of the European Central Bank. Article 108 of the Treaty, reinforced by Article 7 of the Statute, requires an NCB that forms part of the European System of Central Banks (ESCB) to be independent. The legislative proposal contains, *inter alia*, three measures, (i) a substantial reduction of primary capital forcing Suomen Pankki *de facto* to sell part of its foreign reserve assets, (ii) an

1 OJ L 189, 3.7.1998, p. 42.

obligation to transfer 100% of profits to the State, as a rule, and (iii) a strict limitation on Suomen Pankki's right to create financial provisions. The combined effect of these measures will weaken Suomen Pankki's financial position over time, increasing the risk that it may not have sufficient resources in the future to carry out its ESCB-related and other tasks and making it dependent on the decisions of third parties in such situations. In view of the uncertainty about future financial demands on Suomen Pankki, it is vital to have adequate margins and to safeguard the real value of the bank's resources in relation to its tasks. In its present form, the legislative proposal infringes the principle of financial independence with regard to Suomen Pankki and, especially as it entails the indirect enforced sale of foreign reserves, also undermines the principle of institutional independence with regard to Suomen Pankki. Therefore, the ECB concludes that the legislative proposal is incompatible with the Treaty and its intentions. Moreover, as the weakening of the financial position of an NCB forming part of the ESCB/Eurosystem cannot be seen in isolation from the system as a whole, the legislative proposal will have an adverse effect on the credibility and financial standing of the Eurosystem as a whole.

Reduction of Suomen Pankki's primary capital

5. At the end of 2002 the amount of Suomen Pankki's primary capital was EUR 841 million, this figure not having changed since 1984. The legislative proposal suggests reducing the amount of primary capital by nearly 90 % to EUR 100 million, resulting in a transfer of EUR 741 million as income to the State of Finland at the end of the year in which the proposed amendment would enter into force.

6. The principle of financial independence of central banks embedded in Article 108 of the Treaty requires that 'the NCBs be in a position to avail themselves of the appropriate means to ensure that their ESCB-related tasks can be properly fulfilled'[2]. The concept of financial independence also requires that an NCB must, at all times, have sufficient financial means to carry out its other functions, i.e. to perform its national tasks, to meet its international obligations, and to cover properly its administrative and operational expenses. The proposed reduction of Suomen Pankki's capital including the *de facto* enforced sale of foreign reserve assets and also the reduction of a regular source of income increases the risk that Suomen Pankki may in the future have insufficient resources to carry out its ESCB-related tasks or its other tasks. For example, Articles 29 and 30.4 of the Statute oblige NCBs to be prepared to make further capital disbursements and transfers of foreign reserve assets to the ECB, and Article 33 of the Statute obliges NCBs to contribute to potential losses of the ECB. The NCBs also have other commitments regarding their foreign reserve assets and own funds, such as IMF-related commitments. Suomen Pankki's national tasks include those related to financial stability and crisis prevention and management. Although systemic crises tend to be rare events, they can have great impact on the economy and should therefore receive appropriate attention from central banks. In such

2 European Monetary Institute, Convergence Report, March 1998.

cases, an NCB's ability to act swiftly may prove to be particularly valuable. In particular sufficient financial resources will assure public confidence as to the NCB's ability to intervene independently to tackle the crisis. This would also strengthen the credibility of its public statements aimed at restoring confidence in the viability of the financial system as a whole.

7. Reducing the equity of any one NCB and imposing restrictions on the management of its financial resources cannot be considered in isolation, as demonstrated by Articles 30.4, 32 and 33 of the Statute, from the potential effect of such a reduction on the financial position, and therefore on the credibility, of the Eurosystem as a whole. As a result, the ECB, not least as a matter of principle, expresses its serious concern at the proposal to reduce Suomen Pankki's capital, which is based on an assessment made at a given point in time and in isolation from the position of the Eurosystem as a whole. The capital and reserves of an NCB within the Eurosystem[3] form the basis of its financial independence, and by extension the financial independence of the constituent members of the Eurosystem as a whole. There are no objective reasons to justify proposals from Member States that have adopted the euro which weaken the Eurosystem's financial standing and credibility.

