



## OPINION OF THE EUROPEAN CENTRAL BANK

of 14 December 2011

on the Magyar Nemzeti Bank

(CON/2011/104)

### **Introduction and legal basis**

On 2 November 2011, the European Central Bank (ECB) received a request from the Hungarian Ministry for the National Economy for an opinion on a draft law replacing the Law on the Magyar Nemzeti Bank (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 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 provisions<sup>1</sup>, as the draft law relates to 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. Subject of the draft law**

The draft law will recast Law LVIII of 2001 on the Magyar Nemzeti Bank (MNB) (hereinafter the ‘MNB Law’). The draft law maintains several provisions of the MNB Law, as well as introducing new provisions into the current legal framework. Under the new Constitution effective on 1 January 2012, this subject matter will be regulated in a law adopted with a qualified majority, referred to as an organic law.

The draft law will introduce several changes into the MNB’s legislative framework.

#### *1.1 Decision-making bodies*

The draft law modifies the appointment procedure for the Monetary Council adopted in January 2011. The Prime Minister rather than the Governor may give recommendations to Hungary’s President on deputy governors. The possible number of deputy governors will increase to three and the Deputy Chair of the Monetary Council will act for the Governor in the event of his absence<sup>2</sup>.

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<sup>1</sup> OJ L 189, 3.7.1998, p. 42.

<sup>2</sup> Except for the Governor’s power to adopt decrees which he may delegate to a Deputy Governor of his choice.

The Monetary Council will have five to nine members chaired by the Governor. Its members will comprise the Deputy Governors and other members, nominated by Hungary's President, for six years.

The draft law reinstates the Executive Board, with the Governor as Chair, and the Deputy Governors to take over the Governor's implementing responsibilities for Monetary Council decisions. Its further tasks include in particular financial management, internal organisation, operational management of the MNB and auditing. The Monetary Council will become the supreme decision-maker for all MNB tasks.

### 1.2 *Monetary policy*

The MNB may set different levels of reserve ratios for different types of liabilities, individual assets and non-balance sheet items of financial institutions and investment companies. Furthermore, it may remunerate the minimum reserves deposited by the institutions. Remuneration depends on the different reserve ratio components.

### 1.3 *Macroprudential supervision*

The MNB's task is identifying business and economic risks threatening the financial system as a whole and facilitating the prevention and mitigation of systemic risks. On the basis of the Monetary Council's decision, the Governor may issue decrees on this matter. Also, the MNB will track the operations of major financial institutions and assess their liquidity positions.

### 1.4 *Changes in the salary structure*

The draft law proposes three alternative salary structure scenarios linking the remuneration of the Governor, Deputy Governors, other Monetary Council members and the Chair and members of the Supervisory Board to a certain baseline, such as average monthly gross income or the financial sector's average monthly gross income, with the proviso that no MNB employee monthly salary may exceed the salary of the MNB's Deputy Governors.

### 1.5 *Relations with the Government, the ministries and the public*

The Governor will be subject to a comprehensive reporting scheme to the Parliament on request and to the Parliament's Committee for Economic Affairs every six months. In addition, the MNB will be required to draw up a prior annual operating and investment cost plan. The Parliamentary Committee for Economic Affairs and the State Audit Office, on the basis of the MNB's subsequent internal performance review, will monitor its adherence. Article 31(4) of the draft law sets out the competence of the Parliamentary Committee for Economic Affairs and the State Audit Office to examine the operational efficiency of the management of the MNB<sup>3</sup>.

The MNB will submit its opinion on the budget proposal to the Minister responsible for budgetary matters. However, the MNB will no longer have an opportunity to submit this opinion to the

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<sup>3</sup> See for comparison Article 27.2 of the Statute of the ESCB.

Parliament's relevant committee. Furthermore, the Governor will present the MNB's opinion to the Budgetary Council.

1.6 *Relations with the general budget*

The forint and the exchange rate equalisation reserves may be offset against each other. The rules for recapitalisation will change as follows. Recapitalisation will only be available to the Government if the balance of the respective equalisation reserves is negative and this negative balance exceeds the sum of the accumulated profit reserve and the balance sheet. The shareholder may provide capital injections in cash to the accumulated profit reserve any time throughout the year, regardless of the balance of the MNB's accumulated profit reserve.

