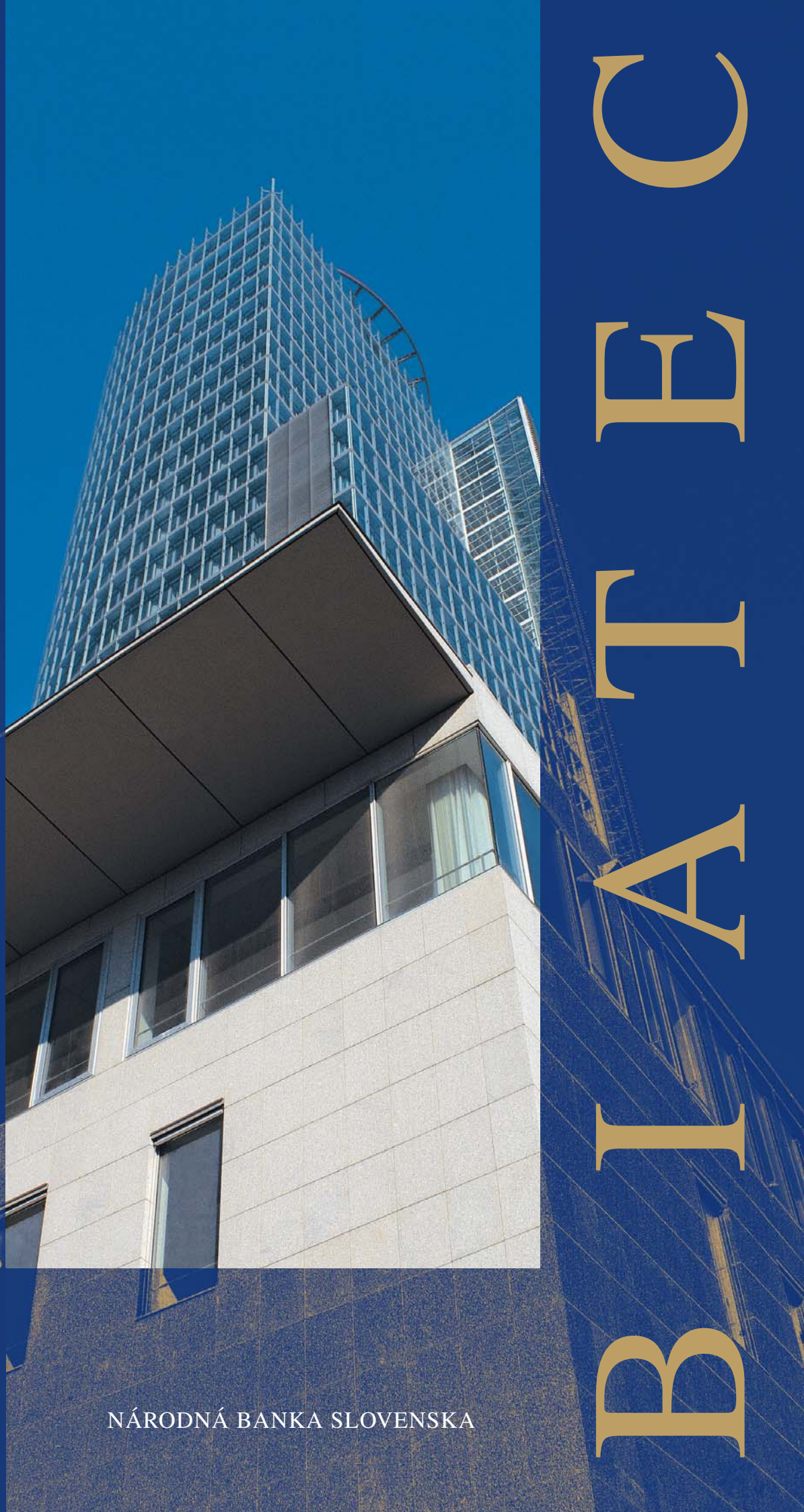


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NÁRODNÁ BANKA SLOVENSKA



# The single currency – instigator of economic and organizational changes



Photo: Pavel Kochan

*The then NBS Governor Ivan Šramko (left) and the European Central Bank President Jean-Claude Trichet standing together in 2008 at the handover of a symbolic star to mark the occasion of Slovakia's entry into the euro area.*

The European single currency has had a major impact on the functioning of the Slovak economy and has brought about several organizational changes in both the public sector and private enterprises. The preparations for the euro introduction were undoubtedly among the most important tasks faced by Národná banka Slovenska in recent years. Therefore this reflection – one of my last as Governor of the central bank – will relate mainly to the euro.

Before the euro was adopted in Slovakia, there were many indications that the advantages of introducing the currency in Slovakia far outweighed the drawbacks. As for the effect of the euro introduction on the Slovak economy, it is still too early to make an objective assessment. The experience

so far, however, confirms that the benefits of the single currency are gradually surpassing the costs borne by the whole society, and the efforts expended, in relation to its introduction. The benefit of the elimination of exchange rate risk was clearly seen even before the euro's adoption in Slovakia. When the currencies of surrounding countries weakened sharply against the euro, after recording trend appreciation over many years, the fact that the Slovak koruna was not adversely affected was thanks to its fixed conversion rate. The single monetary policy is bringing other advantages, too. Národná banka Slovenska no longer needs to monitor the nominal exchange rate and decide on whether to take any intervention measures. And in the event of turbulences, the





Slovak economy is not buffeted by fluctuations in regional sentiment.

The risk of a liquidity shortage in the banking sector has receded and Slovakia has the lowest government and corporate borrowing costs in the V4.

Before the euro introduction, several challenges related to this fundamental decision were being discussed. Among the most prominent was the favourable effect of a strengthening koruna on inflation in Slovakia and the subsequent sustainability of price stability following fixing of the exchange rate. Fears that the euro changeover would bring higher prices were not realized, as events in 2009 confirmed. While Slovakia did lose a possible advantage in the effect of a strengthening exchange rate on inflation, it is also true that the inflation rate is at the lowest level in our history. Another key challenge was the concern about a disproportionate rise in prices during the actual euro changeover. A comprehensive system of consumer protection helped keep the inflationary effect of the euro introduction low. The fact that we can now say the euro changeover went smoothly on the technical side is also due to the responsible approach that we took and to the professional way in which we dealt with the multitude of various tasks that the central bank was responsible for. The introduction of the single European currency in Slovakia can be considered as a great success.

Národná banka Slovenska played a crucial role in this process and contributed to its smoothness and success from the outset. After the Strategy of the Slovak Republic for the Adoption of the Euro was approved in 2003, and set economic policy on a course heading towards Slovakia's entry into the euro area, a number of other significant steps were taken. Among the most important of these were the production and adoption of the National Euro Changeover Plan for the Slovak Republic. The key precondition for the introduction of the euro was compliance with the Maastricht criteria. To meet all the Maastricht criteria represented a demanding task for a transition country, albeit

one where productivity growth was rising sharply and structural reforms were being implemented. This situation was reflected in the fact that the central parity had to be revalued twice while Slovak koruna was in ERM II.

By adopting the euro, Slovakia relinquished its independent monetary policy. The basic parameters are no longer set by the NBS Bank Board but by the ECB Governing Council. The NBS Governor, however, as a member of the Governing Council participates in the monetary policy decision-making for the whole euro area. In addition, many NBS staff are members of various committees and working groups through which they help to form the single monetary policy. Despite the various changes, the principal objective of monetary policy remains price stability.

Since 1 January 2009, NBS has been a member of the Eurosystem, the entity that decides on monetary policy, foreign exchange intervention, foreign currency reserves, the amount of currency in circulation, and international cooperation. NBS, for its part, executes market operations, makes foreign exchange interventions, manages foreign exchange reserves, issues euro banknotes and coins, and actively participates in international discussions.

The adoption of the single monetary policy has not diminished the importance of NBS. On the contrary, in the area of monetary policy it is no longer enough to address only domestic developments. For the central bank, as a full member of the Eurosystem, it is now just as important to address the external environment. The single monetary policy is bringing much more intensive and extensive cooperation with the ECB. Alongside monetary policy issues, we must not forget that the central bank fulfils many other important duties (most notably, it supervises the financial sector and operates the payment system). In these areas, too, the number and scope of tasks rose after the introduction of the euro.

*Ing. Ivan Šramko*

*Former Governor of Národná banka Slovenska*



Photo: Pavel Kochan

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## The central bank's position following the introduction of the euro

...as seen by a former member of the NBS Bank Board who was intensively involved in the single currency's introduction and who subsequently took part in meetings of the ECB Governing Council as the NBS Governor's alternate.



On 1 January 2009, the Slovak Republic became the 16th member of the euro area, after having met all the essential criteria. During the accession process, Národná banka Slovenska was responsible mainly for the criteria of price stability and exchange rate stability. In the final stage, the central bank was probably most visible in regard to the distribution of the new currency and the gradual withdrawal of Slovak korunas, but in addition it had to deal with a multitude of technical issues and details.

Following Slovakia's entry into the euro area, Národná banka Slovenska ceased to conduct an independent monetary policy. Today, instead, there is the European Central Bank setting a single monetary policy for all euro area countries. The NBS Governor is, of course, involved in the monetary policy decision-making for the whole euro area by virtue of his membership of the ECB Governing Council as from 1 January 2009.

Even before then, as part of the European System of Central Banks, we had been participating in the work of the ECB through its existing committees and their working groups, which relate to almost all the activities of Národná banka Slovenska. In the wake of euro area entry, the work of NBS in these committees and working groups became still more intensive.

The entry per se did not mean that, for example, analysis of the Slovak macroeconomic situation receded into the background – NBS continues to devote attention to the development of macroeconomic indicators in Slovakia. The entry has, however, made increasing demands on NBS in regard to monitoring economic development in both individual euro area countries and the euro area as a whole. Based on the analyses of economic developments in Slovakia, the central bank is now producing summary reports on economic developments in Slovakia.

NBS carries out tasks to the same extent as it did before also in the areas of currency circulation management, payment systems operation, and payment systems supervision. Meanwhile, its financial market supervision activities have intensified. As for the management of foreign exchange reserves, Národná banka Slovenska now manages also a proportion of the ECB's reserves.

Since the central bank's core activities have remained largely unchanged or even been extended – whether in monetary policy, statistics, domestic and foreign payments, management of foreign exchange reserves, issuance of banknotes and coins

(currency circulation management), or, of course, in financial market supervision – the so-called service departments are equally necessary, whether they concern administration housekeeping management, information support, legislation, accounting, defence and protection. Likewise, the training and management of human resources has had to be maintained.

Nevertheless, a certain reorganization of Národná banka Slovenska may and must be carried out, and its first stage began already in 2009. Each reorganization, however, has its limits, given that the tasks of NBS in some areas are now more extensive than they were in the past. Reorganization is expected to mean rationalization, while the view that the entire NBS or some of its departments is or are redundant – sometimes discussed at an inappropriate level in the media – is highly distorting and incorrect. A central bank is an integral institutional structure of all advanced countries and almost all of its activities are unsubstitutable.

The changes arising after 1 January 2009 mean new challenges not only for Národná banka Slovenska. As regards how to influence the domestic economy following euro area entry – with NBS having relinquished its independent monetary policy for Slovakia and become jointly responsible for the entire Eurosystem's monetary policy – greater emphasis needs to be placed on financial discipline in the area of fiscal policy. So as to avoid disequilibria emerging in the economy, it will be necessary in future to achieve a balanced general government budget, or a budget surplus. Support for labour availability and mobility will also be required. This should help to dampen any excessive demand-side pressures and their impact on higher inflation, since interest rates will be set for the whole monetary area, i.e. in a "one-size-fits-all" approach.

I am convinced that Národná banka Slovenska has exceptional human and institutional capital at its disposal and that, just as in the past, NBS will ensure the smooth performance of the tasks entrusted to it by law while at the same time being a worthy representative of Slovakia both within the European System of Central Banks and at other international fora.

To the bank and all its staff, I wish every success for the future.

*Ing. Peter Ševčovic*  
Executive Director for the monetary area  
Národná banka Slovenska



# Does the Monetary Policy Department's name need to be reviewed, or its existence justified, following Slovakia's entry into euro area?

Ing. Renáta Konečná  
Národná banka Slovenska

*The answer to this question is not as clear as it may appear at first sight. In the area of monetary policy, the introduction of the euro automatically means that the national central bank loses the capacity to influence the domestic economy by applying standard tools, such as the level of interest rates or the exchange rate. At the same time, it means relinquishing the original, independent (or national) monetary policy and therefore also giving up certain activities related to the conduct of monetary policy.*

In practice, the loss of national monetary policy meant that the Monetary Policy Department ceased drafting proposals for the NBS Bank Board as the basis for interest rate decisions, and also stopped providing a commentary on the set level of NBS rates (known as "Rationale behind the decision of the Bank Board of the NBS on the set levels of the NBS interest rates"). Therefore, current (and also expected) macroeconomic developments, especially the trajectory of inflation, are no longer evaluated in relation to a predetermined target. It was also necessary to change the cyclical ("gap") model that had hitherto been used and was focused on an active monetary policy in an inflation targeting regime.<sup>1</sup> With a dimension of national monetary policy having been relinquished, the scope of the NBS Monthly Bulletin was reduced.

Another activity rendered redundant was monitoring of the exchange rate, which included analyzing of its macroeconomic impacts and proposing possible responses from the central bank. As regards the nominal exchange rate, Slovakia is no longer in the position of being a small open economy, since approximately 90% of its exports and 70% of its imports are now denominated in euros, i.e. in the domestic currency.

Although these activities ceased after euro area entry, they represented only a tiny part of the overall activities of the Monetary Policy Department ("MPD"). Just like many uninvolved laymen and professionals, we expected that after the several years of intensive preparations for the introduction of the single currency, focused on producing various analyses, questionnaires and documents for the missions from the European Commission and the ECB, the pace of work would

ease up considerably and some duties would become obsolete. But during 2008, and especially the second half of the year, our colleagues from euro area central banks gradually disabused us of this notion.

After a year of working within the "club" of countries that use the single currency, we have to say those colleagues were right. The few activities that the MPD was relieved of have more than been made up by supplementary activities that were and are related to the country's full membership of the euro area. They concern a number of areas, namely: monetary policy, analysis, forecasting and statistics.

## MONETARY POLICY AND ANALYSIS

The NBS Governor began participating in the twice a month meetings of the ECB's Governing Council (its purpose being to discuss and decide on monetary policy and other ECB matters in relation to the euro area), in addition to his established attendance at meetings of the ECB's General Council (which meets four times a year and serves as a forum for the exchange of opinions between the central bank governors of the 27 EU Member States). This required the MPD to carry out more in-depth monitoring and analysis of developments in the international economic environment, especially the euro area, which serve for the drafting of the NBS Governor's opinion on materials discussed by the Governing Council (which for a single meeting range in length from around 50 to 300 pages), including presentation proposals.

In addition, the objective of ensuring that NBS is fully represented in monetary-policy matters of

<sup>1</sup> Gavura, M. and Reľovský, B.: A simple model of the transmission mechanism of Slovakia's economy, its structure and properties. *Biatic*, Volume 13, no. 4/2005, Národná banka Slovenska.





2 The process of creating a medium-term forecast at the NBS and the basic features of the current forecast MTF – 2009Q2. *Biatec*, Volume 17, no. 7/2009, Národná banka Slovenska.

3 Reľovský, B. and Široká, J.: A structural model of the Slovak economy. *Biatec*, Volume 17, no. 7/2009, Národná banka Slovenska.

4 AWM – Area-wide model; see Fagan, G., Henry, G. and Mestre, R.: An area-wide model (AWM) for the euro area. ECB Working Paper No 42, January 2001, European Central Bank.

the Eurosystem requires that the level of monitoring and analysis previously applied to the domestic economy now be applied to the euro area economy. A detailed analysis of the global economy is produced on a quarterly basis, and reports and analyses of current developments in the external macroeconomic environment are included in macroeconomic monthly reports. The scope of analyses of the international economy may today be divided into three areas: global economic developments along with commodity markets, the economic situation in the region (the Czech Republic, Poland, Hungary), and economic developments in the euro area. In the case of the euro area, emphasis is also placed on the monitoring of major economies (e.g. Germany).

For this purpose, it was necessary to establish a comprehensive monitoring and analytical system and to specify key activities in regard to the international economy.

Thus, following the euro area entry, analyses of the international environment and of both current and expected economic developments in euro area became a key basis for the NBS Governor's regular involvement and presentations in respect of all economic and monetary policy matters of the euro area. Monetary policy therefore continued to be covered by Národná banka Slovenska, the difference being that its focus was not any more Slovakia's economy, but the broader setting of effective monetary policy for the euro area. In addition to monetary policy commentaries, the MPD participates through its work (whether proactively or in the context of comment proceedings and professional discussions) in the preparation of a full range of analytical materials within the Eurosystem. In the area of teaching activities, we contribute within the remit of our competence to the training of Eurosystem staff.