8. The obligation of Member States to ensure the independence of their NCBs puts them in an exceptional position, since it obliges the Member States to keep at arm's length the assessment of the level of financial resources and the management of the capital of the NCBs. Such assessment should be based on the professional judgement of the relevant independent decision-making body – in Finland the Board of Suomen Pankki – rather than on the financial needs of the State, so that the NCB does not become dependent for its finances on either Government, Parliament or any other third party. The legislative proposal does not contain safeguards to ensure that Suomen Pankki will at all times be able to avail itself of the appropriate means to fulfil its ESCB-related tasks. Therefore the legislative proposal does not take into account this requirement of financial independence.

9. According to the principle of institutional independence embedded in Article 108 of the Treaty and Article 7 of the Statute, the Member States and their Governments are prohibited from seeking to influence the members of the NCBs' decision-making bodies, whose decisions may have an impact on the fulfilment by the NCBs of their ESCB-related tasks. This institutional framework implies that taking into account the restrictions set by the Eurosystem as a whole, it is the NCB itself that determines the structure and composition of its balance sheet. The legislative proposal does not specify how Suomen Pankki should generate the liquidity to pay out to the State the capital being reduced, but considering the structure of Suomen Pankki's balance sheet, and the need to avoid interference with the single monetary policy, the legislative proposal will *de facto* force Suomen Pankki to sell part of its foreign reserve assets. Under Article 105(2) of the Treaty one of the NCBs' ESCB-related tasks is to hold and manage the Member States' official foreign reserves. The indirectly enforced sale of official

3 Those NCBs within the ESCB whose Member States have adopted the euro.

foreign reserves that the legislative proposal entails would circumvent Suomen Pankki's right and obligation, as part of the ESCB, to hold and manage official Member State foreign reserves independently.

10. Moreover, the explanatory memorandum gives reasons for the proposed reduction by referring to Suomen Pankki's lack of an independent monetary policy competence since January 1999. In this context the ECB would emphasise that shifting the monetary policy competence from the NCBs to the ECB did not abolish the NCBs' responsibilities as an integral part of the Eurosystem. The nature of the NCBs' responsibilities has changed from individual to collective Eurosystem responsibilities, with each NCB bearing a share thereof. Furthermore, the Eurosystem has followed a decentralised model of operation that vests in each NCB the responsibility for the implementation of Eurosystem tasks at national level.

Distribution of Suomen Pankki's profit

11. According to the legislative proposal the rules on the allocation of Suomen Pankki's profit would be amended. The current Suomen Pankki Act states that half of the profit is credited as income to the State and the other half is transferred to the reserve fund, unless the Parliamentary Supervisory Council decides to allocate the profits differently. The legislative proposal will change this rule and establish the compulsory transfer of the entire annual profit of Suomen Pankki to the State. A decision by the Parliamentary Supervisory Council to use the profit differently would require special justification.

12. The ECB is seriously concerned with regard to the consequences of a legislative arrangement under which not even a share of Suomen Pankki's profits is allocated to the reserve fund either automatically or based on the independent and professional judgement of the Board of Suomen Pankki after taking into account any possible future risks. The legislative proposal places the use of possible profits for such purpose at the sole discretion of the Parliamentary Supervisory Council. Financial independence in Member States where Government or Parliament can directly or indirectly exercise influence on the distribution of an NCB's profit requires that, statutory provisions guarantee that the proper performance of the NCBs' ESCB-related tasks is not hindered[4]. The legislative proposal is deficient in this respect and incompatible with the requirement of financial independence embedded in Article 108 of the Treaty. Therefore, an explicit safeguard clause should be added to the Suomen Pankki Act in this respect. Additionally, and for the sake of clarity, the explanatory memorandum should state that the need to provide sufficient financial resources for Suomen Pankki's future performance of ESCB-related tasks is a valid justification for not distributing the entire profit to the State.

4 European Monetary Institute, Convergence Report, March 1998.

Suomen Pankki's right to make financial provisions

13. The legislative proposal would abolish Suomen Pankki's right independently to create financial provisions to safeguard the maintenance of the real value of its capital and reserves. The ECB stresses that future financial and economic developments cannot be foreseen with any degree of certainty, and therefore does not consider it justified for an NCB to be deprived of the opportunity to protect the real value of its capital.

14. The legislative proposal allows exchange rate risk and the risk of variation in the market value of securities to be covered by making financial provisions. However, such provisions may only equal the amounts of annual realised net profits resulting from these sources. Where such net realised gains do not exist or are insufficient to cover future exposures, the legislative proposal leaves the decision of allocating regular profits to the general reserve fund to the discretion of the Parliamentary Supervisory Council. This arrangement is not compatible with the requirement for an NCB to be financially independent, as the professional assessment of the Board of Suomen Pankki regarding coverage of future exposures would, under the legislative proposal, not be decisive and there is no guarantee that Suomen Pankki has and will in future have sufficient resources to take care of its tasks.