1.7 *Relations with the Hungarian Financial Supervisory Authority*

The MNB will cooperate with the Financial Supervisory Authority, including, *inter alia*, exchanging information and sharing the results of its on-site checks in matters falling under the Financial Supervisory Authority's powers.

1.8 *Balance sheet and dividend payments*

In the future, the Executive Board rather than the shareholder will adopt the MNB's balance sheet, financial statement, profit and loss statement, as well as decisions on dividend payments, subject to an affirmative resolution by the shareholder.

**2. Need for a stable institutional framework**

2.1 Previous ECB Opinions<sup>4</sup> repeatedly highlighted the key role of credible monetary policy in controlling inflationary expectations and promoting sustainable convergence towards price stability. A credible monetary policy is rooted in an independent central bank with a stable institutional environment. The Treaty's requirement of central bank independence reflects the view that the primary objective of price stability is best served by a fully independent institution with a precisely defined mandate. It is of utmost importance to design an institutional structure that separates monetary policy from the influence of short-term political interests.

2.2 The ECB reiterates its previous observations regarding frequent amendments to the MNB Law. In the context of central bank independence, the central bank legal framework needs to provide a stable basis for the central bank's functioning. The appointment procedure for Monetary Council members, as well as the MNB's decision-making bodies' salary structure, was subject to several recent amendments without consulting these bodies or taking the MNB's functional needs or the prevailing economic environment into account. These frequent changes to the MNB Law are incompatible with the principle of legal certainty. They have already significantly impacted the

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<sup>4</sup> See CON/2007/14, CON/2008/83 and CON/2010/91. All ECB opinions and reports are published on the ECB's website at [www.ecb.europa.eu](http://www.ecb.europa.eu).

MNB's organisational and governance stability<sup>5</sup>, as will the planned increase in the number of members of decision-making bodies.

- 2.3 The ECB understands that the new Constitutional framework justifies a recast of the MNB Law, and would welcome a recast that results in a long-term stable basis for central banking in Hungary.
- 2.4 Some central bank and monetary financing prohibition issues in the ECB's December 2006 and May 2010 Convergence Reports are still not addressed.
- 2.5 The ECB has learned that the version of the draft law submitted to the Government contains substantive amendments compared to the version submitted to the ECB, in particular as regards macroprudential and remuneration policy matters. The ECB reiterates its position that it should be re-consulted if there are substantive amendments proposed to the draft law at a stage when the ECB has not yet adopted its opinion. In such situations, the ECB expects the consulting authority to submit the amended draft legislative provision to it as soon as possible, so that the opinion can be based on the most recent text. The ECB would appreciate the Ministry for the National Economy giving due consideration to honouring its obligation to consult the ECB in the future.

### **3. Subscription to the ECB's capital**

Article 63 of the draft law prohibits the MNB from holding shares in any domestic or international organisation apart from shares in organisations set up in relation to its activity. The ECB seeks clarification that this provision will not impede the MNB's ability to pay its contribution to the ECB's capital.

### **4. Establishment of the balance sheet and the decision on the payment of dividends**

The ECB notes the transfer of these functions from the shareholder to the Executive Board. The affirmative decision by the shareholder in Article 43(2) of the draft law leaves room for doubts over whether profit distribution decision will continue to be subject to the shareholder's resolution<sup>6</sup>. Hence, this provision in conjunction with Article 49(4) and Article 64 of the draft law should be clarified.

### **5. The number of Monetary Council members and decision-making**

- 5.1 Against the backdrop of constant changes in the composition of the MNB's decision-making bodies, the increase in the number of Monetary Council members, together with the possibility of increasing the number of deputy governors - without due justification for the need to amend the MNB's institutional framework - gives rise to concerns whether this could be used to influence the decision-making process to the detriment of central bank independence.

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<sup>5</sup> See CON/2007/14 and CON/2008/83.

