



EUROPEAN CENTRAL BANK
EUROSYSTEM

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ECB-PUBLIC

OPINION OF THE EUROPEAN CENTRAL BANK

of 6 April 2018

on amendments to the Law on Hrvatska Narodna Banka and to the Law on the State Audit Office (CON/2018/17)

Introduction and legal basis

On 23 January 2018 the European Central Bank (ECB) received a request on behalf of the Speaker of *Hrvatski Sabor* (the Croatian Parliament) for an opinion on two draft laws proposed to it by a member of the Croatian Parliament comprising (i) a draft law amending the Law on Hrvatska narodna banka (the 'draft law') and (ii) a draft law amending the Law on the State Audit Office (the 'draft law on the State Audit Office') (hereinafter referred to collectively as the 'draft laws').

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/EC¹, as the draft laws relate to *Hrvatska narodna banka* (HNB). 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 laws

1.1 *State Audit Office's audit of HNB*

1.1.1 The draft law on the State Audit Office provides that *Državni ured za Reviziju* (the State Audit Office) shall audit HNB, which is a new task of the State Audit Office. In this respect, the draft law on the State Audit Office provides that an audit of HNB's annual financial statements and the legality of the overall operations of HNB be performed at least once a year by the State Audit Office in accordance with the law governing financial statement audits, International Audit Standards, International Accounting Standards for regular beneficiaries of the Croatian state budget and those eligible to become beneficiaries of the Croatian state budget.

1.1.2 The draft law provides that the State Audit Office will audit the effectiveness of HNB's business operations in accordance with the regulations governing the procedures of the State Audit Office and the provisions of the Law on Hrvatska narodna banka (hereinafter 'the Law on HNB'). The draft law sets out that this audit shall include the following items which are stated to be related to the balance sheet of HNB: (i) HNB's receivables in relation to loans extended and investments in securities denominated in Croatian Kuna (HRK) or foreign currencies; (ii) HNB's receivables in relation to foreign currency time deposits and securities with foreign banks; (iii) HNB's liabilities in

¹ Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions (OJ L 189, 3.7.1998, p. 42).

respect of foreign currency loans taken out with foreign commercial and central banks and with international financial institutions; (iv) an audit of the financial and day-to-day operations of HNB according to International Standards on Auditing, International Accounting Standards, and International Financial Reporting Standards; (v) the calculation of income and costs of HNB, the production of the profit and loss account, the allocation of profit to the reserves of HNB, the share capital of HNB, and the crediting of excess profit to the Croatian treasury; (vi) the review of the methodology for setting foreign currency exchange rates; (vii) transactions involving physical cash and securities at HNB's depositories, Croatian banks, *Financijska agencija* (Fina, the Financial Agency) and *Hrvatski novčarski zavod* (the Croatian Monetary Institute), including HNB's policy for the manufacture of banknotes and the total production cost of banknotes; (viii) procurement at HNB; (ix) investments of HNB, including buildings and business premises; (x) the supervision of banks by HNB, including the lawfulness and frequency of supervision of large and small banks by HNB; (xi) domestic and foreign payment systems at HNB, including *Hrvatski sustav velikih plaćanja* (HSVP, the Croatian Large Value Payment System); Nacionalni klirinški sustav (NKS, the National Clearing System), HNB as part of the TARGET2 (the Trans-European Automated Real-time Gross Settlement Express Transfer System) and EuroNCS (the Euro National Clearing System), which are used to process Single European Payment Area (SEPA) payments in euro; (xii) HNB statistics; and (xiii) the employment policy of HNB and its lawfulness. The draft law further specifies that the State Audit Office may assess other transactions and procedures that it considers relevant for the purposes of producing a report concerning the operations of HNB, and that HNB will publish its audit reports.

- 1.1.3 The draft law provides that as part of this audit the State Audit Office shall not assess activities relating to the implementation of the goals and the discharge of duties established under the Treaty, the Statute of the European System of Central Banks and of the ECB (hereinafter the 'Statute of the ESCB'), and the Law on HNB.
- 1.1.4 The draft law provides that HNB must present to an authorised state auditor for review the confidential information referred to in Article 37 of the Statute of the ESCB, in accordance with the audit rules of the European System of Central Banks (ESCB). The data contained in such documents, papers, reports, records, and other such information may not be used to draft the audit report. The State Audit Office must ensure that the confidentiality of this information and documents is kept to the same extent as that which HNB applies for professional secrets.
- 1.1.5 The draft law specifies that, without prejudice to the regulations governing the procedures of the State Audit Office, the State Audit Office may not propose the dismissal of members of *Savjet Hrvatske narodne banke* (the HNB Council) nor order any action that might call into question the principle of the institutional, functional, personal, and financial independence of the HNB.
- 1.1.6 The draft law on the State Audit Office provides that, in addition to the State Audit Office, audits of the HNB's annual financial statements may also be performed by independent external auditors selected by *Odbor za financije i državni proračun Hrvatskog sabora* (the Finance and Central Budget Committee of the Croatian Parliament). The audit performed by the State Audit Office will be entirely separate from audits performed by independent external auditors selected in accordance with the Law on HNB.

1.1.7 The draft law on State Audit Office provides that the HNB may disclose to the public the financial statements of its operations as well as other reports on issues within the framework of its statutory mandate that are of public interest in Croatia.

1.2 *HNB's reporting obligations in relation to the Croatian Parliament*

The draft law requires HNB to submit to the Croatian Parliament semi-annual information about the financial condition, the level of price stability achieved and the implementation of monetary policy for the first six months of the current year by 30 September, and for the second six months by 30 March of the following year, and to submit to the Croatian Parliament a regular annual report on its activities and business operations by 1 June of every year. The Croatian Parliament shall take a position by voting on all such reports.

1.3 *Appointment of the members of the HNB Council*

1.3.1 The draft law provides that the HNB Council will comprise a total of nine members, five that will be HNB employees, including the Governor and up to four Vice-Governors, and four that will be external members. The Governor will be the chair of the HNB Council. The Governor will, at the beginning of his term, appoint a Deputy Governor from amongst the Vice-Governors who will deputise for him in the event of his being unable to fulfil his duties.