## FORECASTING

As a result of Slovakia joining the euro area, Národná banka Slovenska participates in all Eurosystem activities and processes. This includes its involvement in the preparation of the joint euro area forecast. Twice a year, all Eurosystem central bank contribute to the production of the "Eurosystem staff macroeconomic projections for the euro area". Before euro area entry, the MPD produced a medium-term forecast on a quarterly basis. After entry, it was necessary in the case of the June and December forecasts to adjust to the ECB's forecasting process by making organizational and technical changes. This meant in practice that over the course of six weeks it was necessary to update the medium-term forecast three times on average, i.e. to attend three times the full number of internal meetings for the baseline forecast and for the short-term and medium-term versions. During this period the national central banks communicate with the ECB and an intensive exchange of information takes place. Staff of the national central banks also meet at the ECB headquarters (in so-called working groups) in or-

der to discuss common assumptions, present national forecasts, compare their forecasts with the ECB's projection, consult over various problematic issues, and seek solutions. This change meant the MPD had to alter its internal forecasting process by making it longer, broader (within the scope of the projected variables) and more intensive, in order to formulate the text or "story" of the forecast and to seek arguments for comparison within the Eurosystem forecasting process. Our success in handling this task is confirmed by the interest shown by certain central banks, both inside and outside the euro area, in seeing a presentation of our prediction process and the internal arrangement of relations within the MPD.

As regards analytical tools, in the area of macroeconomic forecasting it was necessary to construct econometric tools that make possible full compliance with requirements under the Eurosystem's common projection process. That is why NBS has since the euro adoption date been using a new model apparatus – a structural model<sup>3</sup> of a small open economy, which replaced the gap model that had been used up to then and had been focused on an active monetary policy in an inflation targeting regime. The new NBS model may be summed up as a standard econometric model of medium size, based on a synthesis of the AWM<sup>4</sup> model used by the ECB. The new model is used to cover two basic groups of needs arising from this membership, but also domestic requirements. It is used for *forecasting purposes* (twice a year the process of producing the medium-term forecast for the Slovak economy is included in the Eurosystem forecasting process, and twice a year the model is used to prepare the central bank's internal forecast), and it covers *analytical needs* (the model is used for simulations of monetary-policy, fiscal, price or demand shocks, whether in the scope of ECB analyses focused on the whole euro area or analyses concerning only the domestic economy).

As for current trends in macroeconomic modeling, it should be noted that, taking the forward-looking view, the new model represents a stepping stone on the way to the construction of comprehensive model of the Slovak economy based on macroeconomic fundamentals. In future, the central bank's model apparatus used for the above-mentioned purposes is expected to be extended by the inclusion of the so-called Dynamic Stochastic General Equilibrium (DSGE) model.

In the area of econometric modeling and economic research, Národná banka Slovenska, through members of its MPD staff, engages in active cooperation within the ECB's Working Group on Econometric Modelling (WGEM). This cooperation supports the sharing of knowledge in this area, work on common projects, and the more effective construction of internal analytical tools. It is the central banks of small economies that benefit most from this cooperation, since it allows them to draw on the know-how in this area



and more efficiently keep pace with economic research. Another example of cooperation was the consultation with ECB analysts during the design of the above-mentioned structural model.

In addition to these changes in the model forecasting apparatus, directed and used mainly for the medium-term horizon, it was necessary to adjust, establish or amend the forecasting tools used also for the short-term forecast. The original tools were modified for the use of seasonally-adjusted data, and several new models were created, including simple single-equation models and multi-equation models that used both quarterly and monthly indicators for forecasting. Apart from that, there was an increase in requirements not only for the scope of projected variables, but also for the coordination of the forecasting process (harmonization of the data publishing schedule, ESCB forecasting deadlines, and forecasting processes) and the process became more time consuming.

As regards changes in individual projected and analysed variables, the MPD switched to the forecasting of seasonally adjusted time series and changed the focus from year-on-year to quarter-on-quarter. This resulted in the creation of entirely new short-term models and relations and a need to become familiar with the reading of the forecast in regard to the development of individual components from quarter to quarter.

## STATISTICS

After Slovakia joined the euro area, it was necessary to extend the scope of the statistical data that are transmitted and fall within the competence of the MPD, and particularly in the area of balance of payments. The ECB uses Slovakia's balance of payments data when compiling the euro area's balance of payments, which is used for regular monitoring of monetary conditions across the euro area, for analyzing factors affecting financial markets, and for analyzing the development of the M3 monetary aggregate, which is an important indicator in respect of the ECB's monetary policy. It was for these reasons that, after euro area entry, Národná banka Slovenska through the MPD started to transmit (in addition to the „national“ balance of payments that it was already sending) a monthly balance of payments and quarterly statistics for the international investment position vis-à-vis non-euro area countries – in accordance with the change in how non-residents are viewed, and their breakdown into “intra-euro area” and “extra-euro area”, which for the ECB is an important distinction with regard to the relationship between the euro area and the rest of the world. Furthermore, NBS also began transmitting

the quarterly balance of payments and the annual international investment position vis-à-vis selected non-euro area countries representing the euro area's most significant economic partners (16 countries in total), as well as stock and transaction data on the currency structure of debt securities. Satisfying these new ECB requirements necessitated substantial changes in the compilation system for the balance of payments statistics and represented a sharp increase in activities related to the collection and processing of data and to the checking of the required statistics.

## SUMMARY

In general, it may be said that monetary policy (and the functioning of the MPD) need to be viewed in terms of extending monitoring and producing analyses for the whole euro area, so as to adopt appropriate standpoints and present opinions regarding the conduct of the common monetary policy through the ECB. Also no less significant than it was before the euro area entry is the detailed monitoring, analyzing and forecasting of the Slovak economy's development, including supplementary statistical requirements. In all these areas, joining the euro area increased demands on both the scope and quality of activities performed by the MPD.

Amid the loss of the autonomous monetary policy and the exchange rate, the MPD will continue to monitor real variables, i.e. real effective exchange rate as well as interest rates and they impact on the domestic economy, and to extend to a relatively considerable degree the focus on structural policies analysis, above all in the area of labour market and competitiveness of the Slovak economy in the context of the single currency, as well as fiscal development and its sustainability. It is such analyses of these areas, in a country without an autonomous monetary policy, that will be most important, since fiscal policy (in the broadest sense) will represent the most significant and sole channel for preventing the emergence of disequilibria and supporting long-term and sound growth.

In conclusion, it should be noted that the primary aim of this article was to give a broad overview of what joining the euro area meant for one NBS department in terms of reducing or extending its duties. Clearly there has been an intensification of many activities that must be taken in all euro area countries. In this regard, our task, and at the same time objective, is to provide an independent view of current and expected developments in the euro area under the monetary policy decision-making process of the ECB's Governing Council.





# Conduct and change of monetary policy following the euro adoption

Ing. Peter Andresič  
Národná banka Slovenska

*The adoption of the euro and entry of Národná banka Slovenska into the euro area entailed several changes to the assignment and conduct of monetary policy. Most of the changes were not immediately obvious to the general public, since, in contrast to the introduction of euro banknotes, there was no tangible evidence for their occurrence. Nevertheless, these changes were a prerequisite for Slovakia joining the group of countries that use the single currency, as well as for NBS's active participation in the setting and actual conduct of eurozone monetary policy. In this article, we want to focus mainly on those changes that relate directly to the implementation of monetary policy. To better illustrate the context and the changes carried out, we will, however, also remind ourselves of the period leading up to Slovakia's inclusion in the euro area.*

*1 It should be noted that the full range of NBS's options in this area included also other types of operations, such as direct selling or buying of securities, though these trading activities were not used after 2000. The monetary policy tools also included "fine-tuning operations" executed through quick tenders, but NBS has never employed this form of money market intervention.*

## CONDUCT OF MONETARY POLICY UP TO THE END OF 2008

Up to the end of 2008, Národná banka Slovenska was the autonomous monetary authority for Slovakia, and, as such, it implemented the country's monetary policy. This meant that it adopted decisions on monetary policy – particularly on the setting of interest rates – and also carried out all practical procedures in this regard, including the execution of transactions to ensure that the decisions taken were implemented in practice.

Before Slovakia joined the euro area, its banking sector had a substantial liquidity surplus. In this situation, NBS monetary operations were aimed at absorbing surplus liquidity from the market. This sterilisation was effected mainly in two ways, the principal one being the standard 14-day repo tender held on a weekly basis. Auctions of NBS bills served as the second, supplementary method of draining surplus koruna funds from the banking sector, and they were usually held once a month. When the auctions were first employed, the bills were issued with varying maturities, but later the maturity became established at three months. In the event of demand for this longer-term method of sterilization, there would be three issues of NBS bills in the market. The repo tender, as the main monetary operation, and the issuance of NBS bills, as the supplementary operation, were carried out by using the "American" auction method to satisfy demand. Both of these operations were conducted as part of the so-called open market operations and, figuratively speaking, represented the first array of monetary policy tools.<sup>1</sup>

The second array comprised "standing facilities", which unlike open market operations were executed at the request of individual commercial banks. The difference between these operations and open market operations was that each bank

could use them to fine-tune its own liquidity position, either through liquidity-absorbing or liquidity-providing transactions. These transactions had an overnight maturity. Liquidity-providing transactions were limited only by the amount of collateralizable assets in the commercial bank's account, and liquidity-absorbing transactions were not subject to any volume limits. At the same time, the interest rates on overnight transactions set a notional interval for the movement of the shortest money-market rates. The main monetary policy rate, however, was the limit rate for standard weekly tenders. This rate was also applied as the limit rate for satisfied bids in auctions of NBS bills. The interest rate levels were set or reassessed by the NBS Bank Board at its regular monthly meetings.

Participation in these operations was open to all banks, or branches of foreign banks, that had their registered office in Slovakia. As a precondition of participation, it was necessary to satisfy technical and organizational requisites for ensuring the successful execution and settlement of the agreed transactions, as well as to enter into agreements with the NBS concerning the respective transactions.

When listing monetary instruments, it is also necessary to take a closer look at the minimum reserve system and, in particular, at how minimum reserves are assessed. In the Slovak financial market the length of the maintenance period for the application of minimum reserve requirements was the same as the length of the current month, and the actual amount of specified reserves was compared with the average balance over the maintenance period.

Credit operations collateralized, or secured, with the assets of commercial banks were employed only sporadically before eurozone entry, owing



to the overall liquidity surplus that prevailed in the sector. The only eligible collateral used for liquidity-providing operations were government securities, Treasury bills and NBS bills. Overnight liquidity-providing operations were conducted in the form of repo transactions, as were, of course, standard repo tenders. These transactions were executed on the basis of agreements on repo transactions, or, more specifically, on credit operations secured using the repo technique. It is important to note in this regard that each instance of borrowing (or lending, looked at the other way) was collateralized with specific securities that the counterparties – NBS and the commercial bank – had to agree upon precisely. The trading hours for overnight transactions were based on the cycle of the domestic payment system, which in effect meant that banks could initiate the final liquidity-providing or liquidity-absorbing transactions so that they would be settled before 13:30 on a business day.

Standard repo tenders had a fixed cycle, from their announcement to actual execution. On the first day of the week, banks would be informed about the tender; on Tuesday the tender, i.e. the process of submitting, evaluating and accepting bids, would be held, and on Wednesday the transactions were settled. The procedure for issuing Treasury bills was the same, except that it began on Wednesday. In the event that any of these days was a non-business day, the schedule would be shifted accordingly. In the case of both tenders, the deadline for submitting bids was 11:00 on the tender date. The amount of bids satisfied, i.e. the level of interest rates, was solely a decision of the NBS Bank Board. In the case of NBS bills, the decision-making authority was delegated to a member of the NBS Bank Board. The documents referred to in the decision-making process included, inter alia, a summary of the current situation in the domestic financial market, as well as foreign markets, and a forecast for the development of liquidity flows produced in the form of a liquidity table. All other circumstances being equal, the NBS Bank Board would satisfy the full volume of bids in standard tenders. Only in the event of sharp fluctuations in the money market and especially in the foreign exchange market would it consider not satisfying the full volume of bids (known as “reducing the demand”). In the case of NBS bills, the Bank Board reduced the demand so that the amount of bills issued did not exceed 30% of the total amount of liquidity absorbed. On the technical side, the transactions were executed either through the Reuters system or by telephone. NBS announced open market operations, and published their results, both on its website and also through the Reuters system.

As has already been noted, the decision-making process was preceded by analytical work through which the market situation was mapped. In order to improve monitoring of ongoing processes, NBS established a group of panel banks comprising the banks that were the most active participants

in the interbank money market (the so-called “reference banks”). At periodic and, depending on the current situation, also at extraordinary meetings, NBS and this panel banks came together to analyse the current situation in the market. These meetings were also opportunities to discuss technical or organizational procedures relating to the conduct of monetary policy operations. The main purpose of this group of market makers, however, was to participate in the establishing of the money market rates fixing. Domestic market rates represented one of the main qualitative indicators, reflecting not only the current situation, but also expected developments. In this way, the panel banks supported key monetary policy impulses as well as the NBS Bank Board’s operational decision-making. On the other hand, the movement of market rates and the spread between them gave NBS valuable feedback on its key rate-setting decisions and operational decisions to reduce demand in tenders.

#### **CONDUCT OF MONETARY POLICY SINCE JANUARY 2009**

As regards practical implications for the conduct of monetary policy, the most important change brought about by Slovakia’s inclusion in the euro area is that Národná banka Slovenska simultaneously became an organizational part of a greater unit – the Eurosystem, comprising the ECB and the national central banks of all euro area countries. Since the single currency requires a single monetary policy, NBS’s decision-making process was shifted to the ECB, meaning that NBS relinquished its hitherto monetary autonomy. NBS now contributes to the euro area’s decision-making process through the NBS governor, who as a member of the ECB’s Governing Council may submit proposals and vote on monetary policy decisions for the whole euro area. In votes of the Governing Council, the vote of the NBS governor carries the same weight as that of any other NCB governor. Put simply, the decision-making process has been moved from Bratislava to Frankfurt am Main, and the role of the NBS Bank Board in this process has been taken over by the ECB’s Governing Council.

Active participation in the ECB’s decision-making process demands not only knowledge of the situation in Slovakia, but also a detailed overview of developments in the euro area as a whole. Furthermore, it is necessary to monitor the external economic environment that influences the situation and developments in the euro area. As well as covering general processes applicable across the euro area, monitoring and analytical activities related to the drafting of documents must, if the situation requires, focus on the specific problems of individual countries. The meeting of the ECB’s Governing Council is usually held twice a month, while its decision on interest rates is, in ordinary circumstances, taken only once during the reserve maintenance period. The meeting at which rates for the next reserve maintenance period are



decided is held in the week before the end of the current period. A press conference announcing the result of the meeting is held at 13:45 on the Thursday of the respective week and is followed at 14:30 by the ECB President's press conference. The new interest rates apply from the beginning of the next period, i.e. as of the Wednesday of the following week. This schedule is not arbitrary, but is in fact is part of an effort to reduce or eliminate speculative behaviour in banks' liquidity-providing transactions, which arises from expectations of changes to main interest rates.

This brings us to the central part of our topic – the changes in the conduct of monetary policy itself. The first change that the banking sector had to adjust to was the length of the reserve maintenance period, which we have already touched on. The ECB has throughout its existence applied a maintenance period that is not identical to the current calendar month. The original point of this arrangement was to set the maintenance period in such a way that the period ends would not be exposed to large or difficult to predict fluctuations in liquidity. With calendar-month maintenance periods, it was the precisely the last days of the month that were exposed to such an effect. In this situation, it was difficult to estimate the quantity of funds that the sector needed in order to comfortably meet the minimum reserve requirements.

A major change for the whole banking sector was the extending of business hours for the processing of payment orders with a same-day value date. This change was a consequence of the Slovak banking sector joining the single payment system TARGET2. Since the operational hours of the TARGET2 system differ markedly from those of the payment system used before eurozone entry, the time for entering into interbank transactions, as well as transactions with NBS, has shifted too. The latest that a bank can enter into liquidity-providing or liquidity-absorbing transactions with a same-day value date is 18:15, or 18:30 on the last day of a reserve maintenance period. Besides the longer business day hours, another substantial change is the fact that TARGET2 operational days largely ignore national holidays. Over the whole year, not counting weekends, TARGET2 is non-operational for no more than six days. In practice, this means that a bank in Slovakia and a bank in another country can execute a transaction even if the day in question is a national holiday in one of the countries, just as if it were an ordinary business day (except if the day is one of the six non-operational days defined in TARGET2 system). What this means for Národná banka Slovenska is that it must provide for the execution of standard monetary policy operations on holidays, too.

In regard to open market operations there has been a major systemic change. The tools of the Eurosystem are geared mainly towards supplying liquidity, and their structure is largely the same as the structure of the tools that NBS used to employ, except that these focused primarily on

supplying funds. The principal Eurosystem tool is the liquidity-providing tender held on a regular weekly basis. Compared with the NBS tender, the maturity of the standard tender is only half as long – seven days. The shorter maturity is related to the previously mentioned efforts of the ECB to eliminate speculative behaviour among banks. The implementation schedule and sequence of steps are the same as those that NBS applied, and the technical side of the operation execution is also identical. An obvious change is that the ECB is the primary initiator of the operation and its results. NBS may announce by the same means all the particulars of the respective operation, but only after they have been published by the ECB.