<sup>6</sup> See also ECB Convergence Report May 2010, p. 249.

5.2 Apart from the prohibited employment relationships specified under the conflict of interest rules in the draft law, members of the Monetary Council may also have employment relationships other than their membership in the Monetary Council. The draft law provides that, following 1 January 2012, all decisions in connection with MNB tasks previously not taken by the Monetary Council will have to be discussed and decided by the Monetary Council. To provide for a smooth transition in the decision-making process, and to ensure the MNB's operational continuity, the ECB would welcome implementation of the changes in the decision-making process to ensure a smooth handover of decision-making to the Monetary Council. A transitional period would appropriately address this.

## **6. Governor's reporting obligations**

The Governor will be subject to an exceptional reporting obligation at the request of the Speaker of the Hungarian Parliament or the Chair of the Parliamentary Committee for Economic Affairs. The dialogue between national central banks (NCBs) and third parties, even when based on statutory obligations to provide information and exchange views, is compatible with central bank independence provided that:

- (i) it does not result in interference with the independence of the members of the NCB's decision-making bodies;
- (ii) the special status of Governors in their capacity as members of the ECB's General Council is fully respected; and
- (iii) confidentiality requirements resulting from the Statute of the European System of Central Banks and of the European Central Bank (hereinafter 'Statute of the ESCB') are observed<sup>7</sup>.

The ECB understands that such reporting respects the limits of central bank independence set out in the Convergence Report and that it will concern the MNB's activities and monetary policy. The ECB recommends clarifying in this sense the scope of the reporting.

The purpose of the obligation to forward the agenda of the meetings of the Executive Board to the Government<sup>8</sup> is unclear. The representative of the Government participates without voting rights in Monetary Council and not in Executive Board meetings. This obligation should be clarified to avoid the impression that the Government actively takes part in Executive Board decision-making.

## **7. MNB role in macroprudential supervision**

7.1 The ECB welcomes the MNB's new macroprudential mandate to identify, monitor and assess risks to financial stability and take on macroprudential policy in Hungary. Central banks are natural candidates to be assigned a formal macroprudential mandate, given the potential synergies with

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<sup>7</sup> See Convergence Report May 2010, p. 19.

<sup>8</sup> See Article 34(1) of the draft law.

traditional central bank functions relating to promoting financial stability. Furthermore, independence - which is an essential element in central banking - is also a necessary precondition for macroprudential supervision. However, the draft law should ensure that the MNB's macroprudential mandate does not interfere with the orderly fulfilment of its monetary policy mandate, in particular with its primary objective of maintaining price stability, and that it does not restrict the Eurosystem's contribution to the stability of the financial system under Article 127(5) of the Treaty.

- 7.2 The MNB needs to be equipped with tools and powers to efficiently fulfil the tasks attributed to it. In this respect, the ECB notes that the only tool mentioned in the draft law is the adoption of a decree by the Governor 'to prevent the build-up of system risks or reduce such risks in areas not regulated in law or government decrees'.
- 7.3 The ECB also notes that, as the general rules allow the MNB to collect data in the central banking information system, these provisions of the draft law would enable the MNB to collect data specifically in respect of its macroprudential mandate. In this respect, it is of crucial importance, if the MNB is to effectively fulfil its new macroprudential mandate, that it receives in a timely manner all necessary data and information, including information specific to supervised institutions, and that it may designate – in cooperation with the micro-prudential supervisor – systemically relevant financial structures and institutions.

## **8. Changes in the salary structure - financial and personal independence**

The ECB's Convergence Reports in 2008 and 2010, and several ECB opinions<sup>9</sup> on autonomy in staff matters, stressed that Member States may not impair an NCB's ability to recruit and retain the qualified staff necessary for the NCB to perform independently the tasks conferred on it by the Treaty, the Statute of the ESCB and national legislation. Furthermore, an NCB may not be put into a position where it has limited or no control over its staff, or where a Member State's government is in a position to influence the NCB's policy on staff matters.

