EUROPEAN CENTRAL BANK

First assessment[1] of the new draft Law of the Bank of Israel against the requirements of legal independence as laid down in the Treaty establishing the European Community

1. Institutional independence

Institutional independence is a feature of central bank independence which is expressly referred to in Article 108[2] of the Treaty establishing the European Community (hereinafter referred to as "the Treaty") as reproduced in Article 7 of the Statute of the European System of Central Banks and the European Central Bank (hereinafter referred to as "the Statute"). These Articles prohibit the accession NCBs and members of their decision-making bodies from seeking or taking instructions from Community institutions or bodies, from any government of a Member State or from any other body. In addition, they also prohibit Community institutions and bodies and the governments of the Member States from seeking to influence the members of the decision-making bodies of the NCBs whose decisions may have an impact on the fulfilment by the NCBs of their ESCB-related tasks. Against this background, the ECB is of the opinion that the following rights of third parties are incompatible with the Treaty and/or the Statute and therefore require adaptation:

1.1 A right to give instructions

Rights of third parties to give instructions to NCBs, to their decision-making bodies or to its members are incompatible with the Treaty and the Statute as far as ESCB-related tasks are concerned.

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[1] The assessment has been made on the basis of an English translation of the Law of the Bank of Israel and of the proposed amendments.

[2] When exercising the powers and carrying out the tasks and duties conferred upon them by this Treaty and the Statute of the ESCB, neither the ECB, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Community institutions or bodies, from any government of a Member State or from any other body. The Community institutions and bodies and the governments of the Member States undertake to respect this principle and not to seek to influence the members of the decision-making bodies of the ECB or of the national central banks in the performance of their tasks.

- The discussions and decisions of the Monetary Council related to monetary operations are subordinated to the policy target as defined by the Government. According to new Section 20 (a) the Monetary Council shall discuss and decide on the monetary operations which the Bank should undertake in order to achieve **the policy targets determined by the Government** pursuant to Section 3[3]. Moreover, if the Government decides to change objectives and targets, **the Minister of Finance shall give written notice** thereof to the Governor, and these shall be used by the Monetary Council in its discussions.
- According to new Section 21 (c) the members of the Monetary Council shall not receive remuneration from the Bank for their services, but shall receive such remuneration from the Bank according to rules **set by the Minister of Finance**. It has to be ensured that the setting of rules for the remuneration is not used by the Minister of Finance as a tool to indirectly influence the activities of the members of the Monetary Council. Therefore, the remuneration should be established according to fixed and objective rules and should not be subject to any discretionary decisions.
- According to Section 62, the Bank is an inspected body, within its meaning in section 9 (6) of the State Comptroller Law. Due to a lack of knowledge of the provisions of the State Comptroller law a detailed assessment is not possible, in particular as regards the scope of the State Comptroller's activities. However, the following more general aspects are highlighted: An external auditor regime has to comply with the requirement of institutional independence. The guarantee of independence given by Article 108 of the Treaty in respect of the NCBs is a comprehensive one. It applies to the performance not only of the basic central bank tasks, as listed in Article 105(2) of the Treaty, but also to the whole range of duties resulting for the NCBs from the Treaty and the Statute of the ESCB. By appointing an external body with the exclusive power to audit the operations of the Bank and the implicit power to conduct corresponding investigations, the Bank and its decision-making bodies could be put in a position whereby they could be subject to external influence. The threatened or actual exercise of investigative powers would place the Bank and its decision-making bodies under pressure, which would be liable to impair the independence of decision-making required by Article 108 of the Treaty.

1.2 A right to approve, suspend, annul or defer decisions

Rights of third parties to approve, suspend, annul or defer decisions of NCBs are incompatible with the Treaty and the Statute as far as ESCB-related tasks are concerned.