Longer-term refinancing operations (LTROs) are supplementary and commonly used open market operations. In normal circumstances, these operations are executed through a tender held at the end of each month and they have a maturity of three months. In 2009, however, there were also LTROs with maturities of six months, twelve months, and a maturity corresponding to the reserve maintenance period, as well as additional three-month operations. This activity of the Eurosystem is a response to the current situation in the market, but even though these operations account for more than 90% of the funds borrowed by the banking sector, the weekly tender continues to have the position of a main refinancing operation.

When Slovakia joined the euro area, its banking sector as a whole was reporting a substantial liquidity surplus (approximately SKK 400 billion) and thus the participation of Slovak banks in liquidity-providing tenders during the first months after entry was confined to verifying the technical procedures related to them. Since then, however, the participation of domestic banks in these tenders has become more firmly established and can now be described as relatively regular.

Fine-tuning operations are also used by the Eurosystem as part of its active open market transactions. Ordinarily, the tenders for these operations are held when there are substantial imbalances in the money market that will subsequently be reflected in a change in the overnight interest rate. The form of the tender depends on the specific circumstances in the market and may therefore have a liquidity-absorbing or liquidity-providing character. At present, this type of transaction is regularly used towards the end of the reserve maintenance period. Every fine-tuning operation executed last year had a liquidity-absorbing character, and domestic banks participated in all of them.

In addition to these operations, the Eurosystem may, as the situation dictates, execute other operations from its array of tools. These include, for example, individual intervention operations involving the buying of securities or the issue of Treasury bills, a familiar occurrence in Slovakia. Insofar as the Eurosystem used these supplementen-





tary operations during the course of last year, it executed swap operations in Swiss francs and US dollars. Furthermore, in the context of providing assistance or coordinating steps with other central banks, the Eurosystem may arrange other operations too, as for example the foreign currency liquidity-providing operations that were also executed during the course of last year.

As a member of the Eurosystem, Národná banka Slovenska is involved in all of these operations. Indeed, the overall number of open market operations in which it was involved increased markedly in 2009 in comparison with the previous year. The number of participants did not change substantially, and, assuming standard conditions, every bank in Slovakia that meets the required technical and organizational criteria and has entered into the respective agreements may continue to participate in them. In a change to the Eurosystem's customary procedure under which participation in fine-tuning operations was restricted to a selected group of banks, access to the tenders for these operations was opened at the end of 2008 also to other banks, which thus became eligible counterparties for monetary policy operations. As a result, the group of potential participants in standard and fine-tuning operations is currently identical. Although only intended to be temporary, this step has brought positive results that make its permanent implementation a strong probability. There have also been changes in regard to standing facilities. Commercial banks can now access the overnight deposit facility simply by crediting funds to the respective account. The existing "Standing Facilities" module in the TARGET2 system will then ensure that both the principal and the respective interest are remitted back to the depositor's account. Access to the marginal lending facility also takes place automatically in the case where a bank has an outstanding intraday credit at the end of the day. Only a requested overnight liquidity-providing transaction is executed as a business transaction. At present, as in the previous period, individual transactions are executed either through the Reuters system or on the basis of recorded telephone conversations.

Since the conduct of monetary policy in the euro area is based on supplying liquidity to the banking sector, there have also been changes concerning collateralization of credit operations carried out by the central bank. The collaterals that NBS accepts for monetary operations and also for intraday credit are no longer restricted to domestic government securities, and now extend to a full range of domestic and foreign assets, including government securities, corporate bonds and even asset-backed securities or loans of commercial banks. The use of such a wide range of foreign collaterals by the domestic banking sector, or the reciprocal use of domestic eligible assets by foreign banks, places greater organizational

and logistical demands on the individual national central banks, as well as on the respective securities depositories (in Slovakia's case, Centrálny depozitár cenných papierov). Furthermore, national central banks are required, at a bank's request, to include eligible collateral registered abroad among the collaterals with which a monetary operation or intraday credit should be covered. For banks participating in these operations there has also been a significant change in the form or method of collateralizing credit operations. Whereas in the previous period, open market operations would involve repo transactions in particular securities, they now involve so-called pooling, whereby credit operations are collateralized by a group of any eligible assets whose value matches that of the credit. Among other advantages, this means that, where necessary, collateral assets can be replaced almost immediately by other assets simply by depositing the new collaterals in the pool account. This simpler, and at the same time more progressive, form of collateralization has been quickly and smoothly embraced by the domestic banking sector.

After years of experience of monetary policy implementation in the Eurosystem, we believe that a similar conclusion may be drawn in respect of most of the changes made. This is probably supported also by the fact that well before eurozone entry, NBS was endeavouring to apply monetary policy procedures relatively similar to those used by the Eurosystem. At the same time, NBS placed considerable emphasis on preparing the banking sector and held several meetings with participants in monetary policy operations to present the changes that awaited them. Even so, certain problems have arisen, and in regard to technical and organizational procedures there is scope for the optimization of existing procedures – while, of course, preserving the existing system and structure of tools. Today, as in the past, NBS is open to initiatives from the banking sector.

In the end, there is one more change which, though not immediately related to the conduct of monetary policy, did come about with the adoption of the euro currency. For domestic banks, entry into the Eurosystem opened up the opportunity to transact in the incomparably larger euro market with any other bank in the euro area. Thus domestic banks are not restricted to transacting with a relatively narrow group of local partners or competitors. On the other hand, the expiry of the Slovak koruna money market did away with the need for its listing. This spelt the end of the role of domestic market reference banks, and, at the same time, NBS lost an important channel of information about money market developments. The efforts to know about and understand what is happening in the market are now linked with much greater endeavours in regard to the collection, evaluation and analysis of data that is European, not just Slovak, in scope.



# Consistency in the communication policy of Eurosystem central banks

Eva Karasová  
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*At the European Central Bank (ECB), the task of harmonizing and coordinating the communication policies of the European Union's central banks lies with the Eurosystem/ ESCB Communications Committee (ECCO). Its meetings are attended by managerial staff from the national central banks' communication departments and they are held in either one of two compositions: the standard Eurosystem composition, in which only Eurosystem central banks are represented, or the extended ESCB composition, which includes also representatives of NCBs of countries that have not yet adopted the euro. ECCO has a relatively broad mandate that includes: asserting the single voice principle in regard to communication about the euro area's single monetary policy; communicating decisions of the ECB Governing Council; publication activities; financial education; information campaigns; delivering information about the Eurosystem's tasks and objectives; and improving online communication activities.*

Upon Slovakia joining the euro area, Národná banka Slovenska became a member of the Eurosystem, which comprises the ECB and the central banks of countries that have introduced the single euro currency. NBS ceased to conduct an independent monetary policy as from 1 January 2009, when the Slovak koruna was replaced by the euro. Monetary policy decisions in the euro area are taken by the ECB Governing Council, comprising the governors of the NCBs of the euro area countries and the six members of the ECB Executive Board. The NBS Governor is therefore an active participant in its decision-making. The most important decisions of the Governing Council are those relating to interest rates, which are adopted usually once a month.

## COMMUNICATION PRINCIPLES

The response of NBS to joining the Eurosystem has also been seen in the area of communication. A new communication strategy for the period 2009 to 2011 was produced, covering the crucial area of communication about the Eurosystem's monetary policy decisions.

Alongside the principles of openness, transparency and credibility which the central bank has been observing since its establishment, there has been added the new principle of a single voice. In essence, it means that the ECB and euro area central banks are to follow a consistent communication policy in regard to the interpretation and clarification of monetary policy decisions of the ECB Governing Council. After the Governing Council takes its decision on interest rates at its

first meeting of each month, the decision is announced in an introductory statement of the ECB President given at a press conference.

At this press conference, the ECB President explains the grounds of the decision, including the economic analysis, monetary analysis, and assessment of fiscal policies and structural reforms in euro area countries. After presenting the reasons behind the decision on key rates, which can have an immediate impact on euro exchange rates or market interest rates, the ECB President fields questions from journalists. The ECB sends each Eurosystem central bank a press release on the monetary policy decision, translated into its national language, for publication. NBS publishes this press release in Slovak on its website. A live webcast of the ECB President's presentation, and indeed the whole press conference, is also provided by the ECB. Národná banka Slovenska publishes the Slovak version of the ECB President's introductory statement on its website one week after the press conference as part of a monthly ECB bulletin, and it publishes the English version as soon as the publication embargo is lifted.

The single-voice principle is applied also in the forecasting activities of euro area central banks.

National contributions regarding the monthly monetary aggregates of the euro area should not be published by the central banks before they have been published by the ECB and they should not differ from the ECB's data.

ECB produces four forecasts at quarterly intervals. Two of the forecasts (June and December) are produced with the participation of all Euro-



system central banks. Each month, NBS independently produces a Summary Report on Economic Development, containing an analysis of economic developments in the euro area.

As for the regular NBS publications, they include the Annual Report, Financial Stability Report, Analysis of the Slovak Financial Sector, Monthly Bulletin (Summary Report on Economic Development) and Slovak language versions of official ECB publications.

Another communication-related task (and one of the priorities) that NBS took on when Slovakia joined the euro area is to support the financial education of the public in those areas falling within the competence of the central bank and the Eurosystem. In 2009, the ECB for the first time included Slovakia in its surveys of knowledge about central banking issues among euro area citizens. The results were compiled into a summary report for the whole of the euro area.

In order to ensure that communication activities concerning financial education are properly directed, Národná banka Slovenska conducted a representative, high-quality survey in 2009, the first such survey that it had ever undertaken for this purpose. The aim was to establish what the public in Slovakia knew about the positions, roles and competences of NBS and the ECB, about monetary policy and about the Eurosystem. Based on the survey results, NBS began to focus information and publication activities on those topics that people are insufficiently informed about. The target groups in this regard are principally the general public and secondary school students. Furthermore, in line with a 2009 decision of the ECB Governing Council, the communication policies of central banks are to be targeted over the long term on those sections of society hardest hit by the financial crisis. In its delivery of financial education, NBS utilizes various communication channels and tools – press conferences, specialist publications, brochures, leaflets, videos, lectures, exhibitions, open days, the internet, and so on. This year, in cooperation with the ECB and the Bank of Finland, we will enhance our communication tools by providing for the first time on the NBS website electronic games and quizzes focused on education in central banking matters. This tool will help Slovak secondary-school students to prepare for a knowledge competition on central banking that will be open to secondary schools across the euro area. The competition is

being prepared by the ECB in cooperation with the euro area central banks.

In the area of the internet, too, Národná banka Slovenska has been harmonizing its communication policy with the Eurosystem. During 2008, NBS implemented a project to produce a new website that complies with minimum ESCB standards for the operation of central bank websites, and the result was launched on 1 January 2009. This new concept of the NBS website involved importing the legacy website's entire content into a content management system (CMS), fundamentally changing the site's structure, graphics and navigation, optimizing the browser, introducing new modules, and so on. Altogether it was an unprecedented project in terms of execution time, content, and technical level. The website reconstruction was carried out over a period of one year, in fact, over the same length of time that was spent on the communication campaign for the introduction of the euro in Slovakia and by the same department that conducted this campaign. The improvement in the website's development and content was recognized also by the ECB working group that brings together website experts from the euro area central banks.

#### COMMUNICATION ABOUT THE EURO

During the euro adoption period, Národná banka Slovenská had charge of two nationwide committees for the introduction of the euro, one of which was responsible for the communication campaign in the Slovak Republic. This responsibility required the central bank to cooperate very closely with the ECB in regard to the communication campaign for the introduction of the euro in Slovakia. This cooperation continues today, as evidenced by the preparations for a communication campaign for the launch of the new series of euro banknotes (ES2).

Comparing the NBS communication policy prior to and after the central bank's inclusion in the Eurosystem, it may be said that the continuity of principles has been maintained. The scope of NBS communication activity increased in the wake of euro area entry and was improved by the addition of new tools and activities, such as international competitions, financial quizzes, and games focused on financial education in the area of central banking. In the area of communication policy, NBS has successfully, and to the enhancement of its policy, identified itself with the Eurosystem.





# NBS tasks related to the work of ECB decision-making bodies

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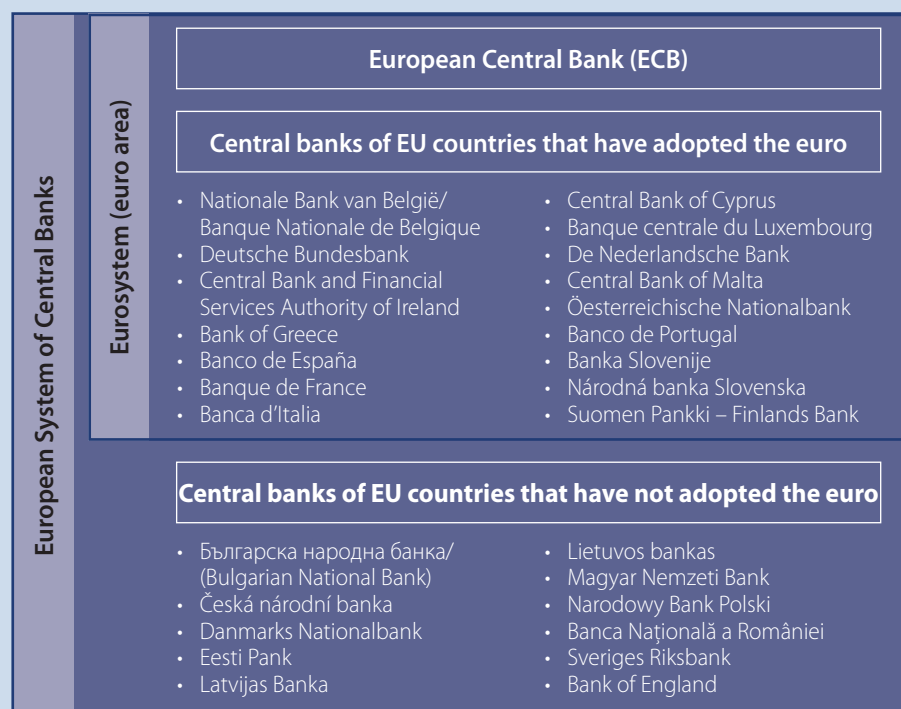
*A year has already passed since 1 January 2009, when Národná banka Slovenska joined the Eurosystem and the NBS Governor became a member of the Governing Council of the European Central Bank. The Governor's new position entails also new tasks for the whole institution, its expert departments and individual staff. Work related to the Eurosystem is now an everyday part of the activities of Národná banka Slovenska.*

Until recently, the term "Eurosystem" was not explicitly mentioned in the Treaty establishing the European Community. Only after the Lisbon Treaty entered into force did the term "Eurosystem" appear in the Treaty on the Functioning of the European Union, specifically in Section 6 (devoted to the ECB), Article 282. The Eurosystem is the system of central banks of countries whose currency is the euro, and its task is to conduct the monetary policy of the European Union.

The Eurosystem functions on the principle of decentralization. The key role in the Eurosystem and in the European System of Central Banks (ESCB) is played by the ECB. The decision-making

bodies of the ECB take decisions that contribute to the fulfilment of the tasks of the Eurosystem and the ESCB. These bodies are the Governing Council, the Executive Board, and the General Council. In fulfilling its tasks in the appropriate scope, the ECB refers to the central banks of the Eurosystem and ESCB. This allows it to act on the basis of the central banks' many years of experience and to make use of their expert knowledge, capacities, infrastructure and contacts. As regards NBS's inclusion in the Eurosystem, the new position of the NBS Governor on the ECB Governing Council is certainly the most important development.

## EUROPEAN SYSTEM OF CENTRAL BANKS





## GOVERNING COUNCIL

The Governing Council consists of the governors of the national central banks of the euro area countries, plus all six members of the Executive Board. The Governing Council adopts the guidelines and takes the decisions necessary to ensure the performance of the tasks entrusted to the Eurosystem, which are in particular:

- to define and implement the monetary policy of the European Union;
- to conduct foreign-exchange operations;
- to hold and manage the official foreign reserves of Member States;
- to promote the smooth operation of payment systems.

Each member of the Governing Council has one vote, and decisions of the Governing Council are taken by a simple majority vote of its members. For decisions on selected issues concerning the Rules of Procedure, the use of different monetary policy instruments, or the inconsistency of an NCB's activities with the tasks of the Eurosystem, the approval of two thirds of the members is required. For decisions on the ECB's capital, foreign exchange reserves, allocation of monetary income and the distribution of net profit (loss), the votes are weighted according to the NCBs' shares in the subscribed capital of the ECB<sup>1</sup>. The weights of the votes of the members of the Executive Board are zero. Such decisions are adopted if the votes cast in favour represent at least two thirds of the subscribed capital of the ECB and represent at least half of the shareholders.