Summary conclusion on the proposed measures affecting Suomen Pankki's finances

15. The combined effect of the proposed legislative measures weakens Suomen Pankki's financial position, allocates the assessment of whether Suomen Pankki has sufficient financial resources to carry out its ESCB-related as well as its other tasks to the judgement of the Parliamentary Supervisory Council without containing any statutory safeguards, and circumvents Suomen Pankki's right and obligation to hold and manage the Member States' official foreign reserves. This, in the view of the ECB, is not consistent with the principles of financial and institutional independence of central banks embedded in the Treaty. The ECB urges the Government of Finland to reconsider the legislative proposal so that said principles are not infringed and to ensure that Suomen Pankki's financial regime will be compatible with the Treaty.

Suomen Pankki's power to issue norms regarding oversight

16. The legislative proposal grants Suomen Pankki certain limited powers to issue norms in order to carry out its duties as part of the Eurosystem. According to the legislative proposal, the norms would only be addressed to those institutions that maintain or participate in such payment and clearing systems as the Finnish Ministry of Finance has designated under the Settlement Finality Directive[5].

17. Article 105(2) of the Treaty and Article 3.1 of the Statute include as a basic Eurosystem central bank task the promotion of the smooth operation of payment systems. For the NCBs of the participating

5 Directive 98/26/EC of the European Parliament and the Council of 19 May 1998 on settlement finality in payment and securities settlement systems, OJ L 166, 11.6.1998, p. 45.

Member States, these Articles provide a legal basis for the oversight of payment systems functionally directly linked with settlement systems. Within the Eurosystem, oversight activities are generally performed at NCB level, in line with the common oversight policy defined for the Eurosystem by the ECB's Governing Council. The ECB understands that in line with the NCBs' oversight function[6], Section 3 of the Suomen Pankki Act provides the legal basis for Suomen Pankki's oversight function by stipulating that it will both participate in maintaining the reliability and efficiency of the payment system and the overall financial system and assist in their development.

18. The ECB supports the proposed measure, which makes it easier for Suomen Pankki to fulfil its oversight function in a sufficiently transparent way. The ECB notes, however, that the wording of the legislative proposal appears relatively restrictive and could prove to be impracticable. Firstly, Suomen Pankki is responsible for overseeing the reliability and efficiency of the overall infrastructure of the financial system, which includes securities settlement systems. Therefore, an explicit reference in the Suomen Pankki Act to Suomen Pankki's oversight function regarding securities clearing and settlement systems might be helpful for the sake of clarification. Secondly, given the broad oversight function of Suomen Pankki, as described in the explanatory memorandum, it would be reasonable for all payment and securities clearing and settlement systems to be brought under the regulatory powers of Suomen Pankki, regardless of whether they are protected by the Settlement Finality Directive. Thirdly, ECB legal acts other than guidelines and instructions, such as decisions or regulations, as well as ESCB-wide agreements, are excluded from the explicit wording of the legislative proposal. The ECB would regret such limits being imposed on the regulatory powers of Suomen Pankki. The ECB notes that when adopting the Treaty Finland undertook to act in a manner enabling its central bank to abide by the legal instruments of the ECB with binding effect on it. The ECB invites the Finnish Government and Parliament to extend the explicit wording of the legislative proposal to cover ECB legal instruments binding on NCBs. This could be done for example by linking Suomen Pankki's power to issue norms to its obligation to carry out its tasks as part of the ESCB. In this context, the ECB would point out that the NCBs are always bound by the content and parameters laid down in ECB legal acts, which do not allow discretionary powers to be used when implementing them.

6 The oversight function of NCBs has been described in detail in previous ECB opinions published on its website http://www.ecb.int. For example see ECB Opinion CON/2003/14 of 7 August 2003 at the request of the Banca d'Italia on a draft regulation on payment systems, payment infrastructures and payment instruments and ECB Opinion CON/2003/15 of 8 August 2003 at the request of Sveriges Riksbank on a draft law amending the Sveriges Riksbank Act (not yet published).

The ECB confirms that it has no objection to the competent national authorities making this opinion publicly available at their discretion. This opinion will be published on the ECB's website.

Done at Frankfurt am Main on 15 October 2003.

The President of the ECB

[signed]

Willem F. DUISENBERG