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- According to Section 27 the amount of banknotes and coins to be issued and re-issued by the Bank requires the approval of the Government. The control of the amount of legal tender media in

[3] As regards the assessment of the new Section 3 see Chapter 4 "Functional independence and statutory objectives".

circulation is closely linked to the basic tasks of a central bank and, therefore, does not allow for any approval by a third party like the Government[4].

- According to Section 31 the Governor's decision on the face value, form, contents and other particulars of the currency note is subject to the approval of the Minister of Finance. As this is considered to be an ESCB-related task, this decision should be left for the Bank without any interference from the Government.
- According to Section 34, the Government shall, upon proposal of the Governor, make regulations for the withdrawal from circulation of spoilt or destroyed currency and for its replacement on conditions prescribed by regulation. As this is considered to be an ESCB-related task, this decision should be left for the Bank without any interference from the Government[5].
- There are other activities of the Bank which are also considered to be ESCB related tasks and which are subject to the approval of the Government like Section 39 (*power to borrow and to guarantee*), Section 47 (*issue of securities*), Section 49 (*regulation of the liquidity of banking coporations*). Therefore, any decision should be left for the Bank without any interference from the Government.[6]

1.3 A right to censor decisions on legal grounds

A right to censor, on legal grounds, decisions relating to the performance of ESCB-related tasks is incompatible with the Treaty and the Statute as the performance of these tasks may not be obstructed at a national level. This is not only an expression of central bank independence but also of the more general requirement of the integration of NCBs in the ESCB (see Section 4 below). A right of the Government to censor decisions on legal grounds and subsequently submit them to third parties for final decision would be equivalent to seeking instructions from third parties, which is incompatible with Article 108 of the Treaty.

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No provision seems to be incompatible.

1.4 A right to participate in decision-making bodies of an NCB with a right to vote

The participation of representatives of third parties in decision-making bodies of an NCB with a right to vote on matters concerning the exercise by the NCB of ESCB-related tasks, even if this vote is not decisive, is incompatible with the Treaty and the Statute.

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[4] The relevant provisions of the Treaty reads as follows: Article 106 (1) "The ECB shall have the exclusive right to authorise the issue of banknotes in the Community. … ."; Article 106 (2) "Member States may issue coins subject to approval by the ECB of the volume of the issue. … "; Article 16 of the Statute: "…. The ECB shall respect as far as possible existing practices regarding issue and design of banknotes."

[5] The corresponding rules applicable to euro banknotes are adopted by the ECB on the basis of Article 106 (1) of the Treaty

[6] It is understood that all activities which are governed by Part Ten of the Law are activities related to banking supervision.

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The new Law is silent on any participation of third parties in decision-making bodies of the Bank of Israel with a right to vote on matters concerning the exercise by the NCB of ESCB-related tasks.

1.5 A right to be consulted (ex ante) on an NCB's decision

An explicit statutory obligation for a NCB to consult third parties provides a formal mechanism to ensure that their views may influence the final decision and is therefore incompatible with the Treaty and the Statute.

However, dialogue between NCBs and third parties, even when based on statutory obligations to provide information and exchange views, is not incompatible with the Treaty and the Statute, provided that:

- this does not result in interference with the independence of the members of decision-making bodies of NCBs;
- the special status of a Governor in his/her capacity as a member of the General Council of the ECB is fully respected; and
- confidentiality requirements resulting from Statute provisions are observed.

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- According to new Section 24 the Monetary Council has to prepare a quarterly report to the Government on its activities. Such reporting does not only include details and analysis of the data, premises and forecasts according to which the monetary policy's planning was effected but also a presentation of the measures being undertaken to achieve the inflation target and other targets determined by the Government and the degree of compliance with such targets, and also, in the event of non-compliance with such targets - a plan of the actions which the Monetary Council intends taking in order to achieve the targets. Such comprehensive reporting on very specific future activities of the Monetary Council related to monetary policy could be seen as leading to a quasi ex-ante consultation of the Government which could be used by the latter to influence final decisions of the Monetary Council. This would be incompatible with the Treaty and the Statute.
- Section 25 (b) obliges the Bank to sent the minutes of the Monetary Council's discussions, without stating the speakers names, shortly after holding each session. It adds to the obligation as laid down in Section 25 (a) to report Monetary Council decisions - including grounds and explanatory notes of the monetary policy and all actions which have been decided - immediately after the meeting to the Minister of Finance The obligatory, immediate and regular sending of the minutes of the discussions could be misused as an instrument to influence decision-making of the Monetary Council. According

to Article 10.4 of the Statute, the proceedings of the meetings of the Governing Council shall be confidential. The Governing Council may decide to make the outcome of its deliberations public.