1.3.2 The draft law provides that the members of the HNB Council (i.e. the Governor, two to four Vice-Governors, and the external members), will be appointed by the Croatian Parliament on the proposal of its *Odbor za izbor, imenovanja i upravne poslove* (Elections, Appointments and Administration Committee) at least three months before the expiry of the term of office for which they are appointed. The Committee will take into account the opinion of *Odbor za financije i državni proračun* (the Finance and State Budget Committee). The draft law further provides that the Governor will be appointed by the Croatian Parliament on the proposal of the President of Croatia, and that the two to four Vice-Governors will be selected and appointed by the Croatian Parliament at the proposal of the President of Croatia after the Finance and State Budget Committee expresses its opinion.

1.3.3 The draft law provides that a candidate for Governor or Vice-Governor must meet the following requirements: (1) be a Croatian citizen; (2) have no criminal record and not be under investigation; (3) be entirely physically and mentally fit to discharge the duties of Governor; (4) hold a university degree in economics and have banking and financial expertise and the professional skills to discharge the duties of Governor; (5) have organisational and management skills and a strong sense of teamwork; (6) have at least ten years of experience in banking or business finance in banks and/or state and/or academic institutions; and (7) have a clear vision of the development of the Croatian monetary and financial system and be well informed about the situation in the Croatian banking sector.

1.3.4 The draft law provides that a candidate for HNB Governor or Vice-Governor shall present to the Finance and State Budget Committee of the Croatian Parliament the proposed HNB work programme for the next term for which the candidate has applied. After consultations and presentations by and of the candidate, the members of the Finance and State Budget Committee

will vote to express their view on the skills and expertise of the candidates for Governor or Vice-Governor.

1.3.5 The draft law provides that the Governor and Vice-Governors will be employed at the HNB on a full-time basis for an indefinite period.

1.3.6 The draft law provides that the external members of the HNB Council will be elected from among various segments of Croatian business and social life (industry, employers, academia, consumer protection associations, etc.) with professional experience in the field of economy and finance.

1.3.7 The draft law provides that the members of the HNB Council will be appointed for a term of six years with only one possibility of reselection. No member of the HNB Council may serve more than two terms as member of the Council. In the event that any member of the HNB Council departs before the end of his/her term, a new member will be selected for the remainder of the departing member's term only.

1.4 *Employees of HNB*

The draft law provides that employment with the HNB, the conclusion of employment contracts, and the appointment of employees to management posts with special powers and responsibilities will be the responsibility of the HNB Governor after a public competition procedure has been completed. Employees in all management posts at the HNB will be subject to reselection at four-year intervals after an internal competition procedure has been completed. Only Croatian citizens may be HNB employees.

1.5 *Secondary market purchases of public sector securities by HNB*

The draft law authorises the HNB, in specific situations and with the aim to achieve financial stability and other aims of monetary credit policy, to repurchase in the secondary market, directly from credit institutions, securities issued by Croatia or a local self-government unit.

1.6 *Foreign currency operations of HNB*

The draft law provides that HNB will monitor, devise, apply, and supervise regulatory measures in the area of foreign currency operations of credit institutions and authorised 'bureaux de change' and will perform and regulate foreign currency operations domestically and in relationships with foreign countries under the provisions of the Law on HNB and the law regulating foreign exchange in Croatia. In this respect, the HNB's foreign exchange operations include: (1) the implementation of domestic foreign exchange policy; (2) foreign exchange market activities, the setting of foreign exchange rates and the exchange rate of the domestic currency, and the publication of the domestic currency exchange rate each day; (3) international payment traffic services; (4) the management of Croatia's foreign liquidity reserves; (5) credit relationships with foreign countries, including the policy for borrowing from and lending to foreign countries, foreign currency debt management, the purchase and sale of foreign currency debts and claims and swap arrangements; (6) relations with international financial institutions (the International Monetary Fund, the World Bank, the ECB, the Bank for International Settlements and development banks); (7) relations with the European Union and the bodies and organisations of the European Union; (8) HNB's bilateral arrangements with foreign countries; (9) correspondent and current account relationships with

foreign banks and financial institutions; (10) control over part of the foreign exchange operations of credit institutions; and (11) management of HNB's risks in international relations.

1.7 *Capital, reserves and allocation of profits and losses of HNB*

1.7.1 The draft law clarifies that the share capital of HNB, which is required to amount to HRK 2,500,000,000, has been paid up by Croatia.

1.7.2 The draft law provides that HNB's general reserves may not exceed twice the amount of the HNB's share capital. The amount of the specific reserves established by HNB to cover identified losses may not exceed the amount of HNB's share capital.

1.7.3 In relation to the appropriation of HNB's profit and the coverage of losses, the draft law provides that HNB's operating profit shall be allocated to general and specific reserves and to the Croatian Treasury. The allocation of operating profit to general and specific reserves shall not exceed the stipulated level of general and specific reserves established by the HNB Council. The residual profit following allocation to general and specific reserves shall constitute extraordinary revenue of the Croatian Treasury. HNB shall cover any operating losses using general reserves, in the first instance. Any operating losses of HNB that cannot be covered from general reserves will be covered by first using specific reserves, then using share capital, and finally by the Croatian Treasury. HNB will transfer the residual operating profit to the Treasury within eight days from the date on which the annual financial statements and operational report for the previous year are delivered to the Croatian Parliament. HNB may establish a special operating fund for the purpose of acquiring property and rights constituting tangible fixed assets or fixed asset investments or both and for the purpose of establishing specialised financial organisations.

1.8 *Certain powers of the HNB over credit institutions*

1.8.1 The draft law provides that a credit institution shall be deemed insolvent if it fails in a timely manner to settle and/or fulfil its statutory and/or contractual obligations domestically and/or abroad and these obligations are not settled on its behalf under a guarantee. HNB may stipulate more detailed criteria for determining the insolvency of credit institutions.

