

COMMITTEE OF GOVERNORS OF THE CENTRAL BANKS
OF THE MEMBER STATES
OF THE EUROPEAN ECONOMIC COMMUNITY

THE CHAIRMAN

Basle, 2nd September 1991

Confidential

Mr. Wim Kok
President of the Council
of the European Communities
Rue de la Loi, 170
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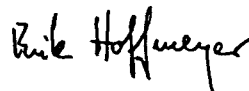
Dear Mr. President,

The Committee of Governors has noted with satisfaction that its proposal for a Statute of the European System of Central Banks and of the European Central Bank has been well received at the IGC and that its thrust has been fully endorsed in the course of negotiations.

The Committee of Governors has noted that in the annex to the Luxembourg Presidency's Non-paper, entitled "Draft articles of the Treaty establishing the EEC amended with a view to the setting-up of an Economic and Monetary Union", dated 6th June 1991, some amendments have been made to the Statute. In addition, a number of square brackets have been introduced into the text, indicating differing opinions with regard to certain provisions.

In order to facilitate discussions on the Statute of the ESCB and the ECB, the Committee of Governors wishes to bring to the attention of the IGC the principal considerations which have guided the Committee in the preparation of certain Articles. These considerations are outlined in the attached note.

Yours sincerely,



Erik Hoffmeyer

Enclosure

EXPLANATORY NOTE ON CERTAIN ARTICLES CONTAINED IN THE
PROPOSED STATUTE OF THE ESCB AND OF THE ECB

The purpose of this note is to bring to the attention of the IGC the principal considerations, beyond what is in the Commentary on the draft Statute, which have guided the Committee of Governors in the preparation of certain Articles of the draft Statute¹ which have been either amended or been placed between brackets in the annex to the Luxembourg Presidency's Non-paper of 6th June 1991.² The following explanations refer primarily to Articles which had been agreed by the Committee of Governors and which therefore did not contain brackets. The note, in addition, also comments briefly on the role of the ESCB in the Economic and Financial Committee to be established under Article 109 B of the Luxembourg Presidency's draft Treaty on Economic and Monetary Union.

I. THE TERM OF OFFICE OF MEMBERS OF THE EXECUTIVE BOARD

In Article 11.2 the length of the term of office - eight years - has been placed between brackets and a sentence stating that "this mandate shall not be renewable" has been added. The Committee of Governors holds the view that the security of tenure granted to Executive Board Members is a crucial element of personal as well as institutional independence. In particular, the term of office should be sufficiently long; for example, an

1 "Draft Statute of the European System of Central Banks and of the European Central Bank", Committee of Governors, 26th April 1991.

2 "Non-paper: Draft articles of the Treaty establishing the EEC amended with a view to the setting-up of an Economic and Monetary Union", Report by the Chairman of the personal representatives of the IGC, 6th June 1991.

appointment for a period of only five years would be too short to guarantee such independence. Moreover, a very short (and not renewable) term of office might also render it difficult to find suitable and qualified candidates who would be willing to serve as a member of the Executive Board.

II. PRUDENTIAL SUPERVISION

The square brackets which have been placed around the references to prudential supervision in Articles 3 (fifth indent), 4.1 and 25 suggest that differing views are held at the IGC about the role to be played by the System in this field. The relevant provisions were introduced into the Statute with three considerations in mind: firstly, the System, even though operating strictly at the macro-economic level, will have a broad oversight of developments in financial markets and institutions and, therefore, should possess a detailed working knowledge which would be of value to the exercise of supervisory functions. Secondly, the ESCB's primary objective of price stability will be supported by the stability and soundness of the banking system in the Community as it evolves. Thirdly, measures to deal with fragility or disturbance in the banking system must take account of their effect on monetary objectives and policies.

The Committee based its proposal on the assumption that, in accordance with the principle of subsidiarity, the task of prudential supervision would remain in the hands of the national authorities for the foreseeable future. Accordingly, the proposed provisions carefully avoid impinging on the ability of competent national authorities to exercise supervisory functions or to adopt measures for which they are responsible. In that context, the ECB would have an advisory and consultative role in the formulation, interpretation and implementation of Community legislation relating to supervisory policies. However, the Statute also recognises the evolutionary character of financial markets and the concurrent need to adapt prudential supervision. Article 25 takes account of possible future developments and opens up the possibility of involving the ECB in prudential supervision on an EC-wide basis if necessary. Such a task could be undertaken by the ECB only if at some point in the future it were designated under secondary Community legislation as the competent supervisory authority.

III. MINIMUM RESERVES

The text of Article 19 as proposed by the Committee of Governors reflects the basic principle that the instruments of monetary policy, including minimum reserve requirements, should be at the full disposal of the ECB in order to ensure the System's operational independence. The Committee of Governors recognises - as stated in the commentary on Article 19 - that the instrument of minimum reserve requirements imposes an obligation on market participants and that therefore the conditions and terms under which minimum reserves can be applied will have to be established. If the IGC considers it necessary to create the legal foundations for imposing minimum reserves in secondary Community legislation - as indicated by the sentence between square brackets which has been added to Article 19 - the Committee of Governors would recommend that this Article defines the scope of such legislation in such a way as to safeguard the System's operational independence and to ensure the necessary flexibility in the use of this instrument. For this reason the sentence between square brackets should be amended to read: "For the application of this Article, the Council shall, in accordance with the procedure laid down in Article 42, define the basis for minimum reserves and the maximum permissible ratios between those reserves and their basis."

IV. MONETARY FINANCING

The formulation of Article 21.1 as proposed in the Statute is intended to rule out the possibility of any kind of direct monetary financing of the public sector by the ECB and national central banks. The provision would not prevent the purchase of government securities in the secondary market in the context of monetary policy operations. The prohibition to grant overdrafts or any other type of credit facility to public sector entities or to purchase debt instruments directly from them is generally regarded as necessary to ensure the System's ability to achieve its primary objective and thus to reinforce its credibility.

