



EUROPEAN CENTRAL BANK

OPINION OF THE EUROPEAN CENTRAL BANK**of 1 April 2005****at the request of Lietuvos bankas on draft rules on minimum reserve requirements for credit institutions****(CON/2005/8)****Introduction**

1. On 14 February 2005 the European Central Bank (ECB) received a request from Lietuvos bankas for an opinion on draft rules on minimum reserve requirements for credit institutions (hereinafter the 'draft rules'). Lietuvos bankas is the national authority that will adopt the draft rules.
2. The ECB's competence to deliver an opinion is based on Article 2(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 provisions¹, as the draft rules relate to instruments of monetary policy of a non-participating Member State. 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.
3. The main objective of the draft rules is to improve compatibility between the minimum reserve system in Lithuania and the Eurosystem's minimum reserve system. In particular, the draft rules propose: (a) that minimum reserves shall be calculated and verified according to the balance sheet statistical reports of monetary financial institutions; (b) that all minimum reserves shall be held in the national currency (the litas); and (c) that the balances of credit institutions held as minimum reserves shall be remunerated. At the same time, Lietuvos bankas wishes to retain certain specific features of the national system for minimum reserves in Lithuania. In addition, Lietuvos bankas has requested the ECB to clarify whether the Eurosystem minimum reserve requirements would be applicable to credit unions established in Lithuania, once Lithuania has adopted the euro.
4. The ECB notes that the legal framework underlying the Eurosystem's minimum reserve system is laid down in: (i) Article 19 of the Statute of the European System of Central Banks and the European Central Bank, (ii) Council Regulation (EC) No 2531/98 of 23 November 1998 concerning the application of minimum reserves by the European Central Bank², and (iii) Regulation (EC) No 1745/2003 of the European Central Bank on the application of minimum

¹ OJ L 189, 3.7.1998, p. 42.

² OJ L 318, 27.11.1998, p. 1.

reserves (ECB/2003/9)³. The purpose of these legal acts, which are directly applicable to and binding on credit institutions, is to ensure that the terms and conditions for the Eurosystem's minimum reserve system are uniform throughout the euro area. Taking into account the aforementioned legal framework for the Eurosystem's reserve requirements, the ECB wishes to provide the following comments on the draft rules.

General observations

5. First, in the course of preparing for the introduction of the euro in Lithuania, Lietuvos bankas will need to examine whether the Eurosystem's requirements can be fulfilled effectively and whether the necessary measures have been adopted in Lithuania to ensure that the authorities have the requisite powers, under Lithuanian law, to assist and cooperate with the ECB in order to collect and verify the information necessary for the Eurosystem's minimum reserve system.
6. Second, because the Eurosystem's minimum reserve system is highly dependent on the Eurosystem's statistical reporting requirements for its data, and because any changes to the statistical reporting requirements will have a direct influence on the size of minimum reserve holdings, a key element for achieving consistency between the Lithuanian minimum reserve system and that of the Eurosystem is the introduction into Lithuanian law of statistical reporting requirements corresponding to those of the Eurosystem.
7. Third, the ECB will have to consider introducing transitional arrangements for the application of the Eurosystem's minimum reserve system for the introduction of the euro in Lithuania, as was the case when Greece adopted the euro on 1 January 2001. This would involve a transitional maintenance period for credit institutions located in Lithuania as well as transitional provisions for credit institutions located in other participating Member States.
8. Taking these general observations into account, the ECB welcomes the initiative of Lietuvos bankas to review the minimum reserve system in Lithuania with a view to bringing it into line with the Eurosystem's minimum reserve system. The ECB notes that, although non-participating Member States retain their powers in the field of monetary policy, it is nevertheless beneficial to gradually achieve consistency with Eurosystem standards so that credit institutions can become acquainted with the minimum reserve requirements that will apply when the euro is introduced in Lithuania.
9. The ECB is also aware that *Lietuvos Respublikos Seimas* (Lithuania's Parliament) is currently considering a draft law to amend the Credit Unions Act. This opinion is based on the law currently in force, and does not take account of any proposed amendment to the Credit Unions Act.

Applicability of the Eurosystem's minimum reserve requirements to Lithuanian credit unions

10. Concerning the query of Lietuvos bankas about the applicability of the Eurosystem's minimum reserve requirements to credit unions established in Lithuania upon the introduction of the euro in

³ OJ L 250, 2.10.2003, p. 10.