1.8.2 The draft law prohibits an insolvent credit institution from making payments from its accounts, approving credits, giving guarantees or assuming new financial obligations, and payment service providers are prohibited from executing payment orders for an insolvent credit institution, except in respect of citizens' savings and current accounts in domestic and foreign currency. If, as part of the supervision or investigation of a credit institution, it is shown that a credit institution has breached certain provisions of the Law on HNB, HNB may declare that credit institution insolvent and adopt measures in relation to that credit institution and specific members of its executive board. Measures which may be taken in relation to an insolvent credit institution or a credit institution breaching the provisions of the Law on Credit Institutions² include (1) the suspension of lending for 15 to 60 days; (2) the suspension of payments to foreign countries for 15 to 60 days, except in relation to mature foreign credits and obligations to foreign countries under conventions, guarantees and issued letters of credit; (3) a restriction on borrowing from foreign countries for 30

² Zakon o kreditnim institucijama (*Narodne novine* no 159/13, 19/15 and 102/15).

to 60 days; and (4) the suspension of securities purchases and lending for 10 to 30 days. The HNB Governor will decide upon and impose such measures and the duration of their application.

1.9 *Obligation to denominate and pay all monetary obligations in Croatia in Kuna*

1.9.1 The draft law provides that all contractual monetary obligations in Croatia shall, unless otherwise provided by law, be denominated, and discharged by means of payment denominated, in Kuna.

1.9.2 The draft law provides that contracting parties may eliminate the risk of a material change in the value of the currency in which a financial obligation is denominated after conclusion of the contract but before maturity of the financial obligation by concluding appropriate protective monetary value clauses, in order to protect themselves against the risk of a change in the value of financial obligations between conclusion and fulfilment of a contract for the discharge or payment of a financial obligation. A Croatian credit institution may agree with a borrower to use a floating interest rate clause or a protective monetary value clause; the simultaneous inclusion of both a protective clause and a floating interest rate is prohibited. Protective monetary or foreign currency clauses may only be used if the financial obligation whose value is being ensured is linked to the floating value of a global currency and the credit institution has a sufficient amount of this currency on deposit or sources of funding in this currency on the credit side of its balance sheet throughout the term of the contract.

1.9.3 The draft law provides that where a credit institution intends to approve a credit for clients in domestic currency and link the credit to the exchange rate of another currency, it must first obtain the opinion of the HNB and *Vijeće za financijsku stabilnost* (the Financial Stability Council).

2. **General observations**

2.1 Although Member States with a derogation, including Croatia, do not yet participate in the third stage of economic and monetary union, they have a legal duty to adapt their national legislation including the statutes of their national central banks (NCBs) to ensure compatibility with the Treaty and the Statute of the ESCB³. Any legislative reform in any such Member State should aim to gradually achieve consistency with Eurosystem standards⁴.

2.2 The ECB would like to recall that it has previously issued Opinions CON/2016/33 and CON/2016/52 in response to legislative consultations from the Croatian authorities on legislative initiatives concerning certain matters addressed in this opinion, including the State Audit Office's audit of HNB, HNB's reporting obligations in relation to the Croatian Parliament and the reduction of the number of terms of office of HNB's Governor and the other members of HNB's Council.

³ Article 131 of the Treaty.

⁴ See paragraph 3.4 of ECB Opinion CON/2008/34, paragraph 2.1 of ECB Opinion CON/2017/17. All ECB opinions are published on the ECB website at www.ecb.europa.eu.

3. Specific observations

3.1 State Audit Office's audit of HNB

3.1.1 As previously noted by the ECB⁵, the principle of institutional independence referred to in Article 130 of the Treaty and Article 7 of the Statute of the ESCB refers the exercise of central bank powers and the performance of the tasks and duties conferred on central banks not being subject to external instructions or government influence. In particular, where a NCB's operations are subject to the control of a state audit office or similar body charged with controlling the use of public finances, the scope of the control (a) should be clearly defined by the legal framework; (b) should be without prejudice to the activities of the NCB's independent external auditors to examine all books and accounts of the NCB⁶ and, further, in line with the principle of institutional independence; (c) should comply with the prohibition on giving instructions to an NCB and its decision-making bodies; and (d) should not interfere with the NCB's ESCB-related tasks⁷. The state audit should be conducted on a non-political, independent and purely professional basis⁸. The draft laws fail to satisfy these requirements and safeguards in a number of respects.

3.1.2 *First*, the draft laws exclude from the scope of the audit activities related to the realisation of goals and the execution of tasks established by the Treaty, the Statute of the ESCB and the Law on HNB⁹. However, in other more specific provisions¹⁰, the draft laws broaden the scope of the audit to include almost all tasks of HNB. The exclusion from the scope of the audit of HNB's activities of the implementation of goals and the discharge of duties under the Law on HNB would seem, literally read, to have the consequence of excluding all of HNB's activities pursuant to the Law on HNB from the scope of the State Audit Office's audit. Since this does not appear to be consistent with the manifest intention of the draft laws, and more importantly with a number of the draft laws' provisions as indicated above, the coexistence of such provisions which on the one hand exclude most of HNB's activities from the scope of the draft laws and on the other hand which include them casts legal doubt on the precise scope of the audit by the State Audit Office. Moreover, the proposed assessment of 'other transactions and procedures that it considers relevant'¹¹ grants undefined, , powers to the State Audit Office in respect of its choice as to what it deems relevant for the preparation of its report on HNB's business operations. Therefore, the scope of the State Audit Office's control of HNB's operations is not clearly defined by the draft laws.

3.1.3 *Second*, the draft laws explicitly state that the audits of the State Audit Office and of HNB's external auditors will be completely separate¹². The draft laws further state that the audit of business operations by the State Audit Office will imply the verification of, *inter alia*, financial and day-to-day operations of the HNB according to International Standards on Auditing, International Accounting

⁵ See paragraph 2.1.1 of Opinion CON/2016/33 and paragraph 3.1.1 of Opinion CON/2016/52.

⁶ See Article 61 of the Law on HNB for the activities of the independent external auditors of the NCBs.

⁷ See the ECB's Convergence Report, June 2016, p. 26-27 and Opinions CON/2011/9, CON/2011/53 and CON/2015/57.

⁸ See the ECB's Convergence Report, June 2016, p. 26-27.

⁹ See Article 1 of the draft law adding Article 61.a (3) of the Law on HNB.

¹⁰ See Article 1 of the draft law adding Article 61.a (2) of the Law on HNB.

