



EUROPEAN CENTRAL BANK

EUROSYSTEM

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ECB-PUBLIC

OPINION OF THE EUROPEAN CENTRAL BANK
of 1 September 2023
on the recapitalisation of the Magyar Nemzeti Bank
(CON/2023/24)

Introduction and legal basis

On 24 July 2023 the European Central Bank (ECB) received a request from the Hungarian Ministry of Finance for an opinion on a draft law amending the Law on the Magyar Nemzeti Bank¹ and the Law on the Economic Stability of Hungary² (hereinafter the ‘draft law’).

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 (TFEU) and the third indent of Article 2(1) of Council Decision 98/415/EC³, as the draft law concerns the Magyar Nemzeti Bank (MNB). 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

- 1.1 The main purpose of the draft law is to modify the provisions of the Law on the Magyar Nemzeti Bank (hereinafter the ‘Law on the MNB’) and the Law on the Economic Stability of Hungary regarding the recapitalisation of the MNB and reimbursement by the State in case the amount of equity of the MNB falls below its subscribed capital.
- 1.2 Under the current provisions of the Law on the MNB⁴, if, at the end of the year under review, the amount of equity of the MNB falls below the subscribed capital, the difference is to be reimbursed from the central budget in equal annual instalments within five years, within 30 days of receipt of the financial statements for the year under review by the shareholder, directly to the profit and loss reserve. For this purpose, the equity consists of the following elements: (1) subscribed capital; (2) retained earnings; (3) valuation reserve; (4) revaluation reserve due to exchange rate change; (5) revaluation reserve of foreign currency securities; and (6) the result of the financial year under review⁵. The subscribed capital of the MNB is ten billion forints (HUF)⁶. If the amount of the equity exceeds the subscribed capital, all outstanding reimbursement obligations will cease. If, within the

¹ A Magyar Nemzeti Bankról szóló 2013. évi CXXXIX. törvény.

² Magyarország gazdasági stabilitásáról szóló 2011. évi CXCV. törvény.

³ 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).

⁴ See Article 166(3) of the Law on the MNB.

⁵ See Annex I to the Decree on the MNB’s accounts (a Magyar Nemzeti Bank éves beszámoló készítési és könyvvizetési kötelezettségének sajátosságairól szóló 221/2000. (XII.19.) Korm. rendelet).

⁶ See Article 5(5) of the Law on the MNB.

five-year period, a new reimbursement obligation is incurred by the central budget, the central budget must ensure that the MNB's equity does not remain below the subscribed capital for a longer period⁷. The Executive Board of the MNB must establish and decide on the financial statements of the MNB,⁸ decide on dividend payments⁹ and approve the report to be sent to the shareholder on the management and assets of the MNB¹⁰. In addition to the above, the current Law on the MNB also stipulates that if, at the end of the year under review, the amount of the equity exceeds the subscribed capital, the MNB pays 50 % of the profit of the year under review as dividends¹¹.

- 1.3 According to the explanatory memorandum accompanying the draft law (hereinafter the 'explanatory memorandum'), the current reimbursement rule may require a large one-off reimbursement from the central budget roughly one year after the adoption of the central budget. The explanatory memorandum also notes that while the negative equity does not bind the central bank in fulfilling its legal mandate, central bank losses may have unintended negative effects for fiscal policy and monetary policy and may reduce the room for manoeuvre for central banks.
- 1.4 Against this background, the draft law proposes to replace the existing reimbursement rule with a general reimbursement commitment. In particular, the draft law provides that if the equity of the MNB is below the subscribed capital for a prolonged period of time, it must be ensured, by direct reimbursement to the retained earnings provided from the central budget, that the amount of the MNB's equity is at least at the level of the subscribed capital within a reasonable period of time, in order to comply with the principle of financial independence. Consequently, if the amount of equity exceeds the subscribed capital at the end of the year under review, the MNB must pay 50 % of its profit for the year under review as a dividend, and there is no obligation to reimburse pursuant to the above in the year following the year under review. Noting that few Union Member States have a recapitalisation rule for their central banks, the explanatory memorandum states that the new reimbursement rule is very close to the Croatian central bank law, and is in harmony with the ECB's convergence criteria.
- 1.5 The draft law provides that the Executive Board of the MNB must approve a year-by-year forecast of the preliminary level of the equity at the end of the previous year and its expected development and send the report to the shareholder and the Fiscal Council by 30 April. The draft law proposes to amend the Law on the Economic Stability of Hungary to stipulate that when providing an opinion on the draft law on the central budget prior to its adoption by the Hungarian Parliament, the Fiscal Council must examine the compliance of the equity of the MNB with the provisions of the Law on the MNB as amended, as set out above.

2. General observations

- 2.1 The ECB would like to emphasise that, although Member States with a derogation, like Hungary, do not yet participate in the third stage of economic and monetary union, they have a legal duty to adapt

⁷ See Article 166(3) of the Law on the MNB.