Lithuania, the ECB notes at the outset that, in a number of euro area Member States, credit unions are currently subject to Eurosystem minimum reserve requirements. The ECB notes that Article 2(1) of Regulation EC No 1745/2003 provides that the following categories of institutions are subject to minimum reserve requirements: (a) credit institutions as defined in the first subparagraph of Article 1(1) of Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking-up and pursuit of the business of credit institutions⁴ (hereinafter the ‘Consolidated Banking Directive’), other than participating national central banks (NCBs); and (b) branches, as defined in Article 1(3) of the Consolidated Banking Directive, of credit institutions as defined in the first subparagraph of Article 1(1) of the same Directive, other than participating NCBs. The first subparagraph of Article 1(1) of the Consolidated Banking Directive defines a credit institution as ‘an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account’. Article 2(3) of the Consolidated Banking Directive exempts certain institutions from the scope of its application, including in particular the NCBs of Member States, post office giro institutions and specifically listed national entities, including⁵ credit unions established in Lithuania, with the sole exception of the Central Credit Union. However, the fact that Lithuanian credit unions are exempt for prudential supervision purposes from the scope of application of the Consolidated Banking Directive does not automatically imply that they would also be exempt from the Eurosystem’s reserve requirements established for monetary policy purposes. Indeed, the ECB considers that in order to apply the Eurosystem’s reserve requirements it is necessary to carry out a material test as to whether an institution fulfils the criteria laid down in the first subparagraph of Article 1(1) of the Consolidated Banking Directive (i.e. whether its business is to receive deposits or other repayable funds from the public and to grant credits for its own account). Therefore, the ECB has examined whether Lithuanian credit unions fulfil the criteria laid down in the first subparagraph of Article 1(1) of the Consolidated Banking Directive.

11. Regarding the nature of the business of a Lithuanian credit union and whether this is ‘to receive deposits or other repayable funds from the public’ within the meaning of the Consolidated Banking Directive, the ECB notes that, under the Lithuanian Act on credit unions⁶ (hereinafter the ‘Credit Unions Act’), Lithuanian credit unions may receive deposits from various persons, including their members and associated members, as well as from associations of credit unions, associations, religious communities/associations, trade union organisations, charities registered in Lithuania, institutions authorised by the Government of Lithuania and/or local authorities, and international or foreign charities. Also, before a credit union joins the Central Credit Union, it may receive deposits from other credit unions which are not members of the Central Credit Union. The ECB notes that, under the Credit Unions Act, a variety of persons may become members of a credit union,

⁴ OJ L 126, 26.5.2000, p. 1, as last amended by Directive 2004/69/EC (OJ L 125, 28.4.2004, p. 44).

⁵ Under the provisions of Annex II, Chapter 3 of the Accession Treaty 2003.

⁶ Lithuanian Official Gazette, 1995, No 26-578, as amended.
The ECB also understands that the Act on credit unions is a special law in relation to the Act on co-operative companies (co-operatives). Lithuanian Official Gazette, 1993, No 20-488, as amended.

including natural persons who are permanently resident in Lithuania and certain legal entities registered in Lithuania (e.g., associations, organisations of trade unions, religious communities and associations and agricultural cooperatives). The ECB also notes that, under the Credit Unions Act, a credit union may restrict its membership by reference to various criteria (e.g., employment in the same entity, membership of the same professional group or organisation, or residence in the same township or ward). Also, a credit union may accept a variety of associated members, including individual (personal) enterprises, economic partnerships, agricultural cooperatives, certain private companies controlled by a member(s) of a credit union, small enterprises, and natural persons who reside, work or study in the ward in which the credit union has its headquarters. The ECB further notes that, under the Credit Unions Act, deposits paid into credit unions are subject to the Lithuanian deposit-guarantee scheme.

12. Regarding whether it is the business of a Lithuanian credit union to ‘grant credits for its own account’ within the meaning of the Consolidated Banking Directive, the ECB notes that, under the Credit Unions Act, credit unions established in Lithuania may grant loans to their members for the purposes specified in the statutes of the credit unions. The ECB considers that the restriction allowing loans to be granted only for the purposes specified in the statutes of credit unions may not be considered as restricting the capacity of credit unions to ‘grant credits for their own account’ within the meaning of the Consolidated Banking Directive. The ECB also notes that, under the Credit Unions Act, credit unions are entitled to engage in other activities appropriate for credit institutions. The ECB further notes that the Credit Unions Act refers to credit unions as ‘credit institutions’. On the basis of the foregoing, the ECB considers that, under Lithuanian law currently in force, credit unions established in Lithuania may engage in certain activities which are common to credit institutions. In particular, they may receive deposits and grant loans on their own account.
13. However, the question remains whether Lithuanian credit unions receive deposits ‘from the public’ within the meaning of the Consolidated Banking Directive. The ECB understands that, in practice, certain Lithuanian credit unions may be rather small, have a narrow membership base and receive deposits from a restricted group. Yet, given that the compass of potential depositors in Lithuanian credit unions is wide, it is difficult to argue that Lithuanian credit unions do not receive deposits ‘from the public’, within the meaning of the Consolidated Banking Directive.
14. In light of the above, the ECB considers that Lithuanian credit unions fall under the definition of a credit institution within the meaning of the Consolidated Banking Directive, and will therefore be subject to the Eurosystem minimum reserve requirements when Lithuania adopts the euro.