¹¹ See Article 1 of the draft law adding Article 61.a (2) (4.8) of the Law on HNB.

¹² See Article 1 of the draft law adding Article 61.c (2) of the Law on HNB.

Standards, and International Financial Reporting Standards. In this respect, the task of evaluating HNB's financial statements already belongs to the independent external auditors¹³. Also, the State Audit Office's audit is stated to include the HNB's balance sheet¹⁴, which is an integral part of the HNB's financial statements, which are already subject to the audit of the HNB's external auditors¹⁵. The draft laws should be adapted so that the scope of audit of the State Audit Office does not overlap with the audit of the external auditors who, given their independence and expertise, are better placed than a State body to audit the financial statements of an NCB. In addition, a duplication of opinions regarding HNB's financial statements may negatively affect the credibility of HNB's accounts. Furthermore, International Accounting Standards and International Financial Reporting Standards are applicable to the preparation of financial statements, not to their auditing.

In addition, the draft law on the State Audit Office states that audits of the HNB's annual financial statements may also be performed by independent external auditors¹⁶, indicating that this is optional rather than mandatory. This is not consistent with the Law on the HNB which requires the prepared financial statements and the overall operation of HNB to be audited by independent external auditors in accordance with audit regulations and the International Auditing Standards¹⁷.

In conclusion, the scope of the State Audit Office's control of HNB's operations, as proposed by the draft laws, is not without prejudice to the activities of HNB's independent external auditors to examine all HNB's books and accounts.

- 3.1.4 *Third*, as already noted in its Opinion CON/2016/33, the ECB understands that the audit performed by the State Audit Office is generally governed by the provisions of the current Law on the State Audit Office. Its provisions stipulate that an audit includes a procedure for examining the auditee's financial transactions in terms of the legal use of funds and for assessing the effectiveness and efficiency of the auditee's operations and how effectively the auditee's general objectives were met or how effectively the objectives of the auditee's individual financial transactions, programmes and projects were met. Furthermore, the auditee must comply with audit findings and notify the State Audit Office of the actions taken in response to the audit findings¹⁸. It follows that the State Audit Office would be empowered to assess whether HNB meets its general objectives, including its primary objective of maintaining price stability. These provisions of the Law on the State Audit Office in conjunction with the relevant provisions of the draft laws are not in line with the principle of central bank independence referred to in Article 130 of the Treaty and Article 7 of the Statute of the ESCB. In this respect it is noted that the draft laws provide that the State Audit Office may not order any action that might call into question the principle of the institutional, functional, personal, and financial independence of the HNB. The ECB understands that this provision is designed to ensure that the scope of control of the State Audit Office is intended to comply with the prohibition on giving instructions to the HNB. For the sake of legal certainty, it is suggested that the draft laws be

13 See Article 61 of the Law on HNB.

14 See Article 1 of the draft law adding Article 61.a (2) of the Law on HNB.

15 See Article 61 of the Law on HNB.

16 See Article 1 of the Law on the amendments to the Law on the State Audit Office.

17 See Article 61 of the Law on HNB.

18 See Article 14 of the Law on the State Audit Office.

adapted to clarify that the above-referenced provisions of the Law on the State Audit Office would not apply to audits of the HNB.

3.1.5 *Fourth*, the scope of the State Audit Office's control of HNB's operations should not interfere with the HNB's ESCB-related tasks. As noted in paragraph 3.1.2, it is legally uncertain whether the HNB's ESCB-related tasks are excluded from the scope of the State Audit Office's audit of business operations. Moreover, although the provisions of the draft law purport to prohibit the State Audit Office from evaluating the activities referring to the realisation of ESCB-related goals and the execution of ESCB-related tasks and from making audit findings relating to HNB's ESCB-related tasks, the draft law specifically provides that the HNB must give to the authorized state auditor an insight into confidential data referred to in Article 37 of the Statute of the ESCB for the purposes of the audit, in accordance with ESCB rules¹⁹. This seems to imply that the State Audit Office would have the right to examine HNB's ESCB-related activities but not to evaluate and make audit findings in respect of them. It is difficult to understand what purpose would be served by such examinations by the State Audit Office in circumstances where the State Audit Office would be unable to make any evaluations or findings as a result of such examinations. The ECB would therefore recommend the exclusion of HNB's ESCB-related tasks from the scope of the State Audit Office's audit of business operations, since this should clearly ensure that the audit would not interfere with HNB's ESCB-related tasks.

Moreover, Article 37 of the Statute of the ESCB requires the members of the governing bodies and the staff of NCBs, even after their duties have ceased, not to disclose information of the kind covered by the obligation of professional secrecy. The primacy of Union law and the rules adopted thereunder mean that national laws on access by third parties (such as the State Audit Office) to documents may not lead to infringements of the ESCB's confidentiality regime. The access of a state audit office to an NCB's information and documents must be limited and must be without prejudice to the ESCB's confidentiality regime to which the members of NCBs' decision-making bodies and staff are subject²⁰. Hence, access by the State Audit Office to HNB's confidential information must be limited to that which is strictly necessary for the performance of the state auditor's tasks. Such access must also be without prejudice both to HNB's independence and to the ESCB confidentiality regime, to which the members of the HNB's decision-making bodies and staff are subject. In this respect the ECB welcomes the provision²¹ that the State Audit Office must safeguard the confidentiality of information and documents disclosed by HNB to the same extent as the professional secrecy provisions applied by HNB²².

3.1.6 *Fifth*, under the draft laws the audit performed by the State Audit Office is stated to include the audit of the HNB as part of the TARGET2 payment system operated by the Eurosystem. This is inconsistent with the provision of the draft laws, which provide that the State Audit Office will not assess activities relating to the implementation of goals and the discharge of duties established

19 See Article 1 of the draft law adding Article 61.b(1) and (2) of the Law HNB.

20 See the ECB's Convergence Report, June 2016, p. 26.

21 See Article 1 of the draft law adding Article 61.b(3) of the Law HNB.

22 See the ECB's Convergence Report, June 2016, Chapter 7.5.3.

under the Treaty, the Statute of the ESCB and the Law on HNB.²³ The TARGET2 payment system is established pursuant to an ECB Guideline adopted pursuant to the first and fourth indents of Article 127(2) of the Treaty,²⁴ and has been identified, pursuant to Decision ECB/2014/35 of the European Central Bank²⁵, as a systemically important payment system (SIPS) overseen by the ECB as competent authority under Regulation (EU) No 795/2014 (ECB/2014/28)²⁶. Therefore, it is suggested to delete the reference to the State Audit Office's audit of TARGET2, since TARGET2 is operated on behalf of the Eurosystem and the scope of control of the State Audit Office should not interfere with HNB's ESCB-related tasks.