To protect the MNB's autonomy in staff matters, in accordance with the principle of central bank independence under Article 130 of the Treaty, the Hungarian authorities must ensure that any amendment to the legislation on the remuneration of the MNB's staff is decided in close cooperation with the MNB, taking due account of the MNB's views<sup>10</sup> regarding the impact of such legislative amendments on its ongoing ability to carry out its tasks. The ECB notes that the recent amendments to the legislation on salaries of the members of the MNB's decision-making have been implemented without taking into account the above aspects of the MNB's financial independence addressed in previous opinions<sup>11</sup>.

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<sup>9</sup> ECB Opinions CON/2008/9, CON/2009/45, CON/2009/47, CON/2010/42, CON/2010/51 and CON/2010/56. All ECB opinions are available on the ECB's website at [www.ecb.europa.eu](http://www.ecb.europa.eu).

<sup>10</sup> See for example paragraph 4.3 of ECB Opinion CON/2010/42 and Opinion CON/2010/56.

<sup>11</sup> See CON/2010/56 and CON/2010/91.

Against this background, the MNB should be effectively involved in drawing up the relevant parts of the draft law so as to safeguard the principle of central bank independence.

## 9. Prohibition on monetary financing

- 9.1 The draft law aims to mirror Union provisions on the prohibition of monetary financing. It provides that Article 123 of the Treaty – having regard to Council Regulation (EC) No 3603/93 of 13 December 1993 specifying definitions for the application of the prohibitions referred to in Articles 104 and 104(b)(1) of the Treaty - is authoritative in MNB's financing of the public sector<sup>12</sup>. The ECB understands that this general provision seeks to state that Article 123 of the Treaty and Regulation (EC) No 3603/93 are applicable to the MNB, addressing some of the defects highlighted in the ECB's Convergence Report in relation to the prohibition on monetary financing<sup>13</sup>. The ECB welcomes these changes. However, in general, it is unnecessary to refer to Article 123 of the Treaty or Regulation (EC) No 3603/93 in national legislation as they are both directly applicable. If, nevertheless, national legislative provisions refer to them, they may not change the scope of application of the monetary financing prohibition<sup>14</sup>. Hence, the wording of Article 15 of the draft law must ensure that financing of the public sector is, as a rule, prohibited pursuant to Article 123 Treaty and Regulation No 3603/93.
- 9.2 The draft law<sup>15</sup> refers to activities to be carried out as an agent of the State. Article 21.2 of the Statute of the ESCB provides that the national central banks may act as fiscal agents. However, they should comply with the monetary financing prohibition, so that such services may not constitute central bank financing of public sector obligations vis-à-vis third parties or credit to the public sector, outside the narrowly defined exceptions specified in Regulation (EC) No 3603/93. Against this background, the ECB believes that the tasks assigned to the MNB under the draft law will be performed in compliance with the prohibition on monetary financing in Article 123 of the Treaty and Regulation (EC) No 3603/93.
- 9.3 The ECB understands that the draft law also refers to possible financing by the MNB of the national deposit guarantee scheme. The only compatible forms of central bank financing of deposit guarantee schemes are: (a) intraday credit in line with the general rules on provision of such credit by the central bank, and (b) short-term emergency liquidity financing under strict conditions established in the ECB's Convergence Reports, i.e. if such funding is short term, addresses urgent situations, systemic stability aspects are at stake and decisions are at the NCB's discretion. These conditions need to be listed in national law in the cases where emergency liquidity financing of the deposit guarantee system is foreseen by the national legal system. Article 13 of the draft law refers to the possibility for MNB to provide a loan to the National Deposit Insurance Fund, subject to the

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<sup>12</sup> See Article 15 of the draft law.

<sup>13</sup> See e.g. the ECB's Convergence Report of May 2010, pp. 249-250.

<sup>14</sup> See the ECB's Convergence Report of May 2010, p. 24.

