



OPINION OF THE EUROPEAN CENTRAL BANK

of 21 April 2010

on an amendment to the rules governing Narodowy Bank Polski's provision against foreign exchange rate risk

(CON/2010/32)

Introduction and legal basis

On 18 March 2010 the European Central Bank (ECB) received a request from the President of Narodowy Bank Polski (NBP) for an opinion on a Monetary Policy Council draft resolution amending the resolution on the principles for creating and releasing the provision against the foreign exchange rate risk of the zloty at the National Bank of Poland (hereinafter the 'draft resolution')¹.

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 of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions², as the draft resolution relates to NBP. 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 resolution

- 1.1 Under Article 65 of the Law on Narodowy Bank Polski³, NBP is obliged to create a provision to cover the risk of changes in the exchange rate of the zloty against other currencies, with the specific rules governing the creating and releasing of the provision being defined by the Monetary Policy Council. Pursuant to this mandate, the relevant rules were defined in Resolution No 9/2006 of the Monetary Policy Council of 19 December 2006 on the principles for creating and releasing the provision against the foreign exchange rate risk of the zloty at the National Bank of Poland⁴. The ECB was not consulted on the draft provisions of Resolution No 9/2006.
- 1.2 The draft resolution changes the way the provision against the foreign exchange rate risk is calculated by NBP. Under Resolution No 9/2006, the following factors are taken into account in estimating the amount of the provision: (i) the amount of the foreign exchange holdings exposed to the foreign exchange rate risk; (ii) the assessment of the foreign exchange rate risk based on

¹ Draft resolution of 16 March 2010.

² OJ L 189, 3.7.1998, p. 42.

³ Law of 29 August 1997 on Narodowy Bank Polski (consolidated text: *Dziennik Ustaw* (Dz. U.) of 2005 No 1, Item 2).

⁴ As published in *Dziennik Urzędowy NBP* of 20 December 2006 No 13, item 16.

generally accepted and consistently applied methods of financial risk assessment; (iii) the existing and anticipated balance of the revaluation account and unrealised foreign exchange gains and losses⁵. The draft resolution proposes to change the treatment of unrealised foreign exchange gains and losses by: (i) deleting the reference to unrealised foreign exchange losses⁶; and (ii) adding an explicit requirement that the amount of the provision should be reduced by the amount of unrealised foreign exchange gains (except for those relating to gold)⁷.

- 1.3 The draft resolution proposes to apply the new calculation method to NBP's annual accounts for the year 2009⁸.

2. General observations

- 2.1 The purpose of national central bank (NCB) capital and reserves is to ensure that the NCB has at its disposal, at all times, the necessary financial resources to conduct monetary policy. A long-term perspective must be taken when establishing an appropriate level of the risk provision, therefore sufficient financial buffers should be created in years of profit to allow an NCB to absorb possible losses without weakening its financial means for implementing monetary policy.⁹ As stated in the ECB's Convergence Reports¹⁰ and previous ECB opinions¹¹, an NCB must be free to independently (which means without interference from any third party, such as a state audit office) create financial provisions to safeguard the real value of its capital and assets. An NCB must also, 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 properly cover its administrative and operational expenses¹².
- 2.2 National rules on the distribution of NCBs' profits must also comply with the monetary financing prohibition laid down in Article 123(1) of the Treaty and Council Regulation (EC) No 3603/93 of 13 December 1993 specifying definitions for the application of the prohibitions referred to in Articles 104 and 104b(1) of the Treaty.¹³ As mentioned in previous ECB opinions, to comply with the monetary financing prohibition, it is of crucial importance that the distribution of profits, by instalments or in full, does not imply advances on future or provisional profits but is rather the

⁵ Paragraph 1(2) of Resolution No 9/2006.

⁶ Paragraph 1(2)(c) of Resolution No 9/2006 as amended by paragraph 1(1) of the draft resolution; according to the explanatory memorandum attached to the draft resolution, this deletion results from the fact that the unrealised foreign exchange losses are included in the financial result as at the balance sheet date.

⁷ New paragraph 1(3) added by paragraph 1(2) of the draft resolution.

⁸ Paragraph 2 of the draft resolution.

⁹ See paragraph 3.4 of Opinion CON/2009/83 and paragraph 3.2 of Opinion CON/2009/53. All ECB opinions are published on the ECB's website at www.ecb.europa.eu.

¹⁰ See the ECB's Convergence Report May 2008, pp. 20-21.

¹¹ See Opinions CON/2003/22 and CON/2004/1; paragraph 2.2.(a) of Opinion CON/2009/59; paragraph 3.2 of Opinion CON/2009/53; paragraph 3.3 of Opinion CON/2009/26; paragraphs 11 and 12 of Opinion CON/2004/1.

¹² See the ECB's Convergence Report May 2008, p. 20. See also paragraph 2.2 of Opinion CON/2009/53; paragraph 2.2.(a) of Opinion CON/2009/59; paragraph 2.3 of Opinion CON/2009/26; paragraph 6 of Opinion CON/2003/22.

¹³ OJ L 332, 31.12.1993, p. 1.

result only of profits that are fully realised, accounted for and audited, which in turn requires due calculation of profits and losses¹⁴.