3.1.7 *Sixth*, the scope of the HNB audit is stated to include the NKS and the EuroNCS. The ECB understands that these systems are not within HNB's competence nor operated by HNB.

3.1.8 *Seventh*, regarding the proposed audit of HNB's employment policy, the ECB notes that the concept of financial independence should be assessed from the perspective of whether any third party is able to exercise either direct or indirect influence not only over an NCB's tasks but also over its ability to fulfil its mandate, both operationally in terms of manpower, and financially in terms of appropriate financial resources. Member States may not impair an NCB's ability to employ and retain the qualified staff necessary for the NCB to perform independently the tasks conferred on it by the Treaty and the Statute of the ESCB. Also, an NCB may not be put into a position where it has limited control or no control over its staff, or where the government of a Member State can influence its policy on staff matters²⁷.

3.1.9 Finally, regarding the provision in the draft law relating to the State Audit Office's audit of the financial and day-to-day operation of HNB, reference is made, *inter alia*, to the review of the appropriateness of the application of international risk assessment standards published by the Basel Committee on Banking Supervision (BASEL) and the establishment of risk reserves. It is not clear why the draft law refers to BASEL standards as these standards do not apply to central banks.

3.2 *HNB reporting obligations in relation to the Croatian Parliament*

3.2.1 As regards the HNB's proposed reporting obligations to the Croatian Parliament, as previously noted by the ECB²⁸, and in line with the principle of institutional independence under Article 130 of the Treaty and Article 7 of the Statute of the ESCB, the NCBs and the members of their decision-making bodies are prohibited from seeking or taking instructions from Union institutions, bodies or agencies, from any government of a Member State or from any other body. In addition, the governments of the Member States are prohibited from seeking to influence the members of the

²³ See Article 1 of the draft law adding Article 61.a (3) of the Law HNB.

²⁴ Guideline ECB/2012/27 of the European Central Bank of 5 December 2012 on a Trans-European Automated Real-time Gross settlement Express Transfer system (TARGET2) (recast) (ECB/2012/27) (OJ L 30, 30.1.2013, p. 1).

²⁵ Decision ECB/2014/35 of the European Central Bank of 13 August 2014 on the identification of TARGET2 as a systemically important payment system pursuant to Regulation (EU) No 795/2014 on oversight requirements for systemically important payment systems (OJ L 245, 20.8.2014, p. 5).

²⁶ Regulation ECB/2014/28 of the European Central Bank (EU) No 795/2014 of 3 July 2014 on oversight requirements for systemically important payment systems (OJ L 217, 23.7.2014, p. 16).

²⁷ See ECB's Convergence Report, June 2016, p. 27.

²⁸ See paragraphs 2.2.2 and 2.2.3 of Opinion CON/2016/33 and paragraphs 3.2.3 and 3.2.4 of Opinion CON/2016/52.

NCBs' decision-making bodies whose decisions may affect the fulfilment of the NCBs' ESCB-related tasks.

- 3.2.2 While the explanatory memorandum emphasises that the independence enjoyed by the members of the HNB bodies in charge of decision-making must not be brought into question during the discussion on HNB's annual report and semi-annual information in the Croatian Parliament, and that the special status of Governors must be respected in terms of their membership in the ECB General Council, and that the Croatian Parliament must respect the confidentiality requirements flowing from the Statute of the ESCB, the ECB understands that the contents of the explanatory memorandum have no legal standing in Croatian law, but constitute mere statements as to the authors' intentions, without providing any statutory or legal guarantees. In addition, these intentions are not reflected in the provisions of the draft law.
- 3.2.3 The draft law does not explicitly clarify the precise implications of the Croatian Parliament's taking a position on the HNB's annual report and semi-annual information regarding HNB's financial condition, the level of price stability achieved and monetary policy implementation. The rights of third parties to approve, suspend, annul or defer an NCB's decisions are incompatible with the Treaty and the Statute of the ESCB as far as ESCB-related tasks are concerned²⁹. Therefore, the Croatian Parliament's competence to take a position on the HNB's annual report on its activities and semi-annual information regarding HNB's financial condition, the level of price stability achieved and monetary policy implementation would affect HNB's institutional independence, as it goes beyond the transparency and accountability obligation of a NCB towards a national parliament. As regards the compatibility of a dialogue between NCBs and third parties with central bank independence, the ECB refers to ECB Opinion CON/2016/33 and ECB Opinion CON/2016/52³⁰, which clarify that such a dialogue is welcome and compatible with central bank independence provided that (1) this does not result in interference with the independence of the members of the NCB's decision-making bodies; (2) the special status of Governors in their capacity as members of the ECB's General Council is fully respected; and (3) confidentiality requirements resulting from the Statute of the ESCB are observed. A 'position' of the Croatian Parliament on the aforementioned annual report and semi-annual information seems to imply that the Croatian Parliament could give direct or indirect instructions to the HNB and its decision-making bodies and members, for example as regards amending HNB's annual report or challenging HNB's assessment regarding price stability and the implementation of monetary policy. Any right of the Croatian Parliament to approve, suspend, annul or defer HNB's decisions would be contrary to HNB's institutional independence under the Treaty and the Statute of the ESCB³¹.

²⁹ See ECB's Convergence Report, June 2016, p. 22.

³⁰ See paragraph 2.2.3 of Opinion CON/2016/33, paragraph 3.2.4 of Opinion CON/2016/52.

³¹ See paragraphs 3.5, 3.6 and 3.7 of Opinion CON/2008/31.