- Section 35 stipulates that in case the total amount of media of payments (currency in circulation, current account deposits with banking co-operations, excluding currency held by banking co-operations and current account deposits of the Government and of the banking co-operations) exceeds on a day fifteen per cent or more of the total amount of the media of payments which have been in existence at any time during the twelve months next preceding that day the Governor has to report to the Government and the Finance Committee of the Knesset and to present a proposal to the Government as to the steps to be taken. As this is considered to be an ESCB-related tasks, any decision should be taken by the Bank without an obligation for ex-ante consultation.

2. Personal independence

Central bank independence is further substantiated by the provisions of the Statute which provides for security of tenure for members of the ECB's decision-making bodies. Governors of accession NCBs will be members of the General Council of the ECB. Article 14.2 of the Statute[7] states that the statutes of NCBs shall, in particular, provide for a minimum term of office for a governor of five years. It also gives protection against the arbitrary dismissal of governors, by stating that a governors may be relieved from office only if he/she no longer fulfils the conditions required for the performance of his/her duties or if he/she has been guilty of serious misconduct, with the possibility of recourse to the European Court of Justice. The statutes of NCBs will need to be in conformity with this.

Against this background, the statutes of NCBs have to respect the following features of personal independence:

2.1 Minimum term of office for governors

The statutes of NCBs must, in accordance with Article 14.2 of the Statute, contain a minimum term of office for a Governor of five years. This, of course, does not preclude longer terms of office, whilst an indefinite term of office does not require the adaptation of statutes if the grounds for the dismissal of a Governor are in line with those of Article 14.2 of the Statute.

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[7] The statutes of the national central banks shall, in particular, provide that the term of office of a Governor of a national central bank shall be no less than five years. A Governor may be relieved from office only if he no longer fulfils the conditions required for the performance of his duties or if he has been guilty of serious misconduct. A decision to this effect may be referred to the Court of Justice by the Governor concerned or the Governing Council on grounds of infringement of this Treaty or of any rule of law relating to its application. Such proceedings shall be instituted within two months of the publication of the decision or of its notification to the plaintiff or, in the absence thereof, of the day on which it came to the knowledge of the latter, as the case may be.

According to Section 12 the Governor shall be appointed for a term of office of five years. This is compliant with the minimum term of office for governors of five years.

2.2 Grounds for dismissal of governors

NCBs' statutes must ensure that Governors may not be dismissed for reasons other than those mentioned in Article 14.2 of the Statute (i.e. no longer fulfilling the conditions required for the performance of his/her duties or being guilty of serious misconduct). The purpose of this requirement is to prevent the dismissal of a Governor from being at the discretion of the authorities involved in his/her appointment, particularly the government or parliament. The statutes of NCBs should contain grounds for dismissal which are compatible with those laid down in Article 14.2 of the Statute or should not mention any grounds for dismissal since Article 14.2 is directly applicable.

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Section 15 lists the grounds of dismissal for the Governor. These grounds of dismissal do not comply with the grounds of dismissal listed in Article 14.2 of the Statute. In particular, the wording "such disagreement exists between the Government and the functions of the bank defined in section 3, as in the opinion of the Government prevents efficient co-operation" or "he has done an act which in the opinion of the Government is unbecoming to his status as governor" leaves too much discretion to the government in deciding whether or not to terminate the term of office of the Governor.