The treatment of subscriptions to the capital of Lithuanian credit unions

15. The ECB notes that, under the Credit Unions Act, members of Lithuanian credit unions may withdraw from a credit union upon giving three months’ written notice. The ECB understands that, upon such withdrawal, funds that have been paid as a subscription to the credit union’s capital may be repaid under the conditions laid down in the Credit Unions Act. Consistent with this, the period

within which the repayments must be made is determined by taking into account the financial position and liquidity of the credit union in question. In any event, the capital has to be repaid within 12 months from the date of a member's withdrawal. In view of these provisions, it has to be considered whether such funds paid to the credit union should be regarded as being in the nature of deposits and, therefore, as liabilities against which minimum reserves have to be held with Lietuvos bankas. This question has not been explicitly decided in the Eurosystem minimum reserve system and is subject to ongoing analysis and discussion. The ECB will provide any relevant information to Lietuvos bankas well in advance of the date on which the Eurosystem's minimum reserve system becomes applicable to Lithuanian credit unions, thus ensuring a smooth transition to the new minimum reserve system.

Technical comments

16. With regard to the detailed provisions of the draft rules, the ECB would like to offer the following technical comments which Lietuvos bankas may wish to reflect upon already at this preparatory stage.
17. Section 18 of the draft rules provides that, where a credit institution frequently revises its data on the reserve base or on the required reserves, Lietuvos bankas may restrict its ability to make further revisions. The ECB notes that, in the Eurosystem's minimum reserve system, revisions to data on the reserve base are generally not excluded given that such revisions can help improve the quality of data. Nevertheless, systematic reporting of incorrect data may be regarded, for the purposes of imposing sanctions for infringements of balance sheet statistical reporting requirements, as 'serious misconduct', for which an increased sanction may be imposed (see Notice of the European Central Bank on the imposition of sanctions for infringement of balance sheet statistical reporting requirements (2004/C 195/10)⁷). In this regard, the ECB notes that, under Section 39 of the draft rules, taking into account the frequency of violations and/or the their impact on a credit institution's reserve base and/or required reserves, Lietuvos bankas may impose an increased penalty if, *inter alia*, it becomes evident that the credit institution has reported incorrect or incomplete data.
18. The ECB draws attention to the fact that the penalties that Lietuvos bankas may impose under Section 39 of the draft rules concern failure to comply with statistical reporting requirements (e.g., incorrect or incomplete reported data, or where the form of the report does not meet the set requirements, or if verification of the accuracy of reported data is hindered). Although failure to comply with statistical reporting requirements directly influences the subsequent setting of the minimum reserve requirement, the ECB itself clearly distinguishes between the two. The ECB's specific sanctioning principles have been set out in two distinct notices, Notice of the European Central Bank on the imposition of sanctions for infringements of balance sheet statistical reporting

⁷ OJ C 195, 31.7.2004, p. 8.

requirements (2004/C 195/10)⁸ and Notice of the European Central Bank on the imposition of sanctions for breaches of the obligation to hold minimum reserves (2000/C 39/04)⁹.

19. Section 41 of the draft rules provides that, upon the failure of a credit institution to comply with reserve requirements, Lietuvos bankas may increase its reserve requirement by up to three times the shortfall of the reserve requirement over the preceding maintenance period. In the context of the Eurosystem's minimum reserve system, such a measure would not necessarily amount to a sanction on a credit institution since the reserve holdings are remunerated at close-to-market rates. Moreover, some credit institutions might benefit from higher reserve requirements, by using the additional reserves as a buffer to offset their own liquidity shocks within the maintenance period. Although the measure is similar to the sanctioning provisions laid down in Article 7 of Council Regulation (EC) No 2531/98, there is an important difference in that Council Regulation (EC) No 2531/98 stipulates that such a deposit of up to three times the shortfall on the minimum reserve requirement shall be a non-interest-bearing deposit, thereby introducing a punitive element.
20. This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 1 April 2005.

[signed]

The President of the ECB

Jean-Claude TRICHET

⁸ OJ C 195, 31.7.2004, p. 8.

⁹ OJ C 39, 11.2.2000, p. 3.