⁸ See Article 12(4), point (b), of the Law on the MNB.

⁹ Pursuant to Article 166(1a) of the Law on the MNB.

¹⁰ See Article 12(4), point (b), of the Law on the MNB.

¹¹ See Article 166(1) of the Law on the MNB.

the statutes of their national central banks (NCBs) to ensure compatibility with the TFEU¹² and the Statute of the European System of Central Banks and of the European Central Bank (hereinafter the 'Statute of the ESCB'). Any legislative reform in non-participating Member States should aim to gradually achieve consistency with Eurosystem standards¹³.

- 2.2 The ECB notes that the provisions of the Law on the MNB to be amended by the draft law only entered into force very recently, and that the ECB recently adopted an opinion on the current rules on dividend payments, recapitalisation and reimbursement of the MNB¹⁴.

3. Specific observations

- 3.1 Article 130 TFEU and Article 7 of the Statute of the ESCB expressly prohibit the ECB, the NCBs, and the members of their decision-making bodies from seeking or taking instructions from Union institutions, bodies, offices or agencies, from any government of a Member State or from any other body, on the one hand, and prohibits those Union institutions, bodies, offices or agencies and any government of a Member State from seeking to influence the members of the decision-making bodies of the ECB and the NCBs in the performance of their tasks, on the other. The intention of these provisions is to shield the European System of Central Banks (ESCB) from all political pressure in order to enable it effectively to pursue the objectives ascribed to its tasks, through the independent exercise of the specific powers conferred on it for that purpose by primary law¹⁵. National rules therefore cannot, without infringing Article 130 TFEU and Article 7 of the Statute of the ESCB, place the NCB concerned in a situation where it is potentially exposed to political pressure or which in any way undermines its ability to carry out independently a task falling within the scope of the ESCB¹⁶.
- 3.2 In that regard, in order to ensure the independence of the ECB, the authors of the TFEU provided, inter alia, in the third sentence of Article 282(3) TFEU, that it is to be independent in the management of its finances. While it is true that neither the TFEU nor the Statute of the ESCB lay down an equivalent rule in respect of the NCBs, the fact remains that the basic tasks of the ESCB fall not only on the ECB but also on the NCBs¹⁷. The ECB has consistently held that the overall independence of the NCB concerned would be jeopardised if it could not autonomously avail itself of sufficient financial resources to perform the ESCB-related tasks required of it under the Treaty and the Statute of the ESCB¹⁸. In order to have at its disposal the funds necessary to carry out its tasks within the ESCB, national rules may not place the NCB concerned in a situation where it is forced to seek the consent of the political authorities mentioned in the first sentence of paragraph 3.1 in order to obtain funding or recapitalisation¹⁹.

¹² See Article 131 TFEU.

¹³ See, for example, paragraph 3.4 of Opinion CON/2008/34, paragraph 2.1 of Opinion CON/2017/17 and paragraph 2.1 of Opinion CON/2022/37. All ECB opinions are available on EUR-Lex.

¹⁴ See Opinion CON/2022/37.

¹⁵ See, for example, judgment of the Court of Justice of 26 February 2019, *Rimšēvičs and ECB v Latvia*, C-202/18 and C-238/18, EU:C:2019:139, paragraph 47.

¹⁶ Judgment of the Court of Justice of 13 September 2022, *Banka Slovenije*, C-45/21, EU:C:2022:670 (hereinafter the 'judgment in Case C-45/21'), paragraphs 97 and 104.

¹⁷ Judgment in Case C-45/21, paragraphs 98 and 99.

¹⁸ ECB Convergence Report 2022, Chapter 2.2.3, first paragraph of the section on 'Financial independence'.

¹⁹ Judgment in Case C-45/21, paragraph 104.

- 3.3 As previously noted²⁰, in order to participate in the implementation of the Union's monetary policy, it is essential that NCBs have the ability to establish reserves²¹. The Law on the MNB stipulates that the MNB must place gains and losses resulting from the valuation of its foreign currency assets and liabilities at the official exchange rate on the last day of the year in question in the HUF revaluation reserve²². In addition, the MNB must place the difference resulting from the market valuation of security based claims denominated in foreign currency in the foreign currency securities revaluation reserve²³. The HUF revaluation reserve and the foreign currency securities revaluation reserve are elements of the MNB's equity²⁴. The ECB understands that, in addition to the abovementioned revaluation reserves, which cannot be regarded as a buffer against all risks and cannot be used to cover financial losses of whatever kind, as they serve to cover dedicated risks, the MNB may freely establish reserves of a general type. As previously noted by the ECB, the NCB is best placed to assess independently what level of reserves is necessary to enable it to perform its tasks²⁵, and such a decision should not be subject to any third party's decision.
- 3.4 The ECB has consistently held that 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 capital and the reserves are carried over. 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 independence²⁶.
- 3.5 As indicated in the explanatory memorandum, the majority of the Member States do not have an explicit mechanism for the recapitalisation of their NCBs by the State in their respective NCBs' statutes. As indicated in the explanatory memorandum, the reimbursement mechanism contained in the draft law closely resembles the recapitalisation mechanism in Croatia, which provides that should the overall capital of the Hrvatska Narodna Banka (HNB), reduced for the loss from previous years, be lower than the capital of the HNB for a longer period, the difference required up to the amount of the capital must be covered from the State budget in the following medium-term period²⁷. The ECB notes that it considered the pre-existing mechanism in Croatia, whereby the HNB's losses that could not be covered from general reserves were automatically covered from the State budget, to be a useful mechanism that served to strengthen the HNB's financial independence. The ECB therefore regretted the fact that this pre-existing mechanism was not maintained in the HNB's statutes²⁸. However, the ECB concluded that this mechanism is consistent with the Treaty and the Statute of the ESCB²⁹.