2.3 Security of tenure of members of the decision-making bodies of NCBs involved in the performance of ESCB-related tasks other than the governors

Personal independence would be jeopardised if the same rules for the security of tenure of office of Governors were not also applied to other members of the decision-making bodies of NCBs involved in the performance of ESCB-related tasks. A requirement to confer comparable security of tenure follows from various Articles of the Treaty and Statute. Article 14.2 of the Statute does not restrict the security of tenure of office to Governors, whilst Article 108 of the Treaty and Article 7 of the Statute refer to "any members of decision-making bodies of NCBs" rather than "Governors". This applies in particular where a Governor is "primus inter pares" between colleagues with equivalent voting rights or where such other members may have to deputise for the Governor.

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- According to Section 12 the Deputy-Governor shall be appointed for a term of office of five years. This is compliant with the minimum term of office for governors of five years.
- According to new Section 21 (a) the other members of the Monetary Council shall be appointed for a term of office of four years. This does not comply with the minimum term of office of five years for the other members of the NCBs involved in the performance of ESCB-related tasks.

- Section 18 lists the grounds of dismissal for the Deputy-Governors. Like in the case of the Governor the grounds of dismissal do not comply with the grounds of dismissal listed in Article 14.2 of the Statute. In particular, the wording "he has done an act which in the opinion of the Government is unbecoming to his status as governor" leaves too much discretion to the government in deciding whether or not to terminate the term of office of the Deputy-Governor.
- The new Section 23 lists the grounds of dismissal for the other members of the Monetary Council. These grounds of dismissal do not comply with the grounds of dismissal listed in Article 14.2 of the Statute. In particular, the wording "the Council member is not performing his function pursuant to this law and the Council member has committed an act unbefitting his status as a Council member" leaves to much discretion to the government in deciding whether or not to terminate the term of office of the other members of the Monetary Council.

2.4 Right of judicial review

Limitation of political discretion in the evaluation of the grounds for dismissal warrants that members of decision-making bodies have a right to have any dismissal decision reviewed by an independent judicial court. Upon accession to the European Union, under Article 14.2 of the Statute such judicial authority will be the European Court of Justice as regards a dismissal of the Governors. It is recommended that the national law/central bank act should foresee a possible review by the national courts of the decision to dismiss any other member of the decision-making bodies of the national central bank.

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The new draft Law is silent on whether the Governor, the Deputy-Governors or any other member of the Monetary Council have a possibility to ask for a review by the national courts of the decision to dismiss him.

2.5 Safeguard against conflicts of interest

Personal independence also entails ensuring that no conflicts of interest arise between the duties of members of decision-making bodies of NCBs vis-à-vis their respective NCB (and of Governors, additionally, vis-à-vis the ECB) and any other functions which such members of decision-making bodies involved in the performance of ESCB-related tasks 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 which might create a conflict of interest. In particular, members of decision-making bodies shall not have an office or interest that may influence their activities whether as representatives of legislative bodies or governments or through office in the executive, whether at central or local level, or with a business organisation. In particular in case of non-executive members of decisions-making bodies care should be taken to prevent potential conflicts of interests.

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- Section 23 establishes rules on conflict of interests for the Governor and the Deputy Governors. This seems to be fine. It is understood that neither the Governor nor the Deputy Governors can be obliged by the Government to represent the Government in government-controlled company or carry out a function in a public institution or be appointed and act as member of a commission set up by the Government or the Knesset. It has to be taken care that any of these activities does not put the Governor or the Deputy-Governor in a position which is to close to the Government and which could cause of conflict with the primary objective of the Central Bank to maintain price stability.
- New Section 24 establishes rules on conflict of interests for the other members of the Monetary Council. Its Paragraph two leaves a lot of discretion as it simply states that a public member shall not be appointed to the Council who is a person whose engagements, positions or other affairs may create a conflict of interest with his office as a Council member. Based on the understanding that it is first of all for the three members of the public committee to ensure that the candidates as will be listed for possible appointment by the Government fulfil the requirements of new Section 24 (a) there seems to be no problem. In order to ensure a comprehensive coverage, it might be advisable to consider also possible cases of conflicts of interest where an other member of the Monetary Council have an office or interest as representative of a business organisation.

