EUROPEAN CENTRAL BANK

OPINION OF THE EUROPEAN CENTRAL BANK

of 31 May 2006

at the request of the Latvian Financial and Capital Market Commission on draft amendments to the Regulation on compliance with liquidity requirements

(CON/2006/26)

Introduction and legal basis

On 27 April 2006 the European Central Bank (ECB) received a request from the Latvian Financial and Capital Market Commission for an opinion on draft amendments to the Regulation on compliance with liquidity requirements (hereinafter the 'draft amendments'). The Latvian Financial and Capital Market Commission is the national authority that will adopt the draft amendments.

The ECB's competence to deliver an opinion is based on Article 105(4) of the Treaty establishing the European Community and the sixth indent 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 amendments relate to rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets. In addition, under Article 2(2) of Decision 98/415/EC, the authorities of Member States other than participating Member States are obliged to consult the ECB on any draft legislative provisions on the instruments of monetary policy. 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

The main objective of the draft amendments is to increase the short-term liquidity of the banking system by both increasing the minimum liquidity ratio and amending the formula for its calculation.

The draft amendments provide for an increase in the liquidity ratio from 30 % to 50 % of the total current liabilities of the bank. The draft amendments also adjust the basis for calculating the liquidity ratio by including only the surplus of claims on monetary financial institutions (MFIs) with a residual maturity of less than 30 days over current liabilities to MFIs with a residual maturity of less than 30 days.

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1 OJ L 189, 3.7.1998, p. 42.

2. General observations

2.1 According to the consultation letter from the Latvian Financial and Capital Market Commission to the ECB, the draft amendments are designed as a precautionary measure to maintain financial stability and the intention is not to address concerns about the financial standing of individual credit institutions. The ECB understands from the explanatory note to the draft amendments that, although at present the indicators of financial strength and asset quality of the Latvian banking sector are satisfactory, existing macroeconomic risks require a slowdown in lending rates. The explanatory note states that the rapid growth in lending rates has been one of the essential factors driving domestic demand, thus increasingly affecting both inflation and the current account deficit. Furthermore, rapid lending growth has increased maturity imbalances between the banking sector's assets and liabilities, thus increasing the liquidity risk. The explanatory note goes on to state that in view of the above, a set of measures for risk mitigation has been considered, incorporating both monetary measures and those measures at the disposal of the banking supervisor.

2.2 The ECB notes that, according to the above explanation, the envisaged change in the supervisory regime for liquidity is not meant to serve prudential purposes but rather macroeconomic ones, notably to overcome the difficulty in countering excessive credit growth in a country with a peg to the euro. The ECB would emphasise that the use of supervisory tools such as the liquidity ratio for macroeconomic purposes is not an uncommon practice in Member States. There have been similar cases where specific circumstances have determined the purpose of supervisory tools, in particular to address the potential risks related to strong credit growth (e.g. in Estonia[2]).

2.3 In that respect, the ECB assumes that the relevant national authorities – in considering the effectiveness of the envisaged measure – have given due consideration to all relevant implications, including the possible structural and competitive effects of the fact that the measure will not apply to foreign branches.

2.4 The ECB understands that, while the consulting authority is the Latvian Financial and Capital Market Commission, the initiative to propose draft amendments to the Regulation on compliance with liquidity requirements originated with Latvijas Banka. In this context, the ECB would like to recall that the objectives of the legislation are of a financial stability – and not monetary policy – nature. Any measures involving monetary policy instruments should fall under the authority of Latvijas Banka.

2 ECB Opinion CON/2006/3 of 13 January 2006 at the request of Eesti Pank on a draft decree establishing a procedure to calculate and comply with reserve requirements and draft decree amending Decree No 12 of 12 July 2002 on credit institutions' prudential ratios.

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

Done at Frankfurt am Main, 31 May 2006.

[signed]

The President of the ECB

Jean-Claude TRICHET