Meetings of the Governing Council are usually held every two weeks, i.e. twice a month. The schedule for these meetings is published on the ECB's website at least one year in advance.

The first meeting of the month is usually held on the first Thursday of the respective month. This meeting is of particular interest to market participants since it is at this first meeting that the decision on key interest rates is taken. This decision is always announced at a subsequent press conference held on the premises of the ECB at 14:30. The press conference is held by the ECB President, Jean-Claude Trichet, who announces the decision of the Governing Council in his introductory statement. After his statement, journalists are given the opportunity to ask questions. The ECB President's introductory statement and the text of the Governing Council's monetary policy decision is at the same time published on the ECB's website.

As part of the preparations for meeting of the Governing Council, working materials are distributed to its members in advance. For the first meeting of the month, these comprise mainly analyses of macroeconomic and financial market developments. Four times a year, in January, April, September and December, the ECB in cooperation with the Monetary Policy Committee submits to the Governing Council broad macroeconomic projections in which it forecasts economic and inflation developments in the euro area. Twice a year, these projections are produced by the ECB's

experts and twice a year by the Eurosystem's experts. The projections give added weight to these four meetings of the Governing Council, and the conclusions that come out of them are published on the ECB website. They also featured in a separate part or box of the ECB's Monthly Bulletin, which in these months is translated into the Slovak language and is also published on the NBS website.

Usually two weeks after its first meeting in a given month, the Governing Council holds a second meeting at which it takes decisions other than rate-setting decisions. The meeting agenda includes a broad range of issues related to the Eurosystem's tasks, for example questions concerning payment systems, financial market operations, the implementation of monetary policy tools, Eurosystem projects, ECB publications, and so on. Normally the second meeting is not followed by a press conference.

The preparatory work for Governing Council meetings is well illustrated by the example of the Eurosystem macroeconomic projections, which are produced in June and December. The process of preparing these projections takes place at several levels. In addition to collecting source data and transmitting them to the ECB in the stipulated format, NBS specialist departments participate in the setting of models, the conduct of analyses, and the production of both partial and complete projections. The resulting projection data are finalized by the Working Group on Forecasting, composed of experts from the ECB and Eurosystem central banks (including NBS) and in the fields of macroeconomics and econometrics. This group reports to the Monetary Policy Committee, which is responsible for the final version of the projections. The Committee is made up of senior staff from Eurosystem central banks, NBS being represented at the level of executive directors and heads of departments. After being approved by the Committee, the macroeconomic projections are included in the agenda of the Governing Council's meeting and are distributed as a working material to members of the Governing Council, including the NBS Governor. At Národná banka Slovenska, an independent opinion is prepared for the Governor, and the Governor holds a briefing (including space for discussion) with most of the experts who took part in the projection preparations, whether on the Monetary Policy Committee or in its working groups. A similar process of preparation attends all of the agenda items of the Governing Council meeting.

## EXECUTIVE BOARD

Another decision-making body is the Executive Board, which comprises the President, the Vice-President and four other members. Each of the six members is appointed for an eight-year term of office that is not renewable. The Executive Board primarily manages the internal business of the ECB, implements monetary policy in accordance with the guidelines specified by the Gov-

<sup>1</sup> The EU national central banks are the sole holders of the capital of the ECB. The subscription of the capital is based on a key in which each NCB is assigned a weighting equal to the sum of 50% of the share of its respective Member State in the total population of the EU and 50% of the share of its respective Member State in the gross domestic product of the EU. The subscribed capital currently stands at €5 760 652 402.58, and NBS's share at 0.6934%.



erning Council, performs tasks delegated to it by the Governing Council, and prepares Governing Council meetings. In practice, this means that the Executive Board draws up the agenda for Governing Council meetings, arranges the discussion materials for each item of the meeting's agenda, and distributes these materials to Governing Council members, either directly at the meeting, or by written proceedings.

### GENERAL COUNCIL

The third decision-making body of the ECB is the General Council. The NBS Governor became a member of the General Council when Slovakia joined the European Union, but he did not become a member of the Governing Council until Slovakia adopted the euro. His membership of the General Council continues.

The existence of the General Council relates to the fact that not all EU Member States have adopted the euro yet. It can therefore be regarded as a transitional body. Its tasks largely pertain to the exchange rate mechanism ERM II, i.e. the system in which EU Member States prepare for the introduction of the euro. The General Council draws up convergence reports on the economies of EU Member States that have not adopted the euro and contributes to the fixing of the exchange rate in the euro adoption process. It also performs tasks in regard to the collection of statistical data and promotes cooperation between the central banks.

The General Council comprises the President and Vice-President of the ECB and the governors of the national central banks of all EU Member States, which means that it currently has 29 members. The General Council meets four times a year and its meetings are usually tied in with a second monthly meeting of the Governing Council. The General Council is significant mainly for countries that have not yet adopted the euro, since it is the forum in which the convergence of their economies is evaluated. It is also the only forum in which the governors of these countries periodically meet the governors of the euro area countries, and the President and Vice-President of the ECB.

### NBS TASKS RELATED TO THE ACTIVITIES OF ECB DECISION-MAKING BODIES

Last year, from 1 January, the governor's membership of the ECB Governing Council and ECB General Council entailed attendance at 22 meetings of the former and four meetings of the latter. The number of materials processed rose more than threefold, and the scope and complexity of

the materials sent from the ECB was greater than ever.

This has made it necessary, on one hand, to have in place organizational arrangements for handling the preparations for Governing Council meetings, and, on the other hand, to ensure that NBS specialist departments, when preparing opinions for Governing Council meetings, take the view not just of Slovakia, but of the Eurosystem too.

In order to highlight the importance of preparations for the meetings of the ECB's Governing Council and General Council, and to ensure all necessary materials for the NBS Governor, Národná banka Slovenska has established the ECB Coordination Section.

The ECB Coordination Section of NBS cooperates closely with the ECB secretariat that submits materials approved by the Executive Board for further approval or discussion by members of the Governing Council or General Council. In both cases, the ECB Coordination Section ensures that NBS receives the materials. It also requests the relevant specialist departments to produce opinions on them, organizes briefings, finalizes materials and opinions in a file for the Governor, and performs further tasks supporting NBS's involvement in the Eurosystem's decision-making process.

Through the ECB Coordination Section, three kinds of materials are distributed within Národná banka Slovenska. The key item is the above-mentioned working materials for meetings of the Governing Council and General Council. In the next category come written proceedings, i.e. materials approved by circular or through consultation in respect of legal acts. The third group comprises various documents containing information for members of the Governing Council and General Council.

Following the transfer of monetary competences from NBS to the ECB, it may seem that working processes in the NBS have been reduced as a result of the euro area entry. In fact, the contrary is true. As a full member of the Eurosystem, NBS is involved in the process of preparing monetary policy decisions for the euro area, and their implementation, and therefore its view is now pan-European and not focused just on Slovakia (which it was until 31 December 2008). The same is true also for other activities that NBS is now performing as a result of its membership of the Eurosystem.

After a year of Eurosystem membership, NBS may be said to have coped with all the challenges posed in this regard and to have become an established component of the Eurosystem.





# Legal framework for the euro introduction – observations after a year

JUDr. Štefan Hrčka  
Národná banka Slovenska

*The first crucial year since the introduction of the euro in Slovakia has already passed. During that time, Slovakia was expected to carry out and fulfil most of the regulatory activities and tasks related to the changeover from its original national currency, the Slovak koruna, to the euro currency. Now, after an appropriate space of time, we can already attempt to make a few observations of an informative, and partially also evaluational, nature regarding the Slovak legal framework for ensuring this changeover. The principal law in this regard is Act no. 659/2007 Coll. on the Introduction of the Euro Currency in the Slovak Republic as amended, which forms the backbone of the Slovak legal framework for the euro conversion and which goes by the short title of the Umbrella Act on the Euro<sup>1</sup>.*

Given that the euro changeover in Slovakia went exceptionally smoothly and efficiently without any systemic problems – a view confirmed by various opinion polls as well as by evaluations from both Slovak and European institutions – it is possible to begin, so to say, from the end by stating the consensus opinion that Slovakia's legal framework for the euro conversion was sound, was prepared in good time, and made a significant contribution to ensuring that the changeover took place without any hitches. In this area, however, I believe there is still scope for various observations, discussed to a greater or lesser degree, on Slovakia's Umbrella Act on the Euro, which includes amendments to 28 different laws, notably an amendment to the Act on Národná banka Slovenska.

## THE DRAFTING OF THE UMBRELLA ACT ON THE EURO

The drafting, scope and discussion of the Umbrella Act on the Euro was no simple matter and ranked among the most demanding in the history of Slovakia's legislative process. I have mentioned at some point that the drafting of the first comprehensive working version of the Umbrella Act took me almost six full weeks at the beginning of 2007. Some may demur that six weeks is not such a long time to spend producing a draft law. However, the gathering of the first partial documents for the drafting of the legislation on the euro introduction in Slovakia began long before the drafting process actually started. In fact, it dated back to the first Convergence Reports produced after the accession of the Slovak Republic to the European Union. Furthermore, the draft Umbrella Act on the Euro underwent the

most demanding and most comprehensive legislative process.

The draft Umbrella Act was first of all discussed in detail at the Národná banka Slovenska and the Slovak Ministry of Finance as well as in the interdepartmental working committees for the euro introduction (especially the Working Committee for Legislation). The draft Umbrella Act was also subjected to what up to that time had been the most extensive interdepartmental comments process ever undertaken. As part of this process, more than 50 different institutions and entities either were invited to express an opinion on the draft law or gave an opinion at their own initiative. The draft Umbrella Act was subsequently discussed by the Slovak Government's Legislative Council, and also underwent a thorough review by both the European Commission and European Central Bank<sup>2</sup>. In due course, the draft law was discussed and approved by the Slovak Government, then it underwent scrutiny by committees of the Slovak parliament (in this case, the bill was reviewed by every one of the committees, something that had previously happened only for the draft Constitution of the Slovak Republic), and, finally, it was approved by the Slovak parliament. Of the 137 MPs who took part in the vote, 136 voted for the bill and none against. The compatibility of Slovak legislation (including the approved Umbrella Act, signed by the Slovak President) with European law was eventually affirmed by the European Commission and the European Central Bank in the Convergence Reports of May 2008, as well as by the European Council when it gave Slovakia the green light to adopt the euro as from 1 January 2009.

<sup>1</sup> The moniker 'umbrella' is used in regard to the object of the Act, namely to establish a precise and general – i.e. umbrella – legal framework for ensuring the smooth and efficient changeover from the Slovak currency to the euro.

<sup>2</sup> The consultation of the ECB lasted for more than five months, and the ECB's lawyers unofficially regarded it as among the three most demanding consultations on draft legislations that the ECB had undertaken up to that time.



<sup>3</sup> For example, the Belgian law served as the basis for the enactment of the Slovak provision under which reserve funds or non-distributable funds of companies, cooperatives and other legal entities may exceptionally be used in the upward rounding of nominal values (to the nearest euro) as part of the redenomination from Slovak korunas to euros, of the nominal value of contributions to capital (including shares) and of the registered capital of business organisations or cooperatives, the ordinary shares of state-owned enterprises, the endowment capital of foundations, and other similar capital of other legal entities.

<sup>4</sup> In Slovenia, by comparison, the Dual Display of Prices Act was promulgated in November 2005 and dual display began (still not according to the conversion rate) in March 2006. As for Slovenia's Umbrella Act on Euro Adoption, it entered into force in October 2006 and the euro changeover took place at the beginning of January 2007.

<sup>5</sup> In particular, its decisions in the case of the consumer association Verbraucher-Zentrale Hamburg and in the Estager case.

<sup>6</sup> Including the par or nominal values of different assets as well as rates and amounts of taxes and fees.

### THE SLOVAK UMBRELLA ACT AND LEGISLATION OF OTHER EURO AREA COUNTRIES

Since Slovakia was not the first country to introduce the euro, its Umbrella Act was of course to some extent based on the respective umbrella acts of the other EU Member States that had adopted the euro and joined the euro area before Slovakia<sup>3</sup>.

The Slovak Umbrella Act on the Euro is, however, far more extensive and detailed than the umbrella law of any of the other EU Member State that adopted the euro before Slovakia. There are several reasons for this, one being the knowledge of how "framework" (or less detailed) legal regulations in Slovakia are quite often interpreted, applied and, above all, circumvented – a situation which, partly due to the slowness of judicial proceedings for law enforcement, may be summed up somewhat mockingly by the maxim "Na Slovensku je to tak" ("That's how it is in Slovakia"). It is precisely because of this negative experience, that Slovakia's Umbrella Act on the Euro was conceived and drafted as a very detailed law. This seemed appropriate in order to minimise the risk of the law being circumvented or ignored during the preparations for the changeover from the Slovak koruna to the euro and when the changeover actually took place.

Another difference between Slovakia and the other euro area countries is that the Slovak Umbrella Act contains the entire underlying statutory regulation of preparations for the euro introduction and the euro changeover, including the statutory regulation of dual display. In several other euro area countries, by contrast, the statutory regulation of dual display is covered by a separate law. One positive difference between the situation in Slovakia and other euro area countries is that the Slovak Umbrella Act (which includes a key amendment to the Act on Národná banka Slovenska) was approved and promulgated more than one year prior to the euro introduction and almost eight months before the start of the dual display of prices – an achievement not matched in any of the other EU Member States that adopted the euro before Slovakia<sup>4</sup>.

Slovakia can also take pride in certain successes during the consultations of the draft Umbrella Act with the European Central Bank and European Commission. The ECB, for its part, officially accepted that, in the case of Slovakia, the exchange of original national banknotes (Slovak banknotes) for euro banknotes in commercial banks could take place a full year after the euro introduction (whereas in previous consultations, the ECB had accepted a period of six months at most). In another first for Slovakia, the European Commission officially accepted that Národná banka Slovenska could, in exceptional circumstances and under strictly stipulated conditions, grant the Deposit Protection Fund and Investment Guarantee Fund (i.e. the institutions guaranteeing bank deposits and customer assets) a short-term loan to cover a

possible urgent and unforeseen need for liquidity. These successes of Slovakia in consultations with EU institutions over the Umbrella Act may in future be used by other EU Member States, if they so wish, when drafting legislation on the euro changeover.

### TAKING INTO ACCOUNT THE EU COURT OF JUSTICE'S CASE LAW CONCERNING THE EURO

The drafting of Slovakia's Umbrella Act also benefited from the fact that account could be taken of the latest case law of the Court of Justice of the European Union concerning the changeover from an original national currency to the euro. The key parts of this case law were established in the years 2004 and 2007 (and to a lesser extent in 2008), in other words only when most of the countries that adopted the euro before Slovakia were not, for time reasons, able to take them into account.

For example, it was primarily based on the EU Court of Justice's euro-related case law<sup>5</sup>, and partially also on the EU's legal framework for the euro, that the Slovak Umbrella Act expressly enacted (in Section 2) the underlying principles and rules for the euro preparations and changeover, which had to be applied in all relations concerned with preparations for the euro introduction and with the euro changeover itself, including dual display. This established the neutrality principle in regard to the euro changeover (i.e. neutrality in the exchange and conversion of money, prices, payments and other values from the Slovak currency into euros), the principle of continuity of contracts (without any change in the actual financial value of the subject matter and other content of legal relations), as well as the principle of the protection of the economic interests of citizens and consumers in regard to the euro changeover. The basic principles and rules on which individual Slovak laws are based typically do not form part of the generally binding text (i.e. their sections), but are more commonly mentioned only in the statement of intent on the law. Often they are not even mentioned in the statement of intent, and this frequently complicates their implementation.

It is also on the basis of the Court of Justice's case law that the Umbrella Act regulates in great detail the principles and rules for the conversion, redenomination and rounding of all amounts<sup>6</sup> from Slovak korunas to euros, which had to and has to be performed according to the conversion rate so that the conversions of unit prices (the quantities and bases for the calculations), partial calculations, and resulting conversions of final amounts, from Slovak korunas to euros, are as accurate as possible and do not have the effect that the actual financial value and level of the final amounts are raised as a result of preparations for the euro changeover and the changeover itself.

Court of Justice case law was also the source of the Slovak Umbrella Act's provision (in Section



23(1)) stipulating that costs and expenses related to the euro introduction may not be used to justify increasing prices (including unit prices), fees or other financial payments and that if prices (including unit prices), fees or other financial payments are increased during the preparation for the euro changeover or the actual changeover, then the real reasons for these increases must be transparent and must be clearly, unambiguously and easily distinguishable from circumstances relating to the euro introduction, meaning also that they must be distinguishable from the conversion and rounding of amounts from Slovak korunas to euros according to the conversion rate, from rounding rules, and from other rules related to the changeover from the Slovak currency to the euro. This statutory provision was exceptionally well received by the Slovak Trade Inspectorate (SOI), since it allowed the SOI to make effective checks for prohibited and illegal price increases related to the euro introduction.