Additional comment: The Monetary Committee has been established as a collegiate body. All its members take shared responsibility for all decisions to be taken. Therefore, it might be useful that single rules on terms of office, grounds for dismissal and conflicts of interest apply to all members of the Monetary Council in an equal manner.

3. Financial independence

If an NCB is fully independent from an institutional point of view, but at the same time unable to avail itself autonomously of the appropriate economic means to fulfil its mandate, its overall independence would nevertheless be undermined. NCBs should be in a position to avail themselves of the appropriate means to ensure that their ESCB-related tasks can be properly fulfilled. An ex post review of an NCB's financial accounts may be regarded as a reflection of an NCB's accountability towards its owners provided that the NCB's statute contains adequate safeguards that such a review will not infringe its independence. Ex ante influence on an NCB's financial means may infringe an NCB's independence. In those countries where third parties and, particularly, the government and/or parliament are in a position, directly or indirectly, to exercise influence on the determination of an NCB's budget or the distribution of profit, the relevant statutory provisions should contain a safeguard clause to ensure that this does not impede the proper performance of the NCB's ESCB-related tasks. Objective and pre-set criteria for allocation of profits and losses and provisions imposing an obligation on the shareholders/owners of the NCBs to cover possible losses do not conflict with the requirement of financial independence. Submission

of draft NCB budgets to third parties for either approval or opinion would go beyond the boundaries of financial independence.

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No provision seems to be incompatible.

4. Functional independence and statutory objectives

Functional independence from a conceptual perspective means having with clarity and legal certainty a primary objective, to which any other activity or objective is subordinated, and for the achievement of which the necessary means and instruments are provided and can be applied by the central bank independent from any other authority. The requirement of the Treaty for central bank independence reflects the generally held view that the achievement of price stability is best served by an institution whose independence would be limited only by the need for transparency, dialogue with third parties and by a precise definition of its mandate. Therefore, Article 105 (1) of the Treaty stipulates that the primary objective of the ESCB[8] shall be to maintain price stability. Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Community with a view to contributing to the achievement of the price stability of the Community as laid down in Article 2[9]. The ESCB shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 4[10].

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New Section 3 (a) does not comply with the requirements of Article 105 (1) of the Treaty. First, the maintenance of price stability is not defined as an objective of the Central Bank but as an function of the Central Bank. Second, the maintenance of price stability is not defined as a primary objective which has

[8] European System of Central Banks which is composed of the ECB and the national central banks of the Member States.

[9] "The Community shall have as its task, by establishing a common market and an economic and monetary union and by implementing common policies or activities referred to in Articles 3 and 4, to promote throughout the Community a harmonious, balanced and sustainable development of economic activities, a high level of employment and of social protection, equality between men and women, sustainable and non-inflationary growth, a high degree of competitiveness and convergence of economic performance, a high level of protection and improvement of the quality of the environment, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among Member States."

[10] "1. For the purposes set out in Article 2, the activities of the Member States and the Community shall include, as provided in this Treaty and in accordance with the timetable set out therein, the adoption of an economic policy which is based on the close coordination of Member States' economic policies, on the internal market and on the definition of common objectives, and conducted in accordance with the principle of an open market economy with free competition.

2. Concurrently with the foregoing, and as provided in this Treaty and in accordance with the timetable and the procedures set out therein, these activities shall include the irrevocable fixing of exchange rates leading to the introduction of a single currency, the ECU, and the definition and conduct of a single monetary policy and exchange-rate policy the primary objective of both of which shall be to maintain price stability and, without prejudice to this objective, to support the general economic policies in the Community, in accordance with the principle of an open market economy with free competition.