3.3 *Appointment of the members of the HNB Council*

- 3.3.1 The draft law states that, in the event any member of the HNB Council departs before the end of his/her term, a new member will be selected for the remainder of the departing member's term only. Article 14.2 of the Statute of the ESCB provides that the term of office of a governor of a national central bank shall be no less than five years. Personal independence would be jeopardised if the same rules for the security of tenure and grounds for dismissal of Governors did not also apply to other members of the decision-making bodies of NCBs involved in the performance of ESCB-related tasks³². Various provisions of the Treaty and of the Statute of the ESCB require comparable security of tenure. As consistently stated in the ECB's convergence reports and opinions, when an NCB's statutes are amended, the amending law should safeguard the security of tenure of the Governor and of other members of decision-making bodies who are involved in the performance of ESCB-related tasks³³. The ECB would recommend that, in the event any member of the HNB Council departs before the end of his/her term, a new member be selected for a term of at least five years, instead of the remainder of the departing member's term only.
- 3.3.2 The ECB takes note of the proposed expansion of the HNB Council by up to nine members, four of whom will be external members drawn from various segments of Croatian business and social life, including industry, employers, academia, consumer protection associations, etc., with professional experience in the field of economy and finance. The personal independence of the members of a NCB's decision-making bodies entails ensuring that no conflict of interest arises between the duties of members of NCB decision-making bodies involved in the performance of ESCB-related tasks in relation to their respective NCBs and any other functions which such members of decision-making bodies may have and which may jeopardise their personal independence. As a matter of principle, membership of a decision-making body involved in the performance of ESCB-related tasks is incompatible with the exercise of other functions that might create a conflict of interest. In particular, members of such decision-making bodies may not hold an office or have an interest that may influence their activities, whether through office in the executive or legislative branches of the state or in regional or local administrations, or through involvement in a business organisation. Particular care should be taken to prevent potential conflicts of interest on the part of non-executive members of decision-making bodies³⁴.
- 3.3.3 With respect to the provisions of the draft law that the members of the HNB Council will be appointed for a term of six years with only one possibility of reselection, and that no member of the HNB Council may serve more than two terms as member of the Council, the ECB recalls that, in view of the principle of central bank independence laid down in Article 130 of the Treaty and Article 7 of the Statute of the ESCB, Governors and other members of NCBs' decision-making bodies involved in the performance of ESCB-related tasks may not be dismissed for reasons other than those mentioned in Article 14.2 of the Statute. Therefore, the current members of HNB's Council should be allowed to complete their current terms of office, irrespective of how many terms

³² See paragraph 2.2 of Opinion CON/2014/51.

³³ See ECB's Convergence Report, June 2016, p. 23.

³⁴ See ECB's Convergence Report, June 2016, pp. 24-25.

of office have already been served in the past, and the draft law should be adapted to explicitly guarantee the completion of their current terms. Moreover, the ECB understands, in accordance with the principles of the rule of law, legal safety, legal predictability and legal certainty under the Croatian Constitution, that the requirement that the members of the HNB Council may not serve more than two terms of office does not apply in respect of terms which were served before the date the draft law comes into effect³⁵. This implies that the current and past members of the HNB Council would be able to serve two terms in the future, and that terms served in the past are not included and do not count towards the calculation of the limitation of two terms. The ECB welcomes this from the perspective of legal certainty³⁶.

- 3.3.4 The draft law would need to clarify, for the sake of legal certainty, whether the Governor and the Vice-Governors would be appointed by the Croatian Parliament on the proposal of the Parliament's Election, Appointment, and Administration Committee, or on the proposal of the President of Croatia, as currently both appointment procedures are envisaged by the draft law.
- 3.3.5 It may be useful to reflect on how a candidate for Governor of HNB would be considered to meet the criterion of being entirely mentally fit to discharge the duties of Governor.
- 3.3.6 The ECB notes that the appointment of the members of the HNB Council is already regulated in detail by the Law on HNB³⁷. The ECB therefore understands that the intention of the draft law is to repeal the relevant provisions of the Law on HNB.

3.4 *Employees of HNB*

Regarding the proposed requirement that employees in all management posts at the HNB be subject to reselection at four-year intervals after an internal competition procedure has been completed, as noted above (see paragraph 3.1.8), the concept of financial independence should be assessed from the perspective of whether any third party is able to exercise either direct or indirect influence not only over an NCB's tasks but also over its ability to fulfil its mandate, including operationally in terms of manpower. Member States may not impair an NCB's ability to employ and retain the qualified staff necessary for the NCB to perform independently the tasks conferred on it by the Treaty and the Statute of the ESCB. Also, an NCB may not be put into a position where it has limited control or no control over its staff, or where the government of a Member State can influence its policy on staff matters³⁸. Against this backdrop, the ECB suggests that further consideration be given to the imposition of a requirement on HNB under the draft law that all managerial posts at the HNB be subject to internal recruitment procedures every four years, as this would appear to intrude on the HNB's ability to independently determine its own policy on staff matters.

3.5 *Secondary Market Purchases of public sector securities by HNB*

Regarding the authorisation to HNB to repurchase public sector securities in the secondary market directly from credit institutions, the ECB notes that, in accordance with the prohibition of monetary

³⁵ See the Decision of the Constitutional Court of the Republic of Croatia U-III-930/2015, 31 March 2015.

³⁶ See paragraph 2.3 of Opinion CON/2016/34 and paragraph 3.3 of Opinion CON/2016/52.

³⁷ See Articles 79, 80 and 82 of the Law on HNB.

³⁸ See ECB's Convergence Report, June 2016, p. 27.

financing under Article 123 of the Treaty³⁹, the purchase directly by the HNB of debt instruments from central governments, regional, local or other public authorities, other bodies governed by public law or public undertakings by Member States shall be prohibited. As noted in the recitals to Council Regulation (EC) No 3603/93⁴⁰ Member States must take appropriate measures to ensure that this prohibition is applied effectively and fully. In particular, purchases made on the secondary market must not be used to circumvent the objective of Article 123 of the Treaty⁴¹.