20 See paragraph 3.2 of Opinion CON/2022/37.

21 Judgment in Case C-45/21, paragraph 100.

22 See Article 147(1) of the Law on the MNB.

23 See Article 147(2) of the Law on the MNB.

24 See Article 147(3) of the Law on the MNB.

25 See, for example, paragraph 3.4.3 of Opinion CON/2017/17.

26 ECB Convergence Report 2022, Chapter 2.2.3, fourth paragraph of the section on 'Financial independence'.

27 See Article 57(7) of the Act on Hrvatska Narodna Banka.

28 See paragraph 2.6 of Opinion CON/2020/8.

29 ECB Convergence Report 2022, Chapter 7.3.4, 'Croatia', 'Conclusions'.

- 3.6 The Hungarian economy is facing important macro-financial challenges. Monetary policy is confronted with very high inflation, with annual Harmonized Index of Consumer Prices inflation standing at 17.6 % in June 2023, which triggered a significant increase in policy rates, with the central bank base rate and the overnight collateralised loan rate currently standing at 13 % and 17.5 %, respectively. This has, among other factors, contributed to losses of about HUF 402 billion in 2022. It is possible that the MNB incurs further losses in 2023. Given these particular challenges, it is important that the MNB maintains a sufficiently strong balance sheet that can absorb possible future losses and safeguard the financial independence and operational effectiveness of the MNB. The Hungarian authorities may wish to take account of these specific circumstances when designing a regime for the possible future recapitalisation of the MNB via the state budget.
- 3.7 Due to the substitution in the draft law of the current reimbursement rule for a general commitment to reimburse the MNB from the central budget, it seems that State authorities have a wide margin of discretion to determine when the MNB's equity would be restored up to the level of the MNB's subscribed capital. That wide margin of discretion on the part of the State authorities is not inconsistent with the Treaty and the Statute of the ESCB.
- 3.8 The Law on the MNB provides that if the amount of equity exceeds the subscribed capital at the end of the year under review, the MNB must pay 50 % of its profit for the year under review as a dividend (automatic dividend payment)³⁰. In addition to this, upon the decision of the Executive Board of the MNB, the MNB pays dividends from the positive amount of the retained earnings supplemented by the loss for the year or 50 % of the profit for the year, up to the amount by which the equity of the MNB exceeds the subscribed capital (discretionary dividend payment)³¹. If in the year under review the equity of the MNB falls under the subscribed capital, no dividend payment, whether automatic or upon the decision of the Executive Board of the MNB, may occur. In relation to dividend payments, the ECB has taken the consistent position that profit allocation rules in NCBs' statutes should ensure that profits may be distributed to the State only after any accumulated losses from previous years have been covered and financial buffers deemed necessary to safeguard the real value of the NCB's capital and assets have been created³². In this respect, the ECB understands that profits may be distributed by the MNB to the State only after any accumulated losses from previous years have been covered, as, under the Hungarian Civil Code and Accounting Act³³, which are also applicable to the MNB³⁴, a dividend may only be paid from positive retained earnings, supplemented by the accumulated losses of previous years.

³⁰ See Article 166(1) of the Law on the MNB.

³¹ See Article 166(1a) of the Law on the MNB.

³² ECB Convergence Report 2022, Chapter 2.2.3, first paragraph of the section on 'Distribution of profits, NCBs' capital and financial provisions'.

³³ See Article 3:88(2) of the Civil Code (A Polgári Törvénykönyvről szóló 2013. évi V. törvény) and Article 37(2) of the Accounting Act (a számvitelről szóló 2000. évi C. törvény).

³⁴ See Article 7 of the Law on the MNB and Article 1(2) of the Decree on the MNB's accounts.

This opinion will be published on EUR-Lex.

Done at Frankfurt am Main, 1 September 2023.

[signed]

The President of the ECB

Christine LAGARDE