In the light of the knowledge gained from the euro changeover, it may be asserted that those provisions in the Umbrella Act on the Euro which take account of the case law of the EU Court of Justice constitute an invaluable component of this law and undoubtedly contributed to the smooth and efficient euro changeover.

### INCORPORATING ELEMENTS OF EU REGULATIONS ON THE EURO INTO SLOVAK LAW

The drafting of Slovakia's Umbrella Act also made use of the basic case law of the EU Court of Justice<sup>7</sup> which allows, in specific cases, the method of transposing and incorporating elements and content of EU Regulations into national legislation, whereas EU law in general hardly ever permits this option<sup>8</sup>. According to the Court of Justice's case law, it is permissible in specific cases, where national legislation fleshes out EU framework regulations (i.e. EU regulations that lay down only the broad principles of a certain legal regulation and leave the specifics of these principles as a matter of national legislation), or where there is a combination of many legal provisions at EU and national level. The Court of Justice case law implies that in such specific cases, the fact that elements and content of EU regulations are transposed and incorporated into national laws, so as to make these laws complete and easier to understand for the persons (addressees) to whom they apply, cannot be considered a breach of EU law. That said, however, any transposition and incorporation of elements of EU regulations into national law may be carried out only in a way that does not restrict or obscure the direct applicability of the EU regulations, since it would otherwise contravene the doctrine of the direct applicability of EU regulations in EU Member States. The Slovak Umbrella Act on the Euro does not violate this doctrine. Moreover, it takes into account the Court of Justice case law<sup>9</sup> implying that too little detail in national legislation was a factor in certain

disputes and judicial proceedings related to the changeover from a national currency to the euro.

The subject matter of the Slovak Umbrella Act on the Euro is a relatively complex legal issue, involving a combination of many legal provisions at the EU level and at the national level. In regard to the changeover from the Slovak currency to the euro, this combination of legal provisions at the EU and national levels was further complicated by the fact that the original national legislation on the Slovak currency (the Slovak koruna) was repealed alongside the entry into force of the EU legal framework for the euro and the euro area (including the EU legal framework concerning the use of euro banknotes and euro coins as legal tender in the euro area). Furthermore, the EU regulations governing the introduction of the euro in EU Member States are in large part framework regulations, especially in that it is the individual Member States which, within the limits laid down in the framework regulations, select their own the euro changeover scenario and timeframe for the various changeover-related steps. For the changeover from the Slovak koruna to the euro, Slovakia decided to apply the so-called "big bang" scenario, i.e. the introduction of the euro meant an immediate (without a transition period) changeover to a situation in which the euro was in cash and non-cash circulation in Slovakia and there was a short dual circulation period of 16 days.

Through the Slovak Umbrella Act on the Euro, elements and content of several euro-related EU regulations were precisely transposed and incorporated into Slovak law, the purpose being to ensure the transparency, integrity, clarity and effective application of the legislation on the changeover from the Slovak currency to the euro. At the same time, however, the Umbrella Act fully respected the case law of the EU Court of Justice in that the origin of transposed provisions was not obscured in any way<sup>10</sup> and the transposed content was not at all modified, nor were the nature, legal effects or direct applicability of the relevant EU regulations restricted or obscured. This construction of the Slovak Umbrella Act on the Euro and its consistent use of the EU Court of Justice's case law was finally accepted also by EU institutions during the consultation process, after a certain initial reluctance.

It is illustrative to point out that if no elements of the EU regulations had been transposed and incorporated into the Slovak Umbrella Act on the Euro, this law could not have transposed and incorporated, for example, even just the rule that final monetary amounts converted to euros according to the conversion rate are generally to be rounded to two decimal places, i.e. to the nearest euro cent. The absence of this general rule on rounding would be at the expense of the Umbrella Act's transparency for a majority of its addressees, i.e. Slovak citizens, since the Umbrella Act regulates several other details regarding rounding (for example, unit prices in euros must in general have at least three decimal places).

<sup>7</sup> For example, the "Variola" case.

<sup>8</sup> Since EU regulations are general binding EU legal acts that are directly applicable in all EU Member States.

<sup>9</sup> For example, the judgment in case C-19/03 of 14 September 2004.

<sup>10</sup> Since with the Umbrella Act's provisions containing the transposed content there is a reference to the relevant provisions of EU regulations.



It is also interesting to note that Slovakia is the last the EU Member State to harmonise its law with EU law in regard to preparation for the introduction of the euro. This, however, is only a result of the Lisbon Treaty, which entered into force on 1 December 2009 and under which European Community law is renamed "European Union" law and the Treaty establishing the European Community becomes the Treaty on the Functioning of the European Union.

In conclusion, it can be restated that the Slovak Umbrella Act on the Euro ensured full harmonisation between Slovak law and European legal framework for the euro and the euro area, while at the same respecting and using the case law of the EU Court of Justice, too. It may also be said that the Slovak legal framework for the euro changeover was prepared to a high standard and in good time and that it made a major contribution to the smooth and efficient changeover from the Slovak currency to the euro.





# Non-cash payments – an area of constant change and innovation

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*In the area of non-cash payments, the introduction of the euro in Slovakia went smoothly and without problems. The reactions in praise of this fact – whether from the European Commission or European Central Bank – are resonating even a year after the end of the entry process. The key to coping successfully with the changeover was the in-depth and lengthy preparation stage for both the banking sector and Národná banka Slovenska. In this regard, it is important to single out the activities of the Banks and Financial Sector Committee and the Banks Sub-Committee, which played a significant and irreplaceable role in the euro introduction process. In the ECB's view, the connection of NBS to the TARGET2 payment system was flawless and set a positive example for the next countries that join the euro area.*

Following Slovakia's entry into the euro area, NBS became fully involved in the activities of Eurosystem working groups and committees in the area of non-cash payments. Preparation for and participation in the work of the Eurosystem (in the so-called standard composition) became part of NBS's working activities.

## TWO PAYMENT SYSTEMS

Since 1 January 2009, NBS has been operating two payment systems, namely EURO SIPS and TARGET2-SK. Eurozone entry brought substantial changes in the payment systems' operation, especially in regard to their functionality. Until 31 December 2008, NBS operated the only interbank payment system in Slovakia – the Slovak Interbank Payment System or SIPS. Through this system, the banking sector had payments both processed and settled. At the same time, the SIPS processed "RTGS payments" (i.e. payments settled practically in real time) as well as "retail payments" (standard payments not requiring immediate finality).

As of 1 January 2009, the SIPS payment system was transformed into the EURO SIPS system, entailing not only a currency switch (SKK to EUR), but also a substantial change in its functionality. Since 1 January 2009, EURO SIPS has functioned as a clearing payment system processing only retail payments, with the settlement of these payments being performed in the national component of the TARGET2 payment system – TARGET2-SK. Thus EURO SIPS became an ancillary system of TARGET2-SK. At present, EURO SIPS has 28 participants (including NBS), and during 2009 it processed an average of almost 500 000 payments per day. The first year after the switch to EURO SIPS can be said to have gone completely smoothly, with no operational problems recorded during this period.

On 2 January 2009, the real-time gross settlement system TARGET2-SK was put into operation as a component of the European TARGET2 system. TARGET2-SK replaced the original RTGS functionality of the original SIPS system, which was one of the conditions for joining the euro area and conducting monetary operations within the Eurosystem. TARGET2-SK currently has 27 direct participants (not including NBS), and its services are also used by three ancillary systems. Each day on average, TARGET2-SK processes 604 payments initiated by Slovak banking sector participants and amounting to €3.48 billion.

NBS provides participants in TARGET2-SK with support in using the systems, and on a daily basis it manages and coordinates the system's operation. At the same time, NBS cooperates closely with other central banks that operate their own TARGET2 systems. During its first year, the system worked without any incidents and all participants' payments were processed and settled in accordance with the stipulated conditions, securely, and on time.

## NEW VERSION OF TARGET2-SK

In November 2009, a new version (3.0) of the Single Shared Platform that forms the technical basis of the TARGET2-SK system was launched into operation. This enhanced certain functionalities and also reflected changes in the SWIFT standards that are used to transmit data between the system and participants. NBS takes part in the preparation and testing of new versions of the SSP. In regard to the testing, NBS cooperated closely with the banking sector, while the sector, as the main user of the system, was actively involved in the process.

Národná banka Slovenska periodically organizes meetings of representatives of TARGET2-SK



users. These working consultations are opportunities to address current questions relating to the operation, use and testing of the TARGET2 system. This forum also allows the representatives of participating organizations to give opinions on the objectives and plans of NBS and other central banks in regard to modifications and developments being prepared for the system.

The TARGET2-SK system met the expectations of the Slovak banking market during the first year of its operational and became an everyday part of the execution of key banking operations.

The central bank has a crucial position in the overall functioning of payment systems. Indeed, supporting the smooth and secure functioning of payment systems is one of the core tasks of the European System of Central Banks, and the exercise of oversight over payment systems contributes substantially in this regard. The role of NBS in this area is laid down also in the Act on Národná banka Slovenska, under which NBS exercises supervision over existing payment systems as well as securities settlement systems.

Before the eurozone entry, an assessment of the securities settlement system operated by the central securities depository, Centrálny depozitár cenných papierov (CDCP), was carried out. CDCP was judged to be compliant with the stipulated standards. During 2009, CDCP also met the recommendations made in the ECB's evaluation report. Also in 2009, the assessment of the retail payment system EURO SIPS was started, and it is due to be completed in the first quarter of 2010.

### TARGET2-SECURITIES (T2S)

When Slovakia joined the euro area, NBS gained the opportunity to be involved, through the working structures of the ECB, in the practical exercise of supervision across the euro area and in preparation of the common procedures and rules under which supervision is exercised.

As part of the common Eurosystem family, NBS has joined projects that the Eurosystem currently sees as priorities in the area of non-cash payments across euro area countries. These priorities include mainly the projects TARGET2 – Securities (T2S) and SEPA (Single Euro Payment Area).

The T2S project is part of the Eurosystem's work in regard to consolidating the infrastructure of the European securities market. The purpose of T2S is to make the settlement of securities transactions as secure and efficient as possible and, in the final stage, to ensure cross-border settlement at the same level and under the same price conditions as domestic settlement. The basis of T2S will be a single IT platform integrated into central banks' RTGS systems. A Eurosystem service provided by central securities depositories, T2S will allow securities transactions to be settled in central bank money within the euro area / EU / EEA, most usually in the euro currency, but also in other currencies under stipulated conditions. T2S will provide delivery-versus-payment (DvP) settlement, and for this purpose securities accounts and cash ac-

counts will be maintained in T2S by, respectively, central depositories and central banks.

Central securities depositories (CSDs) will be the "entry gate" through which the market will be able to access T2S services. Securities accounts will remain legally attributed to individual CSDs, and therefore financial market participants will continue to have contracts with central depositories in order to ensure settlement in their securities accounts. A CSD that decides to use T2S will have to sign a contract with the Eurosystem. The signing of contracts between individual CSDs and the Eurosystem will take place during 2010. In 2009, CSDs signed a Memorandum of Understanding, expressing interest in using the future T2S services. Since, however, the Memorandum is not a legally binding document, it will have to be followed by the signing of legally binding contracts between the Eurosystem and central depositories in 2010.

T2S is a Eurosystem project, which means that the Eurosystem is responsible for the development and future operation of the T2S platform that will provide services for CSDs and their clients. T2S allows direct connection between CSDs and their clients.

The Eurosystem began work on the T2S project back in 2006 with the production of a feasibility study. The next phase involved determining user requirements for T2S services, and this culminated in July 2008 when the ECB's Governing Council issued a decision endorsing the feasibility of the T2S project. At present, the project is in the specification phase. NBS is involved in the T2S project management processes at the level of the both the euro area and the Slovak Republic. NBS is a regular participant in meetings of the T2S Advisory Group, which brings together representatives not only of central banks, but also of CSDs and future users of T2S services. At the national level, the National User Group (NUG-SK) has been established under the charge of NBS. The NUG-SK oversees activities related to the T2S project and its members include, in addition to representatives of NBS and CDCP, representatives of the Ministry of Finance of the Slovak Republic, the banking sector, and the Slovak Association of Securities Dealers. NUG-SK meetings are held periodically, before meetings of the T2S Advisory Group. In this way, members representing the national community acquire regular information about T2S activities and developments and at the same time have the opportunity to put forward any comments or requirements regarding the documentation that is to be discussed at the T2S AG meeting. The T2S is due to go into operation in June 2013.

### SEPA PROJECT

Another consequence of euro area entry was that NBS became an integral part of processes related to the SEPA project, the objective of which is to establish a single area for euro payments. Following on logically from the introduction of euro cash



payments, the SEPA project aims to harmonize procedures, standards and practices in the use of non-cash payments, specifically credit transfers, direct debits and card payments. The purpose of SEPA is to integrate and harmonize conditions for retail payments across the European Union, and both the ECB and European Commission see this project as a priority.

In cooperation with NBS, the Slovak Finance Ministry and the banking sector, the Implementation Plan for SEPA Payment Instruments in the Slovak Republic was updated during 2009. The Implementation Plan describes the basic tasks and objectives that will have to be fulfilled during the implementation process.

Based on positive experiences with the euro introduction, the SEPA Sub-Committee was established as forum in which tasks relating to the Implementation Plan can be regularly discussed and addressed. Also involved in the implementation process is the State Treasury, which is the provider of payment services in the public sector.

From the view of NBS, as operator of the EURO SIPS retail payment system, the decision of the NBS Bank Board on the conversion of the EURO SIPS payment system into a *SEPA-scheme compliant* payment system is especially important. In this regard, the functional specification of EURO SIPS and a feasibility study will be completed in the first half of 2010.

In the field of legislation, Act no. 492/2009 Coll. on payment Services entered into force in 2009. The new Payment Services Act transposes the EU's Payment Services Directive (PSD) and lays the legal basis for putting SEPA payment instruments into practice.

It can be generally said that the SEPA project will ultimately affect all providers as well as users of payment services. Among the most noticeable

changes will be the replacement of the bank connection data currently used in the Slovak Republic with bank connections in the IBAN format, which at present is used only in cross-border payments.

The direct impact on payment service users will be gradual, since the first phase of SEPA implementation concerns mainly the interbank environment, i.e. the communication context of "bank – payment system – bank". Only then will SEPA standards be implemented in the context of "customer – bank" (initiation of payment orders) and "bank – customer" (account statements).

Národná banka Slovenska and the banking sector worked together in setting ambitious objectives for the implementation of SEPA payment instruments in practice. In the case of SEPA payment cards, the deadline for implementing the respective SEPA framework is set for the end of 2011. Then, during 2012, the implementation of SEPA standards for credit transfers will be completed. As for SEPA direct debits, there is considerable divergence between them and the existing direct debits, and that is why no final deadline for their implementation in Slovakia has yet been set.

Once the SEPA payment instruments have been implemented, there will no longer be any differentiation between domestic and cross-border payments. In the final phase, payment service users will be able to make payments to any EU country as easily, and under the same conditions, as they today make domestic payments.

Non-cash payments is an area that is in constant flux, in other words it is an area that is continually seeing change and innovation. Upon Slovakia's entry into the euro area, Národná banka Slovenska became entwined with the Eurosystem's current projects and priorities, and the tasks and objectives of the Eurosystem became the tasks and objectives of NBS, too.

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# Currency circulation management in Slovakia

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*The Currency Circulation Management Department ("CCMD") of Národná banka Slovenska carries out and is responsible for the management of currency circulation in the Slovak Republic, including the preparation of generally binding legal regulations and internal legal regulations in this area. The CCMD puts into circulation, and withdraws from circulation, euro banknotes and coins; it replaces euro banknotes and coins that have become unfit for further circulation due to wear and tear, and it arranges the destruction of invalid and rejected euro banknotes and coins. It stores and manages stocks of euro cash and other asset values. Regarding applications for prior approval to process euro banknotes and coins for other entities in the territory of the Slovak Republic, the CCMD is the competent organizational unit for the first-instance proceedings.*

At the time of preparation for the euro introduction, and when the changeover was taking place, the main tasks of the CCMD were, in particular: to prepare legislation in the area of cash circulation; to oversee the material and technical preparations of its sub-branches and the Cash Handling Section; to ensure a sufficient quantity of euro banknotes and banknotes, the logistical plan, and the frontloading of the banking sector; to arrange the destruction of Slovak currency; and much else besides.

Since 1 January 2009, CCMD staff have been representing Národná banka Slovenska on bodies of the European Central Bank in the Eurosystem composition. Like other ECB committees, the Banknote Committee (BANCO) works in two compositions, a Eurosystem composition in which the ECB and all national central banks of the Eurosystem are represented, and an ESCB composition, in which the ECB and the national central banks of the European System of Central Banks (ESCB) are represented. The area of euro banknotes is comprehensively covered by BANCO and by the respective working groups (counterfeits, issuance, banknotes processing, security, research, and others).

Comparing the work of currency circulation management before and after the introduction of the euro, the main differences stem from the fact that Slovakia, in adopting the euro, became part of an existing system, meaning that we have to respect common rules and procedures and that certain decision-making powers were transferred from the NBS Bank Board to the ECB Governing Council. Entry into the euro area marked the end of NBS's sovereignty in the area of banknotes and coins, as exercised, for example, in deciding on the designs of banknotes and, to some extent, coins.