V. FINANCIAL PROVISIONS

The financial provisions reflect the structure of the System whose constituent entities - the ECB and the national central banks - are vested with their own legal personality while, at the same time, they are integral parts of the System, governed by a common set of rules and committed to the objectives and tasks assigned to it. This structure allows monetary policy decisions to be placed firmly in the hands of the central decision-making bodies, whereas operations arising from the System's tasks can be executed through both the ECB and the national central banks. This approach implies that the assets and liabilities necessary for monetary policy operations would be held within the System, regardless of whether they appear on the balance sheets of the ECB or of individual national central banks and that any monetary income is common to the System, irrespective of where it actually accrues. Apart from income retained by the ECB to build up its reserves, the System's total monetary income will be channelled to the national central banks, which will allocate it in accordance with national law or practice.

In the light of these considerations, the Committee of Governors wishes to make the following observations.

Firstly, in order to emphasise the integral character of the System the national central banks should be shareholders of the ECB (Article 28.2).

Secondly, the Committee of Governors has noted that the Presidency's non-paper provides that the increase in the ECB's capital through additional contributions should be made in accordance with limits and conditions specified in Community legislation (Article 28.1). However, the Committee does not agree that this procedure should also be applied when contributions are made by national central banks in order to offset losses incurred by the ECB (Article 33.2). This procedure for loss-covering would be inconsistent with the integral character of the System, which, as outlined above, is reflected in the rules governing income allocation. The net profits or losses of the ECB form part of the System's common income. As all profits earned by the ECB (other than those transferred to its reserves) will be rechannelled to the national central banks, the same procedure should apply equally to allocation of losses to the extent that they are not covered by the ECB's reserves. For this reason Article 32.5

states that contributions from national central banks needed to cover a loss incurred by the ECB would be made in connection with the annual allocation of the System's common income. The operational flexibility of the System would be significantly impaired if, in the event of recourse to contributions under Article 33.2, the ECB Council would have to request a decision under secondary legislation in order to cover ECB losses. It is therefore suggested that the limits and conditions set by secondary Community legislation for the increase in the ECB's capital (Article 28.1) should not apply to contributions to be made by national central banks pursuant to Article 33.2.

Thirdly, the Committee of Governors noted that Article 33.1 has been amended with a view to limiting the ability of the ECB to transfer part of its net profits to the general reserve fund. However, these limits might inhibit the building up of adequate reserves by the ECB. This would increase the likelihood of recourse to national central banks' contributions pursuant to Article 33.2.

Fourthly, if such limits were to be placed on the ECB's ability to increase its own funds, either internally or externally, it would be desirable to endow the ECB with a larger initial capital than if there were no such restrictions. Careful thought would need to be given to whether a figure such as ecu 5 billion would be sufficient in these circumstances.

Fifthly, the Committee of Governors understands that the brackets around the two indents in Article 29.1 indicate diverging views about the criteria and other elements to be taken into account in the establishment of the key. The proposal of the Committee of Governors reflects the view that the distribution of rights and obligations in financial matters should be based on objective indicators and formulae. Apart from the issue of transitional arrangements to be dealt with in other provisions this aim would best be achieved by a single key derived from easily measurable criteria which provide a satisfactory measure of Member States' relative economic importance. The key based on GDP and population, as proposed in the Statute, would allow an unambiguous calculation, permit an automatic adjustment every five years and thus provide a reliable basis for the determination of national central banks' shares in the subscription of the ECB's capital, the transfer of foreign reserve assets to the ECB, the allocation of monetary income and the weighting of votes. An objective key

would also avoid further political arguments and fresh uncertainty when new members join the Economic and Monetary Union.

Finally, with respect to Article 30, the IGC has set the amount up to which the ECB may call up foreign reserve assets from the national central banks by virtue of a decision of the Council of the ECB, at ecu 50 billion; at the same time, it has introduced the provision that this ceiling might only be raised following a unanimous decision by the Council of Ministers, whereas the Governors' draft provided for such a decision to be taken by qualified majority (see Article 42). The requirement of unanimity might render it extremely difficult to transfer additional foreign reserve assets to the ECB, if needed; it might also undermine the credibility of the exchange rate policy. In setting a ceiling in Article 30.1 for the total amount of reserves to be called up by the ECB without the need to enact Community legislation, due regard would therefore need to be paid to the rigidity or flexibility of any procedure to raise that ceiling.

VI. ROLE OF THE ESCB IN THE ECONOMIC AND FINANCIAL COMMITTEE

Article 109 B in the Non-paper states that an Economic and Financial Committee shall take the place of the present Monetary Committee; it would be composed of representatives from the Member States, from the Commission and from the ESCB, and it would have - among others - the tasks of contributing to the preparation of the work of the ECOFIN Council. The Committee of Governors considers that the co-operation between the ESCB and the institutions of the Community is dealt with adequately and comprehensively in Article 15 of the Statute and that there would be no requirement to include ESCB representatives among the full members of the Economic and Financial Committee. To the extent that contacts between the ESCB and this Committee were considered desirable, they might be established in appropriate ways.

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In addition, the Committee of Governors has noted that the alternative text versions presented in Articles 12.1 and 14.4 of the draft Statute have been replaced by new wording in the Luxembourg Presidency's

Non-paper. Moreover, the square brackets in Article 18.1 of the Statute have been deleted in the Non-paper. The Committee of Governors wishes to draw the attention of the Intergovernmental Conference to the strong views expressed on these Articles in the Commentary (dated 26th April 1991) which has been transmitted together with the draft Statute.

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