<sup>15</sup> See in particular Articles 17 and 18 of the draft law.

prohibition on monetary financing, in urgent and exceptional cases that threaten the stability of the financial system as a whole, and the smooth completion of cash transactions, the due date of which loan may not be greater than three months. It is understood that these conditions are intended to ensure compliance with the monetary financing prohibition. In this respect, the condition that loans are granted at the full discretion of the MNB would in particular need to be included in the draft law. When exercising its discretion to grant a loan, the MNB has to ensure that by doing so it is *de facto* not taking over a State task. The ECB also notes that the issue of monetary financing compliance may require closer scrutiny in circumstances where the facilities are extended for more than one-and-a-half months. Moreover, it may be useful to specify that such loans are extended against adequate collateral, thus introducing an additional safeguard which should minimise the possibility of the MNB suffering any loss.

## 10. Central banking information system

The draft law<sup>16</sup> indicates that even without a request by the Hungarian Central Statistics Office (CSO) MNB is automatically obliged to hand over regularly all individual data available in its statistical information system to the CSO. This rule should be formulated more precisely to clarify that the MNB is only obliged to hand over individual data to the CSO on request. The ECB understands that the good practice of the exchange of data between the two institutions has been working well for several years and is already covered by the MNB Law currently in force.

The rules on code generation used for anonymised data need clarification. Article 21(6) and (13) of the draft law contains contradictory provisions on the deadline for the destruction of the linking codes used in handling anonymised data.

## 11. Compatibility with the Treaties and the Statute of the ESCB

### 11.1 *Personal independence - right of judicial review*

Pursuant to Article 46(12) of the draft law, an action may be brought before the Labour Court by a dismissed Monetary Council member in accordance with the Labour Code. Article 47(5) of the draft provides the same for the Governor. The ECB would welcome clarification that the Labour Court's jurisdiction under the draft law is without prejudice to that of the Court of Justice of the European Union under Article 14.2 of the Statute of the ESCB.

### 11.2 *Institutional independence*

Article 1 of the draft law specifies that the MNB, and members of its bodies, when executing their duties and fulfilling their obligations, should be independent, and may neither request nor take instructions from the Government, the Union institutions, bodies or offices, with the exception of

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<sup>16</sup> See Article 21(3) of the draft law.

the ECB, nor from other Member States' governments or any other organisation or political party. Full respect of central bank independence in Article 130 of the Treaty and Article 7 of the Statute of the ESCB requires a prohibition on government instructions to the central bank or any member of its decision-making bodies, as well as on seeking to influence the members of the MNB's decision-making bodies in the performance of their tasks. This should be clarified in the draft law.

## **12. The Governor's role as a member of the Budgetary Council**

The ECB considers that the provisions of the draft law governing the role of the MNB's Governor as a member of the Budgetary Council conflict with the provisions governing the operations of the Budgetary Council<sup>17</sup>. According to the draft law, the MNB's Governor represents the MNB for the budget proposal in the Budgetary Council, while the provisions governing the operations of the Budgetary Council require a distinction between the tasks fulfilled by the MNB's Governor acting as Governor and as a member of the Budgetary Council. Therefore, the draft law needs to be amended to avoid any conflict with the provisions of the law governing the operations of the Budgetary Council.

## **13. Legal integration of the MNB into the Eurosystem**

Hungary is a Member State with a derogation and must therefore comply with all adaptation requirements under the Treaty. The Hungarian authorities should take this opportunity offered by the recast to make the necessary adjustments to ensure the MNB's full integration into the Eurosystem when Hungary adopts the euro. The draft law should be adapted to comply with Article 127(1) of the Treaty by reflecting the central bank's secondary objective of supporting the general economic policies of the Union and its obligation to comply with the Eurosystem's regime on financial reporting of NCB operations. Similarly, express recognition of the ECB's powers in the fields of monetary policy and monetary policy instruments, collecting statistics, managing foreign reserves, payment systems, issuing banknotes, cooperating with international money institutions under Article 6 of the Statute of the ESCB, imposing sanctions, setting an exchange rate policy and appointing the MNB's auditors, including the powers of the Council of the European in this respect, would be necessary

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

Done at Frankfurt am Main, 14 December 2011.

[signed]

*The President of the ECB*

Mario DRAGHI

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<sup>17</sup> Law LXXV of 2008 on cost-efficient State management and fiscal responsibility.