An important aspect of sovereignty that has been "sacrificed" is NBS's authority to determine the number of banknotes that it must have printed each year. The national central banks (NCBs) of the Eurosystem determine how many euro banknotes are required for the next year or years. This requirement reflects the rise in demand for euro banknotes and the need to replace banknotes that have become unfit for circulation in the respective country. The ECB then summarizes and evaluates the requirements of all NCBs and determines a result that compares with the ECB's estimate for the increase in currency in circulation across the whole euro area. The final estimate is reduced again by the surplus stocks held by NCBs, and the difference represents the final quantity of euro banknotes that the Eurosystem needs to have printed.

After this complicated preparatory procedure in the ECB (Directorate Banknotes), Issue Working Group (IWG), and approval by the BANCO committee, the decision on banknote production is submitted for final approval to the ECB Governing Council, which adopts it through an ECB Guideline on the production of euro banknotes for the respective year. This ECB Guideline stipulates the quantity of euro banknotes that the Eurosystem must procure. On the basis of the adjusted capital key, each NCB is assigned a production allocation of one or several denominations and the NCB is fully responsible for ensuring the production and distribution of the respective quantity. It is important to note that the allocation for a given NCB does not represent the coverage of demand for that country, but rather represents that country's contribution to meeting the overall requirements of the euro area.

The satisfaction of NCB demand for different denominations for the purpose of supplement-





ing stocks is ensured by the individual NCBs, and this whole process is managed by the ECB.

The issuance of euro coins falls within the competence of the individual Member States, under powers delegated by the European Commission. Every year, the ECB approves an issuance volume of euro coins for each Member State, this being the volume that the country is permitted to put into circulation. The issuance of euro coins is governed by Council Regulation (EC) No 975/98 of 3 May 1998 on denominations and technical specifications of euro coins intended for circulation.

In regard to the issuance of euro banknotes and coins, Národná banka Slovenska also ensures the transmission of data on the issuance and recycling of euro banknotes and coins to the common information system maintained by the ECB. These data serve as basic data for managing the level of euro banknote stocks across the whole euro area.

A new task required of NBS following Slovakia's entry into euro area is to implement the Banknote Recycling Framework.

The principal objectives of this framework are, first, to provide credit institutions and professional cash handlers with assistance in complying with the obligations laid down in Article 6 of Council Regulation (EC) No 1338/2001; second, to effectively implement a common policy regard-

ing banknote recycling by credit institutions and other professional cash handlers in order to avoid competitive distortions within the euro area and to contribute to the establishment of a single euro cash area; third, to recommend to credit institutions and other professional cash handlers the observance of due diligence standards concerning the handling of euro banknotes so as to contribute to maintaining the quality and genuineness of euro banknotes in circulation.

The first, legislative part of this complex implementation process was realized by NBS through the issuance of Decree no. 607/2008 Coll. laying down certain details of currency circulation and including amendments to certain decrees. The second part represents the actual performance of the obligations under this Decree and the Framework, i.e. carrying out checks on professional handlers of euro banknotes and coins and on their equipment.

To sum up, with a certain degree of simplification, euro banknotes are managed by the ECB from Frankfurt am Main, and euro coins by the European Commission from Brussels. Meanwhile Národná banka Slovenska, in complying with all the common rules, is responsible for ensuring the smooth circulation of euro banknotes and euro coins in the territory of the Slovak Republic.



# Currency preparation and issuance sees major changes

Banknotes and Coins Department  
Národná banka Slovenska

*The introduction of the euro has brought about major changes also in the area of currency preparation and issuance. Since Slovakia joined the euro area at the beginning of last year, Národná banka Slovenska has had the right, under special regulations, to issue euro banknotes and euro coins (including commemorative euro coins) that are legal tender in euro area countries as well as in participating third countries. Also since that time, NBS has been allowed to issue collector euro coins, which, unlike euro coins and euro commemorative coins, are legal tender only in the territory of the Slovak Republic and are not primarily destined for circulation. Collector coins must, however, be readily distinguishable from euro coins intended for circulation and their face values in euros or euro cents must be different from those of euro coins.*

The entry of Slovakia into the euro area substantially increased the number of tasks related to banknotes and coins, especially in regard to preparation, procurement, the quality management and supervision of production, issuance, and protection. For staff at the Banknotes and Coins Department (BCD), this has meant an increase not only in administrative work, but also in the professional demands placed on them. They are responsible for strategic and operational tasks concerning the preparation, issuance and protection of euro banknotes and euro coins. Compared with the period before the euro introduction, a several fold increase has been recorded in the number – and complexity level – of materials vis-à-vis the European Central Bank (ECB) and European Commission (EC) as well as materials submitted to Eurosystem or EU comment proceedings on which the BCD is required to give an expert opinion.

The demands of the work are intensified by the fact that, within the euro area, the EC directs and coordinates all tasks related to the preparation and issuance of coins and their protection against counterfeiting, and the ECB all tasks related to the preparation, issuance and protection of banknotes.

## **ACTIVE PARTICIPATION IN THE PREPARATION OF LEGAL REGULATIONS**

Thus even in the first year of NBS's membership of the Eurosystem, the BCD played an active part in the preparation of several European legal regulations governing the issuance and protection of euro banknotes and euro coins. Among the most notable were: Council Regulation (EC) No 46/2009 amending Regulation (EC) No 2182/2004 concerning medals and tokens similar to euro coins; Commission Recommendation 2009/23/

EC on common guidelines for the national sides and the issuance of euro coins intended for circulation; Council Regulation (EC) No 44/2009 amending Regulation (EC) No 1338/2001 laying down measures necessary for the protection of the euro against counterfeiting; and the Proposal for a Council Regulation concerning authentication of euro coins and handling of euro coins unfit for circulation.

When NBS joined the Eurosystem, the status of NBS's delegated representatives on ECB and EC working groups and expert groups changed substantially. From having observer status, these representatives became full members of the committees and now take part in decisions relating to the preparation of operational and strategic materials of the Eurosystem and European Commission. Since the euro introduction, the BCD has in this way made a substantial contribution also to the implementation of the ECB's strategic tasks concerning the preparation and protection of euro banknotes.

## **PROJECT FOR A SECOND SERIES OF BANKNOTES (ES2)**

At meetings of the ESCB's Banknote Committee (BANCO), the NBS representatives participated in preparatory tasks related to the project for a second series of euro banknotes (ES2), in particular the preparation and approval of their technical specification, design and security features, time schedule, testing, and processing. Another priority task was to participate in the following activities: the preparation and approval of guidelines on euro banknote production for 2010; the approval of documents related to the preparation, production, quality control, procurement, and security enhancement of euro banknotes; and, together with the Currency Circulation Management De-



partment, the implementation of a framework for the recycling of banknotes.

On the Banknote Production Working Group (BPWG), representatives of NBS and other national central banks jointly participate in the preparation, monitoring and supervision of the production of euro banknotes in the Eurosystem, as well as in the preparation of regulations, management processes and quality control methods for banknotes. Some of the ES2 project tasks, concerning mainly how to protect the planned new series of banknotes against counterfeiting, were also addressed by the Counterfeit Working Group (CWG), which additionally carried out tasks related to the Counterfeit Monitoring System (CMS-2) project and to the analysis of the proposed new hardware and software solutions for this system.

### PROCUREMENT OF BANKNOTES AND PARTICIPATION IN THEIR PRODUCTION

One of the most substantial changes faced by NBS after it joined the Eurosystem was in the area of banknote procurement. NBS is now required to arrange and participate in the production of banknotes for the requirements of the Eurosystem, on the basis of the current decentralized production scenario with pooling. Under this arrangement, each national central bank is required to ensure the production of an allocated quantity of euro banknotes and to supply them to the Eurosystem within a specific period of time. This quantity results from aggregating the individual NCB requirements, with the total quantity for the Eurosystem then being divided between each NCB according to the conversion equivalent of the individual nominal values and capital key. Slovakia, as a new member of the euro area, is additionally required to return also the euro banknotes that it borrowed for the changeover from the Slovak currency to the euro in 2008 and 2009. The country is now printing 20-euro banknotes that are to be returned to the Eurosystem in 2010 and 2011.

In order to secure the most advantageous possible prices of euro banknotes, NBS and the NCBs of Cyprus, Finland, the Netherlands, Luxembourg, Malta and Slovenia have formed a procurement association known as Joint Euro Tender (JET). For NBS, this arrangement is based on the signing of a cooperation agreement with these NCBs and an agreement on banknote production with the supplying printing works. It is already clear that by participating in JET, NBS has achieved the stated objective of securing the most advantageous prices. The economic benefit of this solution is particularly significant, coming as it does in a year when NBS will have to procure more banknotes than at any other time in its 17-year history – a total of 218.5 million pieces. This means that the cost savings are even more substantial.

The ECB is now making preparations for the implementation of a Single European Tender Procedure (SETP) for the procurement of euro

banknotes. With NBS a member of the respective working group, the BCD is participating in the preparation of a wide-ranging project for the implementation of Guideline ECB/2004/18 on the procurement of euro banknotes. The main aims of this project are: to minimize the production costs of euro banknotes while retaining continuity in their production; to ensure the development of the allocation model; to define criteria for participation in the single procurement; to ensure the review of security and quality criteria and procedures; to set up the tender committee; to assign the contracting authority and responsibility for the management of bids; to arrange the start of the single procurement at an optimal time; and to secure optimum participation of printing works in the preparatory stage, including the assessment of potential risks.

### SUPPRESSION OF COUNTERFEITING BANKNOTES

In 2009, Národná banka Slovenska on behalf of the BCD became a member of a worldwide organization focused on suppressing banknote counterfeiting that uses digital multifunctional equipment – the Central Bank Counterfeit Deterrence Group (CBCDGD).

In connection with the introduction of the euro in Slovakia, there was a surge in the production and use by business entities, especially advertising agencies, of reproductions of euro banknotes and euro coins for advertising aimed at exploiting the currency changeover for commercial purposes. During 2009, the BCD received almost three times as many requests to assess the legality of reproductions of Slovak banknotes and coins and of euro banknotes and coins as it did in 2008. The production and use of euro banknote and coin reproductions is subject to a different legal regulation, and therefore in some cases where the assessment of the legality of euro reproductions was more difficult, it was necessary to consult the respective departments of the ECB and EC.

It should be noted in this regard that an essential condition for the legality of reproductions of euro banknotes and coins is their compliance with copyright protection rules and also with conditions for the production and use of such currency, or any part thereof, in accordance with separate European legal regulations.

Under licence agreements concluded with the copyright holders of the national side designs of Slovak euro coins, Národná banka Slovenska is the holder of the exclusive licence to use the national side designs of Slovak euro coins, which is not subject to any restrictions of substance, time or territory. As for the copyright on the common side of euro coins, its holder in the territory of Slovakia is Národná banka Slovenska (representing Slovakia) under a Copyright Assignment Agreement entered into between the EC and NBS on 19 November 2008. The holder of the copyright on designs of euro banknotes is the ECB under Decision of the ECB of 20 March 2003 on the denomi-



nations, specifications, reproduction, exchange and withdrawal of euro banknotes (ECB/2003/4) (2003/205/EC).

In 2009, NBS also performed tasks concerning euro coins, commemorative coins and collector coins, in regard to their preparation, minting, and supply. In doing so, it made use of the experience of BCD representatives' involvement in the Euro Coins Sub-Committee of the Economic and Financial Committee, the Mint Directors Working Group, the Collector Coins Sub-Group and the Counterfeit Coin Experts Group, with the work of these bodies being directed by the EC. BCD staff actively participated in their meetings and activities.

In the first half of 2009, there arrived the last delivery of euro coins required for currency circulation and NBS stocks (the total supply represented 542 million pieces). Last year, NBS issued two commemorative €2 circulation coins and two collector coins made from precious metals.

#### COMMEMORATIVE COINS AND COLLECTOR COINS

In accordance with European regulations, competitions were held for the designs of collector coins that are due to be issued in 2010. For the first time in the seventeen year history of NBS, the NBS Bank Board approved an issuance plan for commemorative and collector coins for a period of longer than one year. Since the new issuance plan runs from 2010 to 2015, tasks related to the announcement of coin design competitions can be carried out well in advance and sufficient time can be set aside for preparing, minting, supplying, processing and arranging the issues.

After adopting the euro, Slovakia became part of the European market in collector coins, and, as a consequence, sales of numismatic materials almost doubled in comparison with the previous period. NBS sales in this regard were made through domestic and foreign contractual partners, whose numbers multiplied. The experience from last year confirmed that contractual sales of commemorative and collector coins had a positive effect in realizing the estimated interest in euro collector coins. This approach to sales could help satisfy collectors' interest in Slovak coins, improve the quality of the international promotion of NBS and Slovakia, and also ensure the target reduction in stocks of old issues held in the central bank's vaults and the selling out of new issues.

#### NOTIFICATION OBLIGATION

As with the issuance of euro banknotes and euro circulation coins, NBS has a notification obligation in regard to the issuance of euro collector coins, requiring it to publish their nominal values, appearance, technical parameters, basic security features, and other elements of legal tender issued and destined for circulation, in the scope required for informing the public. NBS notifications in this regard are published in the Collection of Laws of the Slovak Republic, in the NBS Gazette, and on the NBS website. They also replace the NBS decrees by which Slovak banknotes and coins were issued prior to the euro introduction.

#### RISE IN COUNTERFEITS

A marked rise in seizures of counterfeit euro banknotes has been recorded since the introduction of the euro. In 2008, the number of counterfeit euro banknotes seized in the Slovak Republic represented 258, whereas in 2009 they numbered 2 093, with their total face value amounting to €157 145. Along with the higher number there were also counterfeits representing a high degree of danger and those requiring a new classification. Apart from counterfeit notes, 810 counterfeit euro coins were seized in 2009, representing more than 47 times as many as in the year before the euro introduction. But despite the substantial rise in the number of counterfeits, it should be noted that this development had been expected and had been a feature of the euro introduction in other countries, too. Slovakia in fact ranks average to low for incidence of counterfeits.

The BCD, as part of Národná banka Slovenska, runs the National Counterfeit Centre (NCC). The NCC's task is to examine, verify and retain counterfeits of euro banknotes and coins and of other foreign currency counterfeits seized in the territory of the Slovak Republic. Even though the number of counterfeits of euro banknotes and coins has risen sharply since the euro introduction, Slovakia is one of the few EU countries which is not late in analyzing these counterfeits and in entering data in the CMS monitoring system.

In every central bank, the preparation, production procurement, and protection of banknotes and coins is a highly specific area and its results can be seen in the banknotes and coins that we come across in everyday life. The first year of operation under the new conditions confirms that NBS managed to ensure both a smooth changeover from the Slovak koruna to the euro currency and the full inclusion of Slovakia among euro area countries, where euro banknotes and coins have been in use since 2002.





# The Role of the Central Bank of Malta in the Eurosystem

Brian Micallef, Rita Schembri<sup>1</sup>

*This article considers how the role and responsibilities of the Central Bank of Malta (CBM) have changed as a result of its integration in the Eurosystem with effect from 1 January 2008. The article is written from a broad perspective, addressing both those tasks directly related to the Bank's participation in the Eurosystem and other ancillary tasks. The article concludes that the CBM retains an important role in both the formulation and implementation of monetary policy. Although some specific tasks have been replaced by new ones, the CBM also continues to perform many of its previous functions, although often in a transformed and upgraded manner.*

With Malta's adoption of the euro on 1 January 2008, the Central Bank of Malta (CBM) became a member of the Eurosystem, which includes the European Central Bank (ECB) and the national central banks (NCBs) of those countries that have adopted the euro. This event marked the end of the preparatory process that started in May 2004 with Malta's membership in the EU and the CBM's participation in the European System of Central Banks (ESCB) but it has also ushered in a new phase where most of the operations of the CBM are aligned with the operational framework of the Eurosystem.

It is commonly held that central banks are mainly involved in the conduct of monetary policy. That perspective naturally raises the question of whether the transfer of monetary policy to the ECB makes the CBM redundant. As this article seeks to explain, this is not the case.

First, participation in the Eurosystem's deliberations on monetary policy has required the further development and reorientation of the Bank's analytical and research capacity. Moreover, central banks are entrusted with various other tasks that are aside from monetary policy, and this applies as much in the Eurosystem as it did to the CBM before Malta's accession to the EU and as an ESCB member outside the Eurosystem between 2004 and 2007.

Second, NCBs are also allowed to perform functions that are not mentioned in the Statute, provided that these do not interfere with the objectives and tasks of the Eurosystem and the ESCB and provided that they are undertaken on the responsibility and liability of the NCB concerned and are not construed as a Eurosystem/ESCB task.

The tasks related to EMU are enshrined in the Treaty on the Functioning of the European Union (henceforth, 'the Treaty'), and the *Statute of the European System of Central Banks and of the European Central Bank* (henceforth, 'the Statute'). These list the definition and implementation of monetary

policy as only one of the four basic tasks of the Eurosystem.