3.6 *Capital, reserves and allocation of profits and losses of HNB*

- 3.6.1 Even if an NCB is fully independent from a functional, institutional and personal point of view, its overall independence would be jeopardised if it could not autonomously avail itself of sufficient financial resources to fulfil its mandate (i.e. to perform the ESCB-related tasks required of it under the Treaty and the Statute of the ESCB). Member States may not put their NCBs in a position where they have insufficient financial resources and inadequate net equity⁴² to carry out their ESCB-related tasks.⁴³ Financial independence requires that in performing its tasks an NCB can independently assess the risks involved and has the power to decide on any necessary precautions to take. An NCB is best placed to make these assessments and needs to have the necessary tools to evaluate the relevant circumstances and to make forecasts.
- 3.6.2 The principle of financial independence requires an NCB to have sufficient means not only to perform its ESCB-related tasks but also its national tasks, e.g. financing its administration and own operations⁴⁴.
- 3.6.3 Financial independence also implies that an NCB should always be sufficiently capitalised. In particular, any situation should be avoided whereby for a prolonged period of time an NCB's net equity is below the level of its statutory capital or is even negative, including where losses beyond the level of capital and the other financial buffers, such as reserves and general risk provisions, are carried over. Any such situation may negatively impact on the NCB's ability to perform its ESCB-related tasks but also its national tasks. Therefore, the event of an NCB's net equity becoming less than its statutory capital or even negative would require that the respective Member State provides the NCB with an appropriate amount of capital at least up to the level of the statutory capital within a reasonable period of time so as to comply with the principle of financial independence⁴⁵.
- 3.6.4 With regard to profit allocation, an NCB's statutes may prescribe how its profits are to be allocated. In the absence of such provisions, decisions on the allocation of profits should be taken by the NCB's decision-making bodies on professional grounds, and should not be subject to the discretion of third parties unless there is an express safeguard clause stating that this is without prejudice to the financial means necessary for carrying out the NCB's ESCB-related tasks as well as national

³⁹ See also Article 78 of the Law on HNB.

⁴⁰ See Recital 7 of 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 (OJ L 332, 31.12.1993, p. 1).

⁴¹ See Case C-62/14 *Gauweiler and Others v. Deutscher Bundestag*, paras. 93-127, EU:C:2015:400.

⁴² See paragraph 3.3 of Opinion CON/2014/24, paragraph 2.2 of Opinion CON/2014/27 and paragraph 3.1.1 of Opinion CON/2014/56.

⁴³ See ECB's Convergence Report, June 2016, p. 25.

⁴⁴ See ECB's Convergence Report, June 2016, pp. 25, 188 and paragraph 4.3 of Opinion CON/2009/85.

⁴⁵ See ECB's Convergence Report, June 2016, pp. 25-26.

tasks. Profits may be distributed to the State budget only after any accumulated losses from previous years have been covered⁴⁶ and financial provisions deemed necessary to safeguard the real value of the NCB's capital and assets have been created⁴⁷. Any amendment to the profit distribution rules of an NCB should only be initiated and decided in cooperation with the NCB, which is best placed to assess its required level of reserve capital⁴⁸. As regards financial provisions or buffers, NCBs must be free to independently create financial provisions to safeguard the real value of their capital and assets. Member States may also not hamper NCBs from building up their reserve capital to a level which is necessary for a member of the ESCB to fulfil its tasks⁴⁹.

- 3.6.5 Based on the foregoing, the proposed limitations on the quantity of HNB's general reserves to twice the amount of HNB's share capital and on the amount of HNB's specific reserves to the amount of HNB's share capital would be inconsistent with the principle of financial independence. HNB is best positioned to assess the risks involved in its operations and what financial precautions need to be taken to guard against these risks, including the establishment of the necessary level of general and specific reserves or other types of financial buffers such as general risk provisions.
- 3.6.6 In addition, the ECB welcomes that under the draft law losses of HNB would ultimately be covered by the Croatian Treasury. However, using share capital to cover losses that cannot be covered from general and specific reserves could lead to situations whereby the net equity is below the level of HNB's statutory capital, a situation which should be avoided for a prolonged period of time. The reference to HNB's share capital for covering losses should therefore be removed from the draft law.
- 3.6.7 The ECB notes that when applying the rules of the draft law, the HNB would need to release, for the benefit of the State budget, a considerable part of its existing reserves. The proposed statutory reduction of HNB's general reserves could also diminish its financial independence.
- 3.6.8 Finally, in relation to the establishment of a special operating fund to acquire property and rights constituting tangible fixed assets and/or fixed asset investments and to establish specialised financial organisations, it is not clear how the establishment of such fund would relate to the other provisions addressing capital, reserves and allocation of profits and losses of the HNB⁵⁰. In any case, any such fund or specialized financial organization may not be utilized in such a manner as to breach HNB's obligations with respect to the prohibition of monetary financing under Article 123 of the Treaty⁵¹.

3.7 *Foreign Currency Operations of HNB*

- 3.7.1 The ECB notes that, under the Law on HNB, HNB's tasks include the definition and implementation of monetary and foreign exchange policies and the holding and management of Croatia's foreign

46 See paragraph 4.3 of Opinion CON/2009/85 and paragraph 2.2. of Opinion CON/2009/53.

47 See ECB's Convergence Report, June 2016, pp. 25, 27 and paragraph 3.3 of Opinion CON/2009/26 and paragraph 2.1 of Opinion CON/2012/69.

48 See paragraphs 3.6 and 4.2 of Opinion CON/2009/83 and paragraph 3.3 of Opinion CON/2009/53.

49 See paragraph 4.2 of Opinion CON/2008/34, paragraph 2.3 of Opinion CON/2009/26 and paragraph 2.1 of Opinion CON/2012/69.

50 See Article 1 of the draft law amending Article 57 of the Law on HNB.

51 See paragraph 6.4 of the ECB's Annual Report 2015.

reserves. HNB enjoys various related competences and powers to implement monetary and foreign exchange policies, conduct open market operations, lay down monetary and foreign exchange policy measures and instruments, trade in foreign currency and foreign cash, manage foreign reserves, open accounts abroad, carry out all types of banking and financial transactions with other central banks, credit and financial institutions outside Croatia, and international institutions and organizations, and enter into payment and clearing agreements with foreign clearing institutions. The Law on HNB also contains provisions with respect to consultations and reporting by the Ministry of Finance with and to the HNB on the foreign borrowing transactions of Croatia⁵².