3. Specific comments

3.1 Calculation method

3.1.1 Although the NBP is not subject to Guideline ECB/2006/16 of 10 November 2006 on the legal framework for accounting and financial reporting in the European System of Central Banks¹⁵, the ECB appreciates that the NBP has adopted the Eurosystem legal framework in relation to accounting and financial reporting in order to achieve consistency with Eurosystem standards.

3.1.2 The draft resolution includes an amendment to the calculation method of the size of the foreign exchange rate risk provision. The calculation method for the size of this provision, in turn, directly affects the allocation of NBP's profit and its remittance to the State budget under Article 69(4) of the Law on Narodowy Bank Polski.

3.1.3 The ECB understands that in the period 2004 to 2006 the unrealised foreign exchange losses led to a depletion of the revaluation account in foreign currencies. In 2007 NBP was not in a position to build up its provision as it posted a net loss. Only in 2008 was it possible to transfer funds into the foreign exchange rate risk provision. The ECB also understands that the proposed changes would lead to NBP establishing a level of the foreign exchange rate risk provision that is significantly less conservative than the level set using the existing calculation method. In this context, the ECB notes that the loss relating to 2007 was carried over into 2008 because of the lack of financial buffers. Therefore, to prevent such a situation in the future, NBP should carefully consider any amendment to the mechanism for building up the provision which may impede the ability of the NBP to maintain an adequate level of financial buffers.

3.1.4 The wording of the proposed paragraph 1(3)¹⁶ could be made clearer. This provision may be understood as a mere clarification that the unrealised foreign exchange gains mentioned in paragraph 1(2)(c) should reduce the amount of the provision and should exclude unrealised gains on gold. However, it may also be implied that, under the new calculation method proposed in the draft resolution, the treatment of unrealised foreign exchange gains would be double: they would be taken into account under paragraph 1(2)(c) and subtracted from the amount of the provision under the new paragraph 1(3).

3.2 Retroactive application

3.2.1 The financial statements for the year 2009 were drawn up as at 31 December 2009, and thereafter audited by an independent auditor, based on the legal framework which was in force at that time, including the rules governing the provision against foreign exchange rate risk contained in Resolution No 9/2006. The draft resolution proposes to apply the new calculation method to the

¹⁴ See paragraph 2.4 of Opinion CON/2009/53 and paragraph 3.3 of Opinion CON/2008/82.

¹⁵ OJ L 348, 11.12.2006, p. 1.

¹⁶ As introduced in Resolution No 9/2006 by paragraph 1(2) of the draft resolution.

NBP's financial statements for the year 2009. This means, first, that the rules according to which the NBP's 2009 financial statements were compiled would be retroactively changed, thereby affecting the size of the foreign exchange rate risk provision; and, second, in terms of procedure, that the entry into force of the retroactively applicable draft resolution would coincide in time with the process of preparation, auditing, authorisation and taking a decision on the approval of the 2009 financial statements by the competent bodies. For these reasons, concerns may arise about whether this process is sound, well-coordinated and transparent¹⁷.

3.2.2 Furthermore, the practical implication of applying the new calculation method before the NBP 2009 financial statements are adopted affects the amount of the risk provision and, consequently, the amount to be transferred by NBP to the State budget under Article 69(4) of the Law on Narodowy Bank Polski. Under the draft resolution, the amount of the risk provision would be reduced after the financial statements were prepared by the NBP's Management Board and after they were audited by an independent auditor; as a consequence, the amount of the profit would be increased by the amount of provisional foreign exchange profit. Hence, the portion of NBP's 2009 annual profit that would be remitted to the State budget would need to be accounted for again and audited. Otherwise, payments to be made to the State budget would effectively include advances on provisional profits in violation of the monetary financing prohibition under Article 123 of the Treaty. Against this background, the ECB stresses the importance of complying with the monetary financing prohibition.

3.3 *Timing of the consultation*

As already mentioned, the ECB received the consultation request on 18 March 2010. The draft resolution was adopted by the Monetary Policy Council on 30 March 2010, i.e. before the ECB's opinion was adopted. In this context the ECB would like to draw attention to certain provisions of Council Decision 98/415/EC regulating the timing of consultation requests. According to Article 4 of Decision 98/415/EC, Member States are required to ensure that the ECB is consulted at an appropriate point in time to allow the consulting authority to take its opinion into consideration before deciding on the substance of the draft legislative provisions. It also follows from Article 3(4) of Decision 98/415/EC that Member States are obliged to suspend the process for the adoption of draft legislative provisions pending submission of the ECB's opinion. The ECB expects that in the future the obligation to consult the ECB at an appropriate stage of the legislative procedure will be respected.

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

¹⁷ According to Article 69(3) of the Law on Narodowy Bank Polski, NBP's annual accounts should be submitted by the NBP President to the Council of Ministers for its approval by 30 April of the year following the financial year to which the accounts relate. Therefore, between the end of the financial year and 30 April of the following year, the accounts should be: (i) drawn up by NBP's Management Board (under Article 17(4)(12)), (ii) audited by an external auditor (under Article 69(1)), and (iii) adopted by the Monetary Policy Council (under Article 12(2)(5)).

Done at Frankfurt am Main, 21 April 2010.

[signed]

The Vice-President of the ECB

Lucas D. PAPADEMOS