Other basic tasks include the conduct of foreign-exchange operations, holding and managing the official foreign reserves of the Member States and the promotion of the smooth operation of payment systems. As a Eurosystem member, therefore, the CBM does not only retain an important participative role in monetary policy, but also in other areas. This stems from the fact that these functions are lawfully entrusted to the Eurosystem as a collective body, and not the ECB.

Beyond these basic tasks, the Eurosystem also has the exclusive right to issue banknotes within the euro area and it also collects statistical information necessary for fulfilling its tasks. The Eurosystem also maintains working relations with relevant institutions, bodies and fora both within the EU and internationally. In such cases as well, responsibility is shared between the ECB and the NCBs. For example, in the field of statistics, the Statute creates an obligation on the NCBs to assist the ECB in the collection of statistics.

The ECB and the NCBs perform the tasks of the ESCB and the Eurosystem tasks together. The Statute itself states that as far as possible and appropriate, the ECB shall have recourse to the NCBs to carry out ESCB tasks.

As far as the NCBs are concerned, a distinction is made between those tasks that are ESCB tasks and are thus performed by all the EU central banks, and those that are the exclusive competence of the Eurosystem and which are therefore limited to the ECB and euro area NCBs collectively. Eurosystem tasks, however, do not supercede ESCB tasks. Rather, they are conducted in addition to and supported by ESCB tasks.

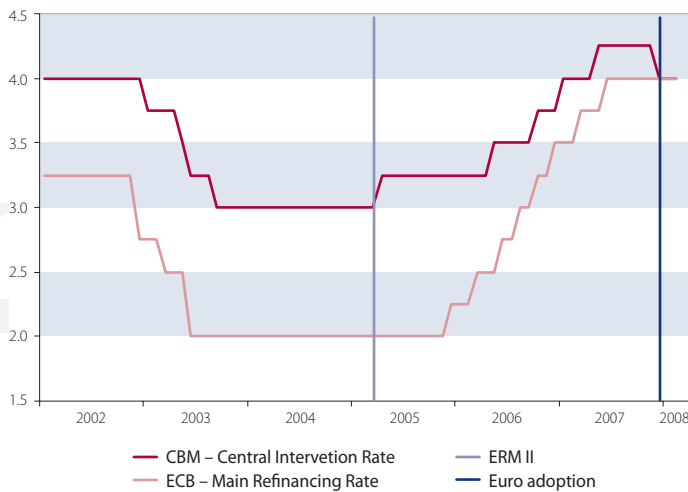
The CBM contributes to ESCB and Eurosystem tasks through its participation in the deliberations of the Governing Council and General Council of the ECB and the various supporting ESCB/Eurosystem Committees and their substructures.<sup>2</sup>

<sup>1</sup> Mr Micallef and Ms Schembri are economists with the Central Bank of Malta. The views expressed in this paper are those of the authors and do not necessarily reflect those of the Bank. The authors would like to thank Mr Alfred Demarco and Dr Bernard Gauci for their useful comments and suggestions.

<sup>2</sup> The ESCB/Eurosystem committees assist the ECB's decision making bodies in the performance of their tasks and expand on the whole range of activities performed by NCBs. These include: monetary policy formulation and operations, accounting, banknotes, banking supervision, communications, IT, internal auditing, payment and settlement systems, statistics, international relations, human resources, legal issues, cost management and the ECB budget. These meet in ESCB and Eurosystem composition, as appropriate. Two additional committees discuss matters related to the ECB's budget and cost methodology.



Chart 1 Key interest rates: CBM and ECB (in %)



Source: ECB, CBM.

3 See ECB (2004) and ECB (2008) for a detailed description of the ECB's monetary policy strategy.

Indeed, the CBM's exposure to Eurosystem tasks started in July 2007, after the Economic and Financial Affairs Council (ECOFIN Council) decided that Malta had fulfilled the convergence criteria and was thus eligible to adopt the euro. Subsequent to that decision, the ECB invited the CBM to attend, as observer, meetings of the Governing Council and selected meetings of committees that meet in Eurosystem composition. While during this interim period, the CBM did not contribute directly to Eurosystem tasks, it continued to perform the tasks it had assumed as an ESCB member, and concurrently executed, on a trial basis, operations aimed at preparing the Bank for eventual integration in the Eurosystem from 1 January 2008.

The Central Bank of Malta Act had earlier been amended to reflect the Bank's integration in the Eurosystem. This notwithstanding, the Act also stipulates a number of tasks that are entrusted to the Bank but which are not mentioned in the Statute. These include overseeing the systemic stability of the domestic financial system, advising the Government on financial and economic matters, performing banking services and maintaining relations with international financial institutions such as the International Monetary Fund (IMF) and the European Bank for Reconstruction and Development (EBRD). The Bank also continues to play an informative and educational role, disseminating the results of the analysis and research conducted within the central banking community, including the ESCB, in its publications and statements.

The remainder of the article is structured as follows. Section 2 expands on the role and responsibilities of the CBM in the context of its participation in the Eurosystem/ESCB while Section 3 focuses on those areas in which the CBM's responsibilities do not arise specifically from the Treaty and Statute, but where the CBM nonetheless has to act in conformity with them. Section 4 summarizes and concludes.

## 1. THE ROLE OF THE CBM IN EUROSISTEM TASKS

### 1.1. Monetary Policy

With Malta's adoption of the euro, the CBM ceased to set interest rates and started to participate in, and implement the monetary policy decisions taken by the Governing Council of the ECB.

However, in an environment where capital moves freely, a central bank pursuing a fixed exchange rate target – as was the case in Malta prior to the introduction of the euro – is severely limited in its ability to conduct an independent monetary policy and set interest rates according to country-specific needs. In such circumstances, the slightest differential between domestic interest rates and those in the country or region whose currency serves as the anchor currency has the potential to trigger large capital flows with potential destabilising effects on the exchange rate.

This fact is illustrated in Figure 1, which shows the evolution of official interest rates in Malta and the euro area over the period 2002-2007. The chart clearly shows that the central intervention rate set by the CBM followed a very similar path to ECB rates well before entry in the EU's Exchange Rate Mechanism II (ERM II), reflecting the euro's role as main anchor currency in previous exchange rate baskets.

The figure also shows a differential in official interest rate levels, reflecting the need to maintain an adequate risk premium to compensate investors for investing in a third currency such as the Maltese lira. This differential between the Maltese lira and euro area interest rates narrowed over the course of ERM II participation, as it became clear that Malta will be able to meet the Maastricht criteria and adopt the single currency on 1 January 2008.

On 28 December 2007, the CBM lowered its central intervention rate to the levels prevailing in the euro area, effectively completing the convergence of official rates with those in the euro area and reducing this interest rate differential to zero.

As a member of the Eurosystem, the CBM jointly contributes, strategically and operationally, to the attainment of the common goals of the System, with due respect to the principle of decentralisation. One of these goals is the pursuit of price stability, which is also the primary objective of the ECB's monetary policy.

The ECB defines price stability as an annual inflation rate for the euro area of below, but close to 2% over the medium term<sup>3</sup>. This means that while euro area inflation may diverge from this target in a particular month, it must be below but close to 2% on average over a number of years. The definition also makes clear that price stability is assessed on the basis of price developments in the euro area as a whole, rather than according to country-specific developments.

Decisions on interest rates are taken during the first of two monthly meetings of the Governing Council.<sup>4</sup> In setting interest rates for the euro area,



the Governing Council assesses various indicators of economic, financial, monetary and credit conditions in the euro area and abroad. This approach ensures that no relevant information is overlooked in identifying future risks to price stability.

Monetary policy decisions in the euro area are subject to the one-member-one-vote principle. The vote of the CBM governor thus carries the same weight as that of other euro area governors.<sup>5</sup> This voting practice is consistent with the principle that members of the Governing Council do not participate as national representatives, but in an independent personal capacity and with a euro area perspective. To preserve this independence, the Treaty stipulates that neither the ECB, nor NCBs or members of their decision-making bodies, may seek or accept instructions from any national or any other body when exercising ESCB/Eurosystem functions.

In order to carry out his responsibilities, the governor of the CBM is briefed by experts from different departments of the Bank on the recent economic and financial market developments in the euro area, drawing on analysis conducted by ECB staff along with other relevant intelligence collected by the CBM itself. After considering this information and the views expressed by these experts, the Governor alone forms a judgment of the appropriateness of the current monetary policy stance and communicates this judgment to the other members of the Governing Council during their regular plenary session. In light of the euro area wide perspective and the comprehensive analytical framework that informs the monetary policy decisions, the preparations ahead of these decisions have become more complex for a small central bank such as the CBM. This new approach is in contrast to the situation prior to euro adoption, where the decision mainly required knowledge of the workings of the Maltese economy and those economies whose currencies served as anchor in the Maltese lira basket that was operative at the time.<sup>6,7</sup>

After the Governing Council decides on the monetary policy stance, the decision is implemented in a decentralised manner by the euro area NCBs, with the Executive Board coordinating the whole operation. Domestic credit institutions eligible to participate in Eurosystem monetary policy operations do so through the respective NCB, on the basis of the same terms and conditions which apply to other eligible counterparties in the euro area.

As in the previous monetary policy operating framework in Malta, the Eurosystem relies on three main types of monetary policy instruments: open market operations, standing facilities and the reserve requirement ratio.<sup>8</sup> The three instruments are used to steer short-term interest rates towards the ECB's key policy rate and to manage liquidity in the euro area money markets.

All monetary policy operations have to be based on adequate collateral in order to protect the Eurosystem from incurring losses. The Eu-

rosystem accepts financial instruments subject to pre-specified minimum standards, issued by both private and public debtors as collateral. To ensure equal treatment, a mechanism was developed by the Eurosystem to provide for the cross-border usage of these financial instruments. This means that while only eligible credit institutions based in Malta are able to participate in the Eurosystem monetary operations through the CBM, their collateral need not be restricted to that held/issued in Malta, but may include any eligible security, in accordance with the ECB's *General Documentation on Eurosystem monetary policy instruments and procedures*.

The main elements present in the monetary policy operational framework prior to the CBM's integration in the Eurosystem, therefore, have remained relevant. What has changed is not the CBM's involvement in monetary policy, rather, the framework within which it acts to implement monetary policy, including the type of operations conducted, their frequency and contractual terms.

The CBM has completely aligned its monetary policy framework with that of the Eurosystem. This has been facilitated by the participation of CBM senior staff in the Monetary Policy Committee and the Market Operations Committee of the ESCB, which regularly discuss matters relevant to the formulation and implementation of monetary policy.

At a domestic level, issues related to the implementation of monetary policy continue to be discussed at the level of the Financial Markets Committee, which brings together experts from the CBM and the credit institutions based in Malta, including those institutions whose business is predominantly internationally-oriented, as these have also become eligible to participate in Eurosystem monetary operations upon euro adoption.

The Governor of the CBM, moreover, may still be requested to appear before the Maltese Parliament to provide information on monetary policy, as long as the independence of the CBM as stipulated in the Treaty is safeguarded.

In summary, membership in the euro area did not entail a significant change in the CBM's monetary policy strategy. Limitations on the use of monetary policy as an economic tool were in effect present well before entry in ERM II as a result of the deliberate policy of the Maltese authorities to pursue a fixed exchange rate regime and an environment of free capital movements. Euro adoption has not diminished in any way the role of the CBM in the formulation and implementation of monetary policy, but has given it a different orientation.

## 1.2. Foreign Exchange Operations

Responsibility for exchange rate matters is shared between the ECOFIN Council and the Eurosystem. The Treaty permits the ECOFIN Council to 'conclude formal agreements on an exchange rate

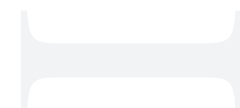
4 The Governing Council meets twice a month. The first meeting of the month focuses on monetary policy decisions, while the second meeting focuses on the operational issues of the Eurosystem.

5 This voting principle will also be retained when the new voting system will enter into force. Under the new rotation system, the total number of votes of governors sitting on the Governing Council of the ECB will be capped at 15 and shared by rotation according to operating rules yet to be defined. While under the new rotation system the CBM governor would not vote at all times, the new voting modalities will not affect his ability to participate in the deliberations of the Governing Council. See article 10.2 of the Statute and ECB Press Release of 20 December 2002, on 'Governing Council prepares for enlargement'.

6 Before joining ERM II, the Maltese lira was linked to a basket of currencies, consisting of the euro, the pound sterling and the US dollar, with weights of 70%, 20% and 10% respectively. In ERM II, the Maltese lira was pegged with the euro at the rate €1 = MTL0.429300

7 A similar argument is raised in Wellink et al (2002) for the case of De Nederlandsche Bank

8 Details on the Eurosystem monetary policy instruments and procedures are available in ECB (2008).





- 9 ECB Annual Report, various editions.  
10 See CBM Press Release dated 4 January 2008 on 'Payment by the Central Bank of Malta of its subscription to the share capital of the ECB and the transfer of its contribution to the foreign reserve assets of the ECB' for further details.

system for the euro in relation to non-Community currencies' and to 'formulate general orientations for exchange rate policy in relation to such currencies'. The ECB is involved in foreign exchange policy matters. However, the single exchange rate policy remains bound to the primary objective of the Eurosystem of maintaining price stability.

While the ECOFIN Council is entrusted with the formulation of the general orientation of the exchange rate policy, the Eurosystem has full and exclusive competence over exchange rate intervention. In particular, it is the Eurosystem that decides whether to apply such intervention in response to any general orientations that could be formulated by the ECOFIN Council, because the Treaty stipulates that such interventions, if conducted, should respect the price stability objective.

The Eurosystem has no exchange rate target, in the sense that the value of the euro against other currencies varies on a daily basis on the basis of market forces. Indeed, since its establishment in 1999, the ECB has only undertaken foreign exchange interventions for policy reasons in 2000, in the context of joint operations with the other central banks of the G7 countries which were aimed at stemming the downward trend in the value of the euro.<sup>9</sup>

The Eurosystem, however, does not neglect exchange rate developments and the euro exchange rate is monitored on an ongoing basis in the context of the Eurosystem's monetary policy strategy.

As a member of the Eurosystem, a national central bank could be called upon to participate in two types of interventions. The first type of intervention could take place in the context of operations in the currencies of ERM II participating countries. The second type of intervention could take place in the foreign exchange markets, where, on behalf of the ECB, the national central bank could be asked to intervene against selected major currencies to influence the respective bilateral exchange rate vis-à-vis the euro.

In view of the fact that such official intervention is normally carried out on a massive scale, the CBM decided to opt out of the foreign exchange interventions on behalf of the ECB.

Prior to the adoption of the euro, the CBM used to play the role of market-maker in the foreign exchange market, where it was prepared to buy and sell to the local banks the foreign exchange denominated in those currencies making up the Maltese lira exchange rate basket. This function was undertaken to support the exchange rate peg and retain confidence in the Maltese lira, thus ensuring liquidity in the local market. Subsequently, with the adoption of the euro – a major international currency – the role of the CBM as a market-maker in foreign exchange has been terminated.

### 1.3. Reserve Management

The Statute stipulates that upon the introduction of the euro, NCBs shall transfer part of their

external reserves to the ECB. The contribution of each national central bank is fixed in proportion to its share in the subscribed capital of the ECB. These foreign reserves are managed by the NCBs, on behalf of the ECB, and on the basis of precise procedures within the parameters established by the ECB.

The NCBs transfer part of their reserves to the ECB so that, whenever needed, the Eurosystem has a sufficient amount of liquid resources for its foreign exchange policy operations involving foreign currencies. The objectives for the management of the ECB's foreign reserves are, in order of importance, liquidity, security and return.

NCBs have the option to abstain from the operational management of the ECB foreign reserves, although to date, no national central bank has done so. They may also avail themselves of a pooling strategy, in which a national central bank pools the operational foreign reserve management activities carried out on behalf of the ECB with another national central bank. Due to their small size, this option is becoming particularly attractive to the recently acceded NCBs in the Eurosystem.

The CBM paid its contribution to the foreign reserve assets of the ECB on 3 January 2008.<sup>10</sup> The amount transferred was composed of 85% in US dollars and the remaining 15% in gold. The operational strategy favoured by the CBM was that of a pooling arrangement. In this regard, the Bank reached an agreement to manage the ECB's foreign reserves in collaboration with the Central Bank and Financial Services Authority of Ireland. Thus, the two authorities take collective decisions on the day-to-day foreign exchange operations involving these reserve assets, in accordance with the strategy defined by the decision-making bodies of the ECB.

Apart from participating in the operational day-to-day management of the ECB's foreign reserves, the CBM has continued to manage its own financial assets in line with its own investment policy. The composition of this portfolio, and therefore decisions on issues such as the proportion invested in different currencies, maturities and type of issuer, are at the discretion of the CBM, provided that the operations it undertakes on the foreign exchange market are reported to the ECB, and those above a certain limit are approved by the latter to ensure consistency with the exchange rate and monetary policy of the euro area. Accordingly, the CBM has also assumed new reporting obligations in this area.