- 3.7.2 As regards supervision over authorised foreign exchange offices, the ECB notes that, under the Law on HNB, HNB's tasks include the issuance and withdrawal of authorisations and approvals in accordance with the laws governing the operation of credit institutions, credit unions, payment institutions, electronic money institutions, payment systems, foreign exchange operations and the operation of authorised foreign exchange offices⁵³. The ECB also understands that under the Law on foreign exchange⁵⁴ Financijski inspektorat (the Financial Inspectorate) of Ministarstvo financija (the Ministry of Finance) also has a role in the supervision of foreign exchange offices⁵⁵.
- 3.7.3 The ECB understands that setting foreign currency exchange rates and the exchange rate of the domestic currency, and publishing the currency exchange rate, is regulated by the Law on foreign exchange⁵⁶.
- 3.7.4 The ECB understands that all payments (whether domestic or to or from a foreign country) are regulated by the Law on payment systems⁵⁷.
- 3.7.5 Contrary to the provision of the draft law which provides that the foreign currency operations of HNB include, *inter alia*, HNB's relationship with the ECB, this relationship is already regulated by the provisions of the Statute of the ESCB and cannot be regulated further by national laws.
- 3.7.6 Against this backdrop, the ECB suggests that the Croatian legislator gives further consideration to the interaction of the provisions of the draft law regarding the foreign currency operations of the HNB and the relevant provisions of the Law on HNB, the Law on foreign exchange, the Law on payment systems and the Statute of the ESCB.
- 3.8 *Certain powers of HNB over credit institutions*

The ECB notes that under the Law on HNB the tasks and powers of the HNB Council include to establish the insolvency of credit institutions and decide on submitting proposals for the initiation of bankruptcy proceedings against credit institutions or on the withdrawal of authorisations of credit institutions⁵⁸. Furthermore, the HNB enjoys a range of powers as the competent supervisor of

52 See Articles 4, 9, 10, 16, 17, 18, 19, 20, 38 and 74 of the Law on HNB.

53 See Article 4 of the Law on HNB.

54 Zakon o deviznom poslovanju (*Narodne novine* no 96/03, 140/05, 132/06, 150/08, 92/09, 133/09, 153/09, 145/10 and 76/13).

55 See Articles 55 and 58 of the Law on foreign exchange.

56 See Article 42-45 of the Law on foreign exchange.

57 Zakon o platnom prometu (*Narodne novine* No 133/09 and 136/12); see Article 1 and 43.

58 See Article 42(9) of the Law on HNB.

credit institutions under the Law on credit institutions⁵⁹ and the Law on resolution of credit institutions and investment companies⁶⁰, including with respect to the potential unavailability of deposits. Certain consequences flowing from the inability of a credit institution to meet its obligations are also regulated by the Law on settlement finality in payment and financial instruments settlement systems⁶¹. The protection of citizens' deposits held at savings and current accounts is also addressed by the Law on deposit insurance⁶². Against this backdrop, the ECB suggests that the Croatian legislator gives further consideration to the interaction and considerable overlap of the provisions of the draft law regarding the proposed powers of the HNB over credit institutions and the relevant provisions of the Law on HNB, the Law on credit institutions⁶³, the Law on resolution of credit institutions and investment companies⁶⁴, the Law on settlement finality in payment and financial instruments settlement systems and the Law on deposit insurance⁶⁵.

3.9 *Obligation to denominate and pay all monetary obligations in Croatia in Kuna*

The ECB understands that the matters addressed by the provisions of the draft law relating to the obligation to denominate and pay all monetary obligations in Croatia in Kuna, besides the Law on HNB, which defines that Kuna shall be legal tender in Croatia and that use of other currencies may be allowed for domestic payments by law⁶⁶, are regulated by other laws in Croatia, including the Law on civil obligations⁶⁷, the Law on credit institutions⁶⁸, the Decision on risk management⁶⁹, the Law on consumer credit⁷⁰, the Law on credit agreements for consumers relating to residential immovable property⁷¹, the Law on Foreign Exchange⁷² and the Law on Payment Systems⁷³. Against this backdrop the ECB suggests that the Croatian legislator gives further consideration to

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- 59 Zakon o kreditnim institucijama (*Narodne novine* no 159/13, 19/15, 102/15 and 15/18).
- 60 Zakon o sanaciji kreditnih institucija i investicijskih društava (*Narodne novine* no 19/15).
- 61 Zakon o konačnosti namire u platnim sustavima i sustavima za namiru financijskih instrumenata (*Narodne novine* no 51/12 and 44/16).
- 62 Zakon o osiguranju depozita ((*Narodne novine* no 82/15).
- 63 The Law on credit institutions transposes Directive 2013/36/EU of the European Parliament and the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.06.2013, p. 338) and implements Regulation (EU) No 575/2013 of the European Parliament and the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 321, 30.11.2013, p. 6).
- 64 The Law on resolution of credit institutions and investment companies transposes Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12.6.2014, p. 190).
- 65 The Law on deposit insurance transposes Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (OJ L 173/149, 12.06.2014).
- 66 See Article 21 of the Law on HNB.
- 67 Zakon o obveznim odnosima (*Narodne novine* No 35/05, 41/08, 125/11 and 78/15); see Articles 21 and 22.
- 68 See Articles 101, 302(6) and 303 of the Law on credit institutions.
- 69 Decision on risk management, (*Narodne novine* No 1/2015 and 94/2016).
- 70 Zakon o potrošačkom kreditiranju (*Narodne novine* No 75/09, 112/12, 143/13, 147/13, 09/2015, 78/15, 102/15 and 52/16); see Articles 4(4) and 5.
- 71 Zakon o stambenom potrošačkom kreditiranju (*Narodne novine* No 101/2017); see Article 13(2) and 13(6).
- 72 See Articles 15 and 17 of the Law on foreign exchange.
- 73 See Article 13 of the Law on payment systems.

the interaction of these provisions of the draft law and the relevant provisions of the aforementioned Laws.

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

Done at Frankfurt am Main, 6 April 2018.

[signed]

The President of the ECB

Mario DRAGHI