3. These activities of the Member States and the Community shall entail compliance with the following guiding principles: stable prices, sound public finances and monetary conditions and a sustainable balance of payments."

priority over any other objectives like the support of the general economic policies of the Government. Third, a provision is missing according to which it is exclusively for the Central Bank as one of its basic tasks to define and implement the monetary policy.

Additional comment linked to independence in general: It might be advisable to add a general sentence in the draft Law which - like Article 108 of the Treaty - explicitly stipulates the independence of the Central Bank of Israel.

5. The prohibition of monetary financing and privileged access

In order to further strengthen the independence of the ECB and the national central banks of the Member States, the Treaty of Maastricht has established clear rules on the prohibition of monetary financing and privileged access. These rules are based on the understanding that the State should be prohibited form using the central bank in order to finance state activities and, thereby, putting at risk the primary objective of price stability. Therefore, in order to be consistent with ECB's norms and standards the rules on the prohibition of monetary financing and privileged access have to be taking into account. This note does not contain an assessment of Section 45 (*Loans to Government*) of the new draft Law of the Central Bank of Israel.

The rules are attached for information and read as follows:

The prohibition of monetary financing covers:

- credit facilities for public bodies with the ECB or NCBs; and
- the direct purchase of debt instruments from such bodies by the ECB or NCBs.

Article 101 (ex 104) of the Treaty, containing the prohibition of monetary financing, reads as follows:

1. Overdraft facilities or any other type of credit facility with the ECB or with the central banks of the Member States (hereinafter referred to as 'national central banks') in favour of Community institutions or bodies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the ECB or national central banks of debt instruments.

2. Paragraph 1 shall not apply to publicly owned credit institutions which, in the context of the supply of reserves by central banks, shall be given the same treatment by national central banks and the ECB as private credit institutions."

The prohibition of monetary financing has been further elaborated in Council Regulation (EC) No 3603/93 of 13 December 1993. This Council Regulation specifies definitions for the application of the above prohibition:

Overdraft facilities

Article 1, Section 1(a) of Council Regulation (EC) No. 3603/93 defines "overdraft facilities" as "any provision of funds to the public sector resulting or likely to result in a debit balance".

Other types of credit facilities

Article 1, Section 1(b) defines "other type of credit facility" as "any claim against the public sector existing at 1 January 1994, except for fixed-maturity claims acquired before that date[11]; any financing of the public sector's obligations vis-à-vis third parties; […] any transaction with the public sector resulting or likely to result in a claim against that sector".

i) Non-negotiable claims acquired before 31 December 1993 without fixed maturity

Article 1, Section 1(b)(i) of Council Regulation (EC) No. 3603/93 requires all outstanding claims of the central bank against the public sector to have a fixed maturity.

ii) Central bank claims against publicly owned credit institutions

Central bank claims against publicly owned credit institutions, i.e. credit institutions which are considered to be part of the public sector as defined in Article 3 of Council Regulation (EC) No. 3603/93[12] are in compliance with the prohibition of central bank financing of the public sector "in the context of the supply of reserves", provided that publicly owned credit institutions receive the same treatment by NCBs as do private credit institutions.

Purchases of debt instruments of the domestic public sector

Purchases of debt instruments of the public sector in the primary market are prohibited by Article 101 of the Treaty. However, in accordance with Article 1 (2) of Council Regulation (EC) No. 3603/93, securities may be acquired from the public sector to ensure the conversion into fixed maturity securities under market conditions of fixed maturity claims acquired before 1 January 1994 which are not negotiable at all or not under market conditions, provided that the maturity of the securities is not subsequent to that of the aforementioned claims.

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[11] The preamble to Council Regulation (EC) No. 3603/93 specifies that it is "desirable that the national central banks participating in the third stage of Economic and Monetary Union enter such a Union having on their balance sheets claims negotiable under market conditions".

[12] For example, in most countries the Postal Cheque Office is a credit institution forming part of the public sector.