### 1.4. Payment Systems

Central banks have an interest in the safety, efficiency and smooth operation of payment systems, as these have implications for financial stability, the transmission of monetary policy and public confidence in the currencies underlying the payments processed through them. Increasingly, central banks are also interested in the efficiency and safety of securities settlement sys-





tems, even if they do not necessarily operate such systems themselves.

The CBM remains the only entity authorised to approve domestic payment systems in Malta. It may, and indeed has, also issued directives regulating operational aspects of payment systems such as the security of payments, as well as directives on cross-border transfers and electronic payment systems, provided that these are in line with the Treaty and are subordinate to ECB regulations in this area. Together with the Eurosystem, the CBM is also responsible for ensuring the smooth operation of payment systems in the euro area.

Indeed, the promotion of the smooth operation of payment systems is a basic task of the Eurosystem, which it carries out by overseeing the operations of payment systems and providing facilities to ensure efficient and sound clearing and payment systems. In this context, it has developed two systems the Trans-European Automated Real-time Gross Settlement Express Transfer system (TARGET) and its successor TARGET2. The latter consists of a single technical platform for payments in euro, and connects the euro area NCBs and other participants, such as financial institutions and stock exchanges, in payment and settlement systems.

The CBM formed part of the first wave of countries that migrated to TARGET2 in November 2007. TARGET2 offers a safe environment in which participating banks can more easily access a larger pool of European banks and in which they can thus effect payments in euro more efficiently. With the local banks having access to TARGET2, MaRIS, which was the local payment system for large value inter-bank payments in Maltese lira, terminated its operations. Apart from the main banks in Malta, the CBM and the Malta Stock Exchange also participate in TARGET2.

In the euro area, most decisions on payment and settlement systems are taken by the Eurosystem although the ECOFIN Council may also provide guidance on strategic issues in this area. Within the Eurosystem, these issues are discussed by the Payments and Settlement Systems Committee. Moreover, in the context of an increase in cross-border provision of payment services and cross-border access to payment systems, all ESCB central banks cooperate in ensuring the safety and stability of payment systems in the EU. Such co-operation takes place in terms of a Memorandum of Understanding (MoU) signed by the EU banking supervisory authorities and central banks, which also provides for information sharing between these two types of authorities.

A similar arrangement is largely mirrored at the domestic level, in terms of a specific MoU between the CBM and the domestic financial supervisory, the Malta Financial Services Authority (MFSA).

Notwithstanding its status as a Eurosystem central bank, the CBM also continues to manage the Malta Clearing House, the mechanism through

which cheques and other retail payments such as money orders are exchanged and cleared.

A lesser known fact, albeit of no lesser importance, is the role played by the Eurosystem as a catalyst for changes and innovations in the area of payment and settlement systems. Apart from providing the necessary infrastructure, the Eurosystem also cooperates with the private sector to identify, and where possible, address barriers to payment systems innovations. Efforts in this area are currently directed towards a number of projects, including TARGET2-Securities (T2S), a system to improve the efficiency of Eurosystem collateral management (referred to as CCBM2) and the Single Euro Payments Area (SEPA)<sup>11</sup>.

While the T2S and CCBM2 projects are still under development, SEPA went live in January 2008. It aims at allowing customers to make non-cash euro payments to any beneficiary located anywhere in the euro area using a single bank account and a single set of harmonised payment instruments. In practice, this means that the discriminatory charges between 'domestic' and 'cross-border' payments in euro will cease to exist, to the benefit of the consumer. The role of the Eurosystem in this project is that of a catalyst, while leaving its implementation to operators in the private financial sector. At the national level, the implementation of SEPA is being co-ordinated by the CBM and the Malta Bankers' Association, through the Payments System User Group, which includes representatives of the banks.

### 1.5. Banknotes

According to the Treaty and the Statute, the Governing Council has the exclusive right to authorise the issue of euro banknotes. To ensure efficiency, the production of euro banknotes is conducted through a decentralized pooling scenario among NCBs. Each national central bank is allocated a production quota of one or more specific denominations and total production is then redistributed among NCBs according to identified needs. The ECB also authorizes the volume of coin issuance by each national central bank.

For this process to work smoothly, Eurosystem NCBs have to provide estimates of the amount of banknotes required in their respective country two years before they are actually printed in order to allow a timely determination of the total production requirements of the Eurosystem. The CBM has had to introduce more sophisticated techniques to estimate Malta's cash requirements and thus participate in this exercise.

In February 2007, the Eurosystem also agreed on a medium-term framework aimed at achieving the convergence of cash services provided by NCBs, including a minimum time window of six hours per day between the opening and closing hours of service for the deposit and withdrawal of cash from NCBs. Following a consultation process, the CBM and the local commercial banks agreed that the current arrangements are satisfactory and in line with the minimum time window re-

<sup>11</sup> See ECB (2007) for non-technical information on the role of the Eurosystem in these projects.



12 Further information on the appearance and security features of euro banknotes and coins is available at:

13 Monetary financial institutions (MFIs) are financial institutions which together form the money-issuing sector of the euro area. These include the Eurosystem, resident credit institutions (as defined in Community law) and all other resident financial institutions whose business is to receive deposits and/or close substitutes for deposits from entities other than MFIs and, for their own account (at least in economic terms), to grant credit and/or invest in securities. The latter group consists predominantly of money market funds. Other financial institutions (OFIs) are corporations or quasi-corporations other than insurance corporations and pension funds that are engaged mainly in financial intermediation by incurring liabilities in forms other than currency, deposits and/or close substitutes for deposits from institutional entities other than MFIs, in particular those engaged primarily in long-term financing, such as corporations engaged in financial leasing, financial vehicle corporations created to be holders of securitised assets, financial holding corporations, dealers in securities and derivatives (when dealing for their own account), venture capital corporations and development capital companies.

quested by the Eurosystem. Accordingly, no further changes were deemed necessary in Malta at this stage, although the Eurosystem is still considering how it can enhance further such services.

The Eurosystem is also active in the fight against counterfeiting of the euro, and in this regard works closely with Europol and the European Commission, especially the European Anti-Fraud Office. It also actively trains professional cash handlers in the recognition and handling of counterfeit banknotes.<sup>12</sup>

In order to maintain the quality and integrity of the banknotes in circulation, euro area NCBs check each euro banknote returned to them for authenticity and fitness, using fully automated banknote processing machines.

In this context, each euro area Member State also has an obligation to establish national analysis centres to examine counterfeit banknotes and coins, as the responsibility for protecting the euro against counterfeits falls primarily on Member States. The CBM has been entrusted with the responsibility to carry out this work and report to the respective ECB and European Commission technical centres, the former for counterfeit banknotes, the latter for counterfeit coins. For this purpose, the CBM's Currency Surveillance Unit acts as the National Counterfeit Centre and Coin National Analysis Centre.

The CBM participates in discussions and activities on these matters, and collaborates with the Malta Police, other local authorities, the credit institutions and other professional cash handlers to ensure compliance with Eurosystem recommendations in this area.

With the adoption of the euro, credit institutions and other professional cash handlers in Malta must also comply with the ECB's Banknote Recycling Framework, which defines uniform rules and minimum standards for banknote processing. This framework is intended to ensure that euro banknotes are checked for their fitness and authenticity before they are re-issued in circulation. The CBM achieved compliance with this framework in 2008. The other institutions subject to this framework implemented it by 1 January 2010.

### 1.6. Statistics

The collection and compilation of statistics is an important task of central banks. Euro area statistics are an important component of the information underlying monetary policy decisions, the analysis of financial sector conditions and the oversight of payment systems. They are also used as input in the research and publications of the ECB.

In an ESCB context, work in the area of statistics is shared between the ECB and the NCBs. The former compiles euro area aggregates based on national data submitted by each national central bank. Such data are based on common definitions and classifications to ensure sufficient comparability and allow ECB staff to derive a meaningful aggregate for the euro area.

Towards this end, the ECB is authorized by Community law to issue guidelines and regulations for the development, collection, compilation and dissemination of statistics. Guidelines are addressed to NCBs, while regulations are addressed to monetary and other financial institutions (MFIs and OFIs).<sup>13</sup> Both have become legally binding upon euro adoption.

In recent years, the CBM has taken a number of steps to converge towards the more ambitious statistical standards that apply to Eurosystem participants. In particular, it has embarked on the compilation of additional monetary statistics. It has also invested in statistical databases and automated transmission systems which allow a more secure and efficient collection and transmission of data. With the National Statistics Office (NSO), the CBM has been involved in developing a framework for a direct reporting data collection system based on statistical surveys, where external transactions are concerned. It is also working on the creation of an annual and quarterly set of financial accounts, and aims to enhance the collection of statistics from the OFIs.

Convergence towards Eurosystem requirements has been facilitated by the Bank's participation in the Statistics Committee of the ESCB and its sub-structures.

From a broader EU perspective, responsibility for statistics is shared between the ECB and Eurostat. The division of responsibilities between these two institutions is laid down in terms of an MoU signed in March 2003. Generally, the ECB is responsible for the collection of money, banking and financial market statistics, the international reserve statistics of the Eurosystem and effective euro exchange rates, while Eurostat focuses on real economy indicators. The latter category includes a wide range of items such as prices and cost indices, the national accounts, government finance statistics, the labour market and external trade. The two institutions jointly contribute to the compilation of balance of payments statistics and quarterly sector accounts, comprising financial and non-financial accounts on a stock and flow basis.

This arrangement at European level is largely mirrored in the local context, where the CBM and the NSO have signed a co-operative agreement to enhance the quality of the statistical compilation process in Malta.

With the NSO, CBM experts also participate in the (EU) Committee on Monetary, Financial and Balance of Payments Statistics. At the local level, work is also co-ordinated at the level of the Technical Committee on Financial Statistics. Moreover, the CBM, in conjunction with the NSO and the Ministry of Finance, participates in a committee on government finance statistics Committee, which was set up to improve the quality of government finance statistics and to compile the government deficit and debt data in terms of the Excessive Deficit Procedure. A separate internal CBM committee also ensures that Maltese mon-



etary and financial statistics meet the reporting requirements and standards laid down by the ECB and Eurostat.

While some of these national structures were in place before the CBM joined the Eurosystem, the scope of their work has increased markedly in view of the increase in the range, detail and frequency of the statistics that are expected of euro area central banks and national statistics offices.

Apart from meeting its obligations towards the ECB, the CBM continues to provide statistics to the IMF in connection with the latter's surveillance of the international monetary and financial system, and also in fulfilment of the requirements of the Special Data Dissemination Standard.

## 2. NON-EUROSYSTEM TASKS PERFORMED IN TERMS OF THE CENTRAL BANK OF MALTA ACT

NCBs are allowed to perform additional functions that are not mentioned in the Statute, as long as these do not interfere with the objectives and tasks of the ESCB, and are performed on the own responsibility and liability of the central bank concerned. This Section considers the role of the CBM in financial stability and in the execution of tasks that are not mandated by the Statute.

### 2.1. Financial Stability

A healthy financial system is indispensable for the effective transmission of monetary policy to the real economy. Accordingly, financial stability and price stability are complementary goals and central banks often assign considerable importance to both.

A financial system is deemed to be stable when its main components, i.e. financial institutions, markets and infrastructures, are able to absorb adverse shocks without any significant impairment to the allocation of savings to investment opportunities.

At a domestic level, responsibility for financial stability is shared between the CBM and the MFSA. In this division of responsibilities, the CBM focuses on the overall systemic stability of the domestic financial sector, while the MFSA contributes through the regulation and supervision of the individual financial intermediaries.

The CBM's role in overseeing overall systemic stability is performed primarily through the continuous monitoring of the various components of the financial system, including the payment and settlement systems. In particular, efforts are geared toward the early identification and timely correction of potential weaknesses that may render the financial system vulnerable to domestic and international shocks.

Regular discussions on matters relevant to financial stability also take place between the CBM and the MFSA in the context of a domestic standing group which was established specifically to exchange information on matters of common interest, in terms of an MoU which was signed in

2003. With the Ministry of Finance, the two authorities also participate in a working group on domestic crisis management.

Whereas direct responsibility for the pursuit of financial stability and prudential supervision rests with the national competent authorities, the Treaty has assigned to the Eurosystem the important task of contributing to the smooth conduct of policies in these fields.

The ECB and the NCBs of the euro area work together to monitor the stability of the financial system, with the aim of identifying sources of vulnerability and assessing the degree of resilience of the financial system in the euro area. The result of this financial stability analysis is regularly presented to the Economic and Financial Committee (EFC). NCBs also offer advice to the national authorities and the European Commission on the scope and implementation of Community legislation in these fields.

The Eurosystem also promotes arrangements for the maintenance of financial stability and the effective management of financial crises, including the smooth cooperation between central banks and supervisory authorities, particularly at EU level – as in the case of ongoing discussions concerning the creation of the European Systemic Risk Board – but also in an international context. The need for cooperation at EU level follows from the fact that the risk of financial contagion is amplified in financial markets with a high degree of integration, such as those of the EU. Domestic oversight thus needs to be complemented with cross-border oversight and the management of crisis simulation.

In cooperating for the safeguarding of the financial system, the CBM and the MFSA actively participate in ESCB and EU activities.

At the ESCB level, the CBM participates in the Banking Supervision Committee and its substructures, including some of its *ad hoc* task forces that from time to time are established to address specific issues related to financial stability. As a participant in these structures, the CBM also contributes to analyses in ECB publications such as the *Financial Stability Review*, the *EU Banking Sector Stability Report* and the *EU Banking Structures Report*.

At the EU level, the CBM and the MFSA are members of the Committee of European Banking Supervisors. With the Ministry of Finance, the CBM participates in discussions of the EFC on financial stability issues.

### 2.2. National Advisor to Government

In terms of the CBM Act, the Bank advises the Maltese government on financial and economic matters. This advisory function reflects the expertise that the CBM has developed over the years in international financial matters, in particular through its participation in the various ESCB and EU committees/forums. Acting on such independent advice, the government may be in a better position to propose the policies necessary for the economic development of the country.



### 2.3. Banking Services

The CBM has also retained its role as banker to the government and to the rest of the domestic banking system and continues to provide a range of banking services to the public and to credit and financial institutions in Malta. It has also continued to provide banking and foreign exchange services to the public sector. In this case, however, and in conformity with the provisions of the Treaty, the Bank may not hold any securities issued in the primary market by any EU government or public institution or body, nor extend to such entities any preferential access to credit. The CBM also continues to act as a market maker in government securities, although it is working with the other authorities to identify arrangements whereby this function could be performed by other entities.

### 2.4. International relations

Apart from participating in ESCB and EU committees, the CBM has also strengthened its bilateral relations with the constituent members of these fora. The CBM also continues to build up its relations with other EU and international institutions. As it did prior to its integration in the Eurosystem, the CBM attends meeting of the EFC and its sub-committees. It is also the institution that represents Malta in the IMF and together with the Ministry of Finance it represents Malta in the EBRD. While not a member of the World Bank, the CBM also monitors the relevant developments in the World Bank and its affiliates, and collaborates with the Ministry of Finance on certain issues related to Malta's membership in these institutions.

## 3. CONCLUSION

The analysis presented in this article makes it clear that the role and responsibilities of the CBM did not diminish with the introduction of the euro and the subsequent integration of the Bank in the Eurosystem.

In the field of monetary policy, the CBM's integration in the Eurosystem has not reduced the need for economic, monetary and financial analyses, although the preparation for monetary policy

deliberations has assumed a different orientation and has also become more rigorous as it is no longer determined by the constraints of a fixed exchange rate policy. Moreover, the decentralised approach to monetary policy implementation necessitates that domestic credit institutions continue to participate in monetary policy operations through the CBM.

Participation in the Eurosystem has increased the responsibilities of the CBM. This is most evident in the management of the foreign reserve assets of the ECB, the inspection of euro banknotes and the compilation of statistical information relevant to Eurosystem decisions. In the area of payment systems, the domestic MaRIS system was replaced by TARGET2. While continuing to perform many of the tasks that it previously performed in relation to MaRIS, the CBM now also actively supports initiatives endorsed by the ECB to enhance the efficiency and safety of payments and securities settlement systems and to encourage financial market integration in the EU. The ongoing integration of European financial markets in turn has strengthened the need for further cooperation at the EU level in the area of financial stability. The only area where the CBM's role has diminished is in relation to foreign exchange interventions, which partly reflects the reduced scope of such interventions as a result of the adoption of an international currency whose value against other currencies is determined by market forces.

In addition, the CBM continues to perform a number of tasks which are not among the basic tasks of the Eurosystem. In particular, it continues to exercise its oversight of the financial system and to co-operate with other local and international authorities in their pursuit of financial stability. It also acts as an advisor to the government, continues to provide banking services and represents Malta in a number of international institutions.

These tasks indicate the broad and encompassing nature of the CBM's sphere of activities, which apart from becoming more complex and challenging have also come to offer a unique opportunity to enhance the Bank's expertise in these activities.

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