The acquisition of debt instruments of the public sector in the secondary market is in compliance with the Treaty to the extent that purchases made on the secondary markets are not used to circumvent the objective of Treaty Article 101.

Purchases by the NCB of one Member State of marketable debt instruments issued by the public sector of another Member State

Article 2 (1) of Council Regulation (EC) No. 3603/93 reads as follows: "During Stage Two of EMU, purchases by the national central bank of one Member State of marketable debt instruments issued by the public sector of another Member State shall not be considered as direct purchases within the meaning of Article 104 of the Treaty, provided that such purchases are conducted for the sole purpose of managing foreign exchange reserves."

Intra-day credit facilities and provisions employed to avoid overnight credit

Article 4 of Council Regulation (EC) No. 3603/93 reads as follows: "Intra-day credits by the European Central Bank or the national banks to the public sector shall not be considered as a credit facility within the meaning of Article 104 of the Treaty, provided that they remain limited to the day and that no extension is possible".

Clearing of cheques issued by third parties for the public sector's account

Article 5 of Council Regulation No. 3603/93 reads as follows: "Where the European Central Bank or the national central banks receive from the public sector, for collection, cheques issued by third parties and credit the public sector's account before the drawee bank has been debited, this operation shall not be considered as a credit facility within the meaning of Article 104 of the Treaty, if a fixed period of time corresponding to the normal period for the collection of cheques by the central bank of the Member State concerned has elapsed since receipt of the cheque, provided that any float which may arise is exceptional, is of a small amount and averages out in the short term."

Central banks' holdings of coins

Article 6 of the Council Regulation (EC) No. 3603/93 provides that the "holding by the European Central Bank or the national central banks of coins issued by the public sector and credited to the public sector shall not be regarded as a credit facility within the meaning of Article 104 of the Treaty where the amount of these assets remains at less than 10% of the coins in circulation."

The prohibition of privileged access covers:

access to funds of financial institutions on non-market oriented conditions.

Article 102 (ex Article 104a) of the Treaty establishing the European Community, containing the prohibition of privileged access, reads as follows:

1. "Any measure, not based on prudential considerations, establishing privileged access by Community institutions or bodies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States to financial institutions, shall be prohibited.

2. The Council, acting in accordance with the procedure referred to in Article 252, shall, before 1 January 1994, specify definitions for the application of the prohibition referred to in paragraph 1".

The prohibition of privileged access has been elaborated in Council Regulation (EC) No 3604/93 of 13 December 1993. This Council Regulation specifies definitions for the application of the above prohibition. Several of such definitions are clarified below.

Article 1 (1) of the Council Regulation defines the measures mentioned in Article 102 as any law, regulation or any other binding legal instrument adopted in the exercise of public authority which obliges financial institutions to acquire or to hold liabilities of the public sector, or confers tax advantages which may benefit only financial institutions or financial advantages which do not comply with the principles of a market economy, in order to encourage the acquiring or the holding by those institutions of such liabilities.

According to Articles 3 (2) and 4 (2) of the Council Regulation, central banks shall, for the purpose of Treaty Article 102, neither be considered to form part of the public sector, nor to form part of the financial institutions. Nevertheless, according to Article 3 (2) of the Council Regulation, national central banks must not, as public authorities, take measures establishing privileged access within the meaning of Article 102 of the Treaty. In particular, the preamble to this Regulation states that "the rules on mobilisation or pledging of debt instruments enacted by the European Central Bank or by national central banks must not be used as a means of circumventing the prohibition of privileged access".
In this context, the following statement has been attached to the Regulation:

> "The Council and the Commission confirm that the following are not regarded as measures establishing privileged access: measures taken by national central banks or the European Central Bank which, in respect of the mobilisation or pledging of public sector debt instruments, provide for more favourable terms than those applying in the case of other debt instruments, on condition that the differences do not relate to the interest rate for providing liquidities under a given instrument of monetary policy and are justified

exclusively by differences in the solvency of the issuers or in the liquidity of the